TaxZone Newthwire

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Editorial Note

The latest missives to hit the desks of practising accountants are the new draconian provisions regarding the pre-disclosure of tax avoidance arrangements. As will be seen later, and in common with the money laundering regulations, these provisions can be perceived as a 'sledgehammer to crack a nut'.

What has been worrying the government and the Inland Revenue are the arrangements entered into by very large quoted companies to avoid (quite legally) enormous amounts of corporation tax. However, once again it will be the small and medium sized businesses that will suffer from what appears to be 'overkill'.

Personally, I do not approve of those arrangements that go to the very edge of the law, and would not introduce them to my clients. However, this country has a long history of allowing taxpayers to arrange their affairs to the best tax advantage, provided this is within the law. It appears that is about to change.

This principle was enshrined within case law, but has been undermined in recent years by the judiciary, public opinion and the current government. The current government attempted to introduce the 'moral argument' as part of its crusade, and both the Revenue and Customs have attempted to equate 'avoidance' with 'evasion'. It has now gone one stage further in the 2004 Budget. One can foresee a complete tax avoidance regime being introduced in future years, unless things change.

Regards

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Disclaimer

History

Tax avoidance is enshrined in case law that was determined between 70 and 80 years ago. The remarks of judges in two famous cases highlighted the culture of that time. In Duke of Westminster v CIR 19 TC 490 the judgment of Lord Tomlin contained the following statement:

'Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.'

Some years later, in the case of Ayrshire Pullman Motor Services & Ritchie v CIR 27 TC 331 Lord Clyde observed:

'No man in this country is under the smallest obligation, moral or otherwise, so as to arrange his legal relations in his business or to his property so as to enable the Inland Revenue to put the largest possible shovel in his stores'.

High taxation

These attitudes could certainly be justified in the post second World War years when the top rate for an individual reached 98% in the 1960s and 1970s, with the possibility of additional surcharges on top. Not unsurprisingly that era spawned a burgeoning tax avoidance industry.

This era is well documented by Nigel Tutt in his book The History of Tax Avoidance. Individuals such as Roy Tucker and Ron Plummer, through their Rossminster companies, Godfrey Bradman, Michael Hepker and Patrick Taylor became 'tax famous' as proponents of tax planning schemes.

Revenue ire

Some of these tax avoidance schemes appeared to be so outrageous, and the loss to the public revenue was so great, that the anger of the Inland Revenue was aroused. Eventually this led to the famous Rossminster raids (see [1980] STC 42) and subsequent court actions attacking arrangements made.

The Rossminster case was followed by W T Ramsay Ltd [1981] STC 174 and Furniss v Dawson [1984] STC 153. In these cases the courts sought to undermine complex tax avoidance measures on the grounds of artificiality and the use of composite transactions to get round existing tax law.

Other cases followed, and presumably the government and the Revenue assumed that the judgments in the two cases would be confirmed. In practice this did not happen, and the issues became further blurred by varying judgments in later cases.

Other developments

However, other developments were occurring. The governments of the time were committed to reducing the rates of personal and corporate taxation, and this has been achieved successfully, although undermined by the various 'stealth taxes'.

At the same time public and political opinion began to question tax avoidance. This campaign grew until at the turn of the 21st century the Revenue and Customs were trying to equate tax avoidance and tax evasion. They also attempted to introduce the 'moral argument' in an attempt to bring the tax planning industry into line.

At the same time various senior judges, perhaps under the weight of political opinion of the time, began to question the judgments in the two old cases that I mentioned at the beginning of this wire. Lord Roskill did this in Furniss v Dawson, and a particular thorn in the side of tax avoidance was Lord Templeman. Other judges who adversely commented on the old legislation were Lord Steyn and Lord Cooke of Thorndon.

The scene was therefore set for the announcements made in the 2004 Budget, regarding which the professions had been pre- warned in the November 2003 statement. However, the severity of the disclosure regime and the administrative complexities were a surprise.

The 2004 Budget

It is not possible to examine in detail all the technical points that have emerged from the 2004 Finance Bill and Statutory instruments so far issued. At the time of writing this wire a consortium of large law firms are attempting to gain exemption from the new provisions. It is also a pity that much of the detail is being promulgated by secondary legislation in the form of Statutory Instruments. However, I would like to draw the attention of subscribers to a number of issues concerning the new legislation and regulations:

- As reported in the professional press, the planned consultation period allowed in respect of the new provisions is less than the statutory 12 weeks. By the time this wire goes online, only a few days will be left. It is intended that the new system will come into operation on 1 August 2004.

- Within five days of implementing a scheme, advisers will have to provide:
  A description of the scheme,
  Details of the transactions involved,
  The statutory provisions that they are applying and the expected tax consequences of the tax planning scheme.

- Failure to comply could result in a penalty of up to 5,000 pounds. There is also a daily penalty and 'scheme users' can also be subject to penalties.

- An arrangement is available for implementation when the promoter provides sufficient details to clients or potential clients to enable them to consider whether they should implement the scheme or the arrangements. Schemes will have to be reported as soon as the adviser becomes aware of any transaction that forms part of a 'notifiable arrangement'.

- The Inland Revenue will undertake to return a reference number for the scheme within 30 days, but this will not indicate any judgement on its admissibility.

- The new system incorporates the following concepts:

(1) Persons affected.
(2) Notifiable arrangements.
(3) Notifiable proposals.
(4) Tax advantage.
(5) Promoters.
(6) The Promoter's duties.
(7) Information required.
(8) Reference number.
(9) Duty to notify.
(10)The effective date.
(11)Legal professional privilege.

Commentary

It is interesting to quote from the proceedings of Standing Committee A, Sittings 1 & 2. Although the remarks of Howard Flight MP apply to VAT avoidance, they no doubt apply equally to direct tax:

'As drafted, the Bill states that businesses have a duty to pay the maximum VAT that they can and, if they do not, they should disclose it as an avoidance scheme. The conceptual problem emanates from a failure when drafting by the government and Customs to produce any definition of unacceptable VAT avoidance. We must clarify what constitutes acceptable VAT and tax planning and what does not. The definition of unacceptable tax avoidance in new Schedule 11A is so widely drawn as to mean anything not maximising VAT costs to a business could be deemed unacceptable tax avoidance...'

Mr Flight has gone a stage further, and the Human Rights Committee of Parliament has been asked to rule on Tory claims that the government's crackdown on tax avoidance amounts to a breach of basic principles. Opinion of leading counsel has been obtained on this issue. In the Joint Lords and Commons Committee Mr Flight also complained about the retrospective nature of other provisions in the Finance Bill during a furious row with the Paymaster General, Dawn Primarolo.

The way in which the new rules have defined a 'notifiable tax advantage' clearly demonstrates a lack of understanding by government and the Revenue of how businesses operate. Advisers would be helped greatly if a list of allowable schemes was published by the authorities.

The Finance Bill itself leaves the way open for the notification regime to be extended to any direct tax, including national insurance, because of its integration with income tax.

As it stands the draft law and regulations will produce an administrative nightmare that will result in numerous unnecessary reports and the inevitable gridlock in Revenue systems. Those readers who have studied the 20 page Revenue document 'Tackling Direct Tax Avoidance - Disclosure Requirements Draft Guidance' will be aware of this fact.

It is also worth mentioning that, apparently, the Treasury is most interested in employment-related schemes and schemes involving financial instruments. The drafting of the law and regulations, however, would seem to bring very small tax-saving measures proposed to a client within the ambit of disclosure. Once again, as with the money laundering regulations, we have the spectre of the government and Revenue acting as prep school headmasters and punishing the whole school because of the transgressions of a few.

It behoves the members of the CCAB to take immediate and urgent action to avoid a tax disaster. Current proposals have the potential to be just as draconian as the money laundering regulations. One view of what is happening is that the proposed measures are transitional before the introduction of a full-blown anti-avoidance regime. The new Chairman of Revenue and Customs must not expect to be popular. Fortunately he has been a chief executive in a commercial company, where the popularity of the CEO is not expected. However, in his new post it is not only employed staff but also 'customers' who will be critical of the attitudes and actions of the new monolith.

Professional action

The Chartered Institute of Taxation have now responded forcefully to the new draft regulations and guidance on the subject of tax avoidance. In addition to the points that I have mentioned above, the CIOT has commented, inter alia, on the following points:

- The Institute takes issue with the statement that once a scheme is 'ready to be proposed to a client' it is disclosable.
- There is confusion as to whether a scheme implemented by a client prior to 18 March 2004 and now proposed to another client comes within the regulations.
- If the regulations are to be kept within manageable limits, then the Inland Revenue will need to publish a 'white list' of schemes that are not regarded as 'abusive'. This list would include personal pensions schemes, ISAs etc.

- The definition of 'promoter' within Clause 291 is currently far too wide.
- Paragraph 3 of the Schedule is too wide in scope. For instance:

  (1)A cheque is regarded as a 'security'.

  (2)It appears that if a company pays a director-shareholder dividends rather than a salary, then this procedure has to be reported as a tax avoidance scheme.

  (3)Para 3(1)(e) catches any asset, including, it seems, luncheon vouchers, childcare vouchers etc. Is this really intended?

  (4)Situations where an employer writes off an employee's season ticket loan where the employee remains on the staff and the season ticket has expired also appear to come within the regulations.
- The regulations do not make it clear when the disclosure requirements have been met. In the view of the CIOT this should be when the form is received or treated as received by the Revenue.
- Where a disclosure form is sent by first class post, it should be deemed to be received by the Revenue the day after posting.
- It should be possible to make disclosures by electronic means.

Any Answers

There have been a few Any Answers queries on site regarding tax planning.

Cost of tax planning

On 22 January 2002 Verka asked whether the cost of tax planning is a tax allowable expense. John Mackay observed that, for smaller clients, there would unlikely to be a specific fee for tax planning. It is taken as read that that function comes within the realm of best advice and within the engagement arrangements.

However, as Harry Ross stated, in the case of a large corporate client, and where a specific fee was charged, advice on corporation tax planning is likely to be tax disallowable. However, fees for remuneration planning may well be allowable. The organisation that supplied the planning advice ought to be able to confirm whether or not their fee was tax allowable.
http://www.accountingweb.co.uk/item/69794

Tax Planning - LLP

Two directors of a limited company were proposing to set up a limited liability partnership to provide services to the company. One of the reasons for this arrangement was to run the business cars through the LLP and avoid car benefit assessments on directors etc.

ADS, in a query dated 25 February 2003, asked whether this was a common tax planning strategy. Were there any adverse tax implications? What was the VAT position? Can an LLP be a member of a group VAT registration?

I would comment, first of all, that if this idea was promoted from 1 August 2004 on by the accountant or other professional adviser of the company, then it would need to be notified to the Inland Revenue under the new disclosure rules.

Based on legislation then in force Montrose gave some very valuable advice. First of all it must be remembered that IR35 applies to partnerships (including LLPs) as well as companies, and the whole arrangement was likely to be counterproductive.

A better scheme might be for the trading company and the directors to form an LLP. This would avoid NIC charges on the profit share of the directors on the assumption that their partnership share was similar to previous directors remuneration. The car benefit point would follow automatically. From a company law point of view, approval of an Extraordinary General Meeting would be prudent, and the directors' fiduciary duties to the company should be watched.

For VAT, an LLP is a separate entity, and theoretically might join a VAT group. This is commented on in the well-known De Voil publication regarding VAT.
http://www.accountingweb.co.uk/item/104175

Is tax planning evasion?

This was the title of an item posted by Red Queen (on behalf of Humpty Dumpty) on 11 March 2004. This query arose from an article in the Financial Times where the writer(s) were obviously confusing tax planning (legal avoidance) and tax evasion (an illegal act).

There were a number of replies to this item, some tongue in cheek, but the reality of the 2004 Budget and Finance bill is now with us. It has been fairly clear for some time that leading figures in the Inland Revenue and Customs & Excise do equate tax planning and legal avoidance with illegal evasion, and this is demonstrated by the new legislation and regulations.

Whether the current government, if it remains in power, will go one stage further and seek to introduce general anti-tax avoidance legislation remains to be seen. As more than one respondent observed, such a measure would be almost impossible to enforce, but it is not beyond the realms of possibility in the current political climate.
http://www.accountingweb.co.uk/item/124070

Ask a question

Readers with a current case should post their query in Any Answers.

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