
HM Revenue and Customs

Modernising Powers, Deterrents and Safeguards

Working with Tax Agents
A Consultation Document
April 2009

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Summary table

Scope of the consultation

Topic of this consultation:	How HM Revenue and Customs (HMRC) interacts with tax agents to ensure that clients' returns and claims are correct when submitted.
Scope of this consultation:	Since the inception of its Review of Powers, deterrents and safeguards HMRC has consulted on a number of aspects of the tax system with a view to modernisation and, where it makes sense, alignment across taxes. As part of this process the Review is now looking at how HMRC interacts with tax agents to ensure that clients' returns and claims are correct when submitted. The consultation is intended to raise issues and ask questions rather than prescribe solutions.
Impact Assessment:	An impact assessment is published separately as part of this consultation.

Basic Information

Who should read:	Tax agents and others involved with the preparation of tax returns and their clients.
Duration:	From Budget 2009 to 7 August 2009.
Enquiries:	The Review can be contacted by telephone on 020 7147 3223 or at powers.review-of-hmrc@hmrc.gsi.gov.uk .
How to respond:	Responses should be sent to: powers.review-of-hmrc@hmrc.gsi.gov.uk , or HMRC Review of Powers: Room 1/72, 100 Parliament Street, London SW1A 2BQ.
Additional ways to become involved:	HMRC will be inviting tax agents, their representatives and other interested parties to meet with the Review team and discuss the issues raised in the consultation document.
After the consultation:	Responses to this consultation will be published around the 2009 Pre-Budget Report.

Background

Getting to this stage:	The Review of Powers, Deterrents and Safeguards was set up to provide a framework of law and practice for HMRC that is appropriate to the merged Department's tasks and allows those tasks to be carried out effectively and efficiently while also providing appropriate safeguards for taxpayers.
Previous engagement:	<p>This is the seventeenth consultative document published by the Review. These have covered safeguards, criminal investigation powers, penalties, payment services and debt management. These formal consultations have been supplemented by various methods of informal consultation through workshops, conferences and other meetings with taxpayers, advisers and their representative bodies, as well as regular meetings of the Review of Powers Consultative Committee which was established in June 2005.</p> <p>Consultations have continued beyond the legislative process and changes have been made to guidance and operational practice to reflect these.</p> <p>Here is a link to the Review's website:</p> <p>http://www.hmrc.gov.uk/about/powers-appeal.htm</p>

Chapter 1: Introduction

- 1.1 Since its creation, HMRC have invested significant time and resources towards modernising the way it administers the tax system. This work has included the activities of its customer units and a fundamental review of its powers, deterrents and safeguards. The aim is to improve its relationship with its customers with a view to fostering greater mutual trust. Work with large businesses has led the way on this.
- 1.2 HMRC recognises the vital role that tax agents play in the delivery of the UK tax system. They represent 70 per cent of all SME businesses within the UK and over 60 per cent of all other income tax self assessment (ITSA) taxpayers. That representation covers all taxes and duties in varying levels of complexity. Who might be considered to be a tax agent is less clear today than hitherto. Among others it includes accountants, solicitors, payroll bureaux, specialist advisers and Value Added Tax (VAT) specialists. Of those who might be more traditionally seen as tax agents around 70 per cent are affiliated to one of the main professional bodies within the UK. Some 80 per cent of agents have a professional qualification. Those figures suggest that a significant number of tax agents have neither been through formally recognised training nor are they subject to the monitoring procedures used by the main professional bodies.
- 1.3 HMRC does not require any agent acting on behalf of a client to demonstrate their level of competence or be a member of a recognised professional body before they are authorised to do business with the Department.
- 1.4 This consultation explores how HMRC interacts with tax agents, and asks whether changes could be made that would better serve UK revenue protection, taxpayers, agents and professional bodies.

Working to the same end

- 1.5 Tax agents play a crucial role in helping HMRC to tackle risks to the tax base and execute basic transactions. HMRC is able to accept the majority of returns¹ without checking their accuracy individually, (instead it risk scores them). That is possible because of the work done by taxpayers and their agents to ensure those returns are correct. This includes one-to-one contacts with clients, the provision of help and assistance and the use of pre-return assurance checks used by many agents to identify areas of risk.
- 1.6 HMRC is looking at how it can do more to share understanding of risks with tax agents and are, for instance, piloting a series of toolkits that will share information on what constitutes risks from HMRC's perspective and provide agents with a clearer view of where they

¹ References in this consultation to “returns” can generally be taken to include claims or other documents submitted to HMRC which determine a tax liability.

should target their pre-return checks to reduce the risk of error in their clients' returns.

- 1.7 HMRC will continue working with agents and their representative bodies to explore how a mutual understanding of pre-return processes can best support the client, the tax agent and HMRC.
- 1.8 Conversely, HMRC does not underestimate the importance of the tax agent's role in protecting the interests of their clients, and that on occasion this may require a firm stance to be taken. We also recognise that the agent has a contractual relationship with the client which determines the extent and nature of the work that is to be undertaken.
- 1.9 Those agents who are members of professional bodies are subject to rules about how they should act when they encounter possible evasion of tax. Generally, these involve advising the client to make a disclosure and terminating the relationship if they will not do so.

Working together

- 1.10 HMRC's Business Customer Directorate and representative bodies have been working together to improve HMRC's relationship with tax agents through greater face to face engagement. Engagement of tax agents at a local level is key to improving the level of basic services delivered by HMRC. And greater agent understanding of HMRC's processes should help reduce the cost of client compliance. The reinvigoration of regular "Working Together" meetings between groups of local tax agents and HMRC staff is a key element in making this happen. In addition HMRC is pleased to accept invitations to a number of formal and informal events over the course of a year which provide the opportunity to explain and debate proposed changes as well as hear how the professional community will respond.
- 1.11 Nationally, the relationship between HMRC and the professional tax agent community supports a number of specifically created committees to review policy, operational and implementation issues. The contribution to consultation from individual tax agents, firms from some of the smallest to the largest, and representative bodies has been enormous. That is particularly so as consultation often now involves not just responding to formal consultations, but also workshops, face to face meetings, and reviewing guidance, awareness material and training. There is increasingly a shared aim to undertake joint training so that advisers and HMRC staff can discuss practical issues together and, hopefully, come to more of a shared understanding.
- 1.12 HMRC is working in other ways with representative bodies, including to support professional standards. For instance the Commissioners for Revenue and Customs Act which created the new Department introduced a "gateway" that enables HMRC to report agents to their professional body with a request for disciplinary measures to be taken

if the agent's standards of integrity are believed to be less than expected from someone performing the trusted role that agents and advisers fulfil. Such a process applied well clear benefits for both the professions and HMRC. Chapter 4 explores the disclosure arrangements in a little more detail.

This consultation

- 1.13 This consultation is intended to raise issues and ask questions rather than propose definitive solutions.
- 1.14 **Chapter 2** outlines the design principles which have underpinned the work of the Review of Powers to date and presents for consideration some additional principles which could underpin thinking about how to develop HMRC's relationship with tax agents to ensure that clients' returns and claims are correct when submitted.
- 1.15 **Chapter 3** looks at the changing environment and risks posed to the tax base across a number of areas: the market for tax advice, tax avoidance, changes to taxpayer penalties, existing legislation relating to tax agents, and the circumstances wherein the performance of certain tax agents may fall below an acceptable standard.
- 1.16 **Chapter 4** considers how HMRC might assess and respond to these risks, and examines the extent to which this may depend on whether the tax agent has made a mistake, failed to take reasonable care, or acted deliberately. It goes on to consider how HMRC can work with professional bodies.
- 1.17 **Chapter 5** looks at the case for a scheme of registration for tax agents and examines whether there may be benefits from a definition of who is a tax agent.
- 1.18 **Annex B** examines the current legislative framework in more detail.
- 1.19 **Annex C** outlines the provisions which operate in respect of tax agents in the United States and in Australia.

How to comment

- 1.20 The questions on which this consultation is focused are summarised in **Annex A**. However, HMRC welcome comments on any aspect of this consultation document. Comments should be received by **7 August 2009**:
 - by e-mail to: powers.review-of-hmrc@hmrc.gsi.gov.uk
 - or by post to: HMRC Review of Powers, Room 1/72, 100 Parliament Street, London SW1A 2BQ
 - or by fax to: 020 7147 2375.

This document can also be accessed from the HMRC Internet site:
www.hmrc.gov.uk/consultations/index.htm

Hard copies are available from the above address. The Review Team can be contacted by telephone on: 020 7147 3223.

Confidentiality

- 1.21 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).
- 1.22 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If HMRC receive a request for disclosure of the information they will take full account of your explanation, but they cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HMRC.
- 1.23 HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

The Government's Consultation Code of Practice

- 1.24 This consultation is being conducted in accordance with the Government's Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in **Annex D**.

Chapter 2: Design principles

- 2.1 The Review of Powers team has a now well established approach to consultation. There is for example a need to balance a comprehensive consideration of the issues with the requirement for HMRC to be operationally effective.
- 2.2 Part of the early work has been to understand the principles which should underpin the design of any new powers and safeguards. Since it began the Review has developed a range of principles that play a key role in assessing the effectiveness of both the current regimes and proposals for change.

Powers and the statutory obligations they impose need to be

- set within a clear statutory framework,
- easily understood – by taxpayers, their advisers and HMRC staff,
- straightforward to comply with,
- proportionate to what HMRC needs to discharge its responsibilities or to protect the Exchequer from the risk assessed,
- used consistently,
- effective in providing the information HMRC needs to assess risk, and
- effective in discovering and dealing with non-compliance and in helping people to return to compliance.

Safeguards for citizens and businesses must be

- clear,
- publicised,
- accessible,
- effective,
- responsive to the nature and purpose of particular powers and sanctions, and
- conformant with Human Rights and other relevant non-tax legislation.

Sanctions for non-compliance must be

- set in statute,
- clear and publicised,
- proportionate to the offence,
- used consistently, and
- effective in deterring non-compliance and returning the non-compliant to compliance.

- 2.3 These design principles are just as relevant in looking at HMRC powers and safeguards which apply to tax agents. There may however be some design principles which apply when looking at tax agents rather than their clients. We have identified a number of additional principles.

The need to reassure competent tax agents

- 2.4 In its interactions with tax agents HMRC needs to ensure that it has minimal impact on those doing a competent job in assisting their clients in submitting correct tax returns. The actions of the tax authority should not distort existing market rates or competitiveness within the tax agent sector. HMRC has no wish to see either the creation of a two tier market where price determines the level of compliance with obligations or a market where tax agents feel unable to represent their clients in a traditional direct, open and transparent contractual relationship due to the obligations imposed upon them as representatives. In the latter case, HMRC sees no benefit in the relationship between the agent, client and HMRC becoming indirect or detached as this will likely distort compliance obligations and add to costs between the customer, adviser and HMRC.
- 2.5 Where tax agents do not belong to professional bodies, they should not be disadvantaged where they follow accepted procedures or otherwise demonstrate their competence.
- 2.6 Where powers are needed they should be strong enough to reassure the overwhelming majority that those who are not competent and those who deliberately break the rules are subject to an appropriate level of HMRC scrutiny, and that action can and will be taken to remedy any shortcomings.

Support professional standards

- 2.7 A number of professional and regulatory bodies, not to mention the great body of their clients, have a very strong interest in ensuring that professional standards are maintained and improved. A condition of membership will generally include testing the competence of those seeking admittance. HMRC recognises the importance of working with those bodies to achieve common goals.
- 2.8 Current monitoring of professional standards and integrity varies in depth and scope across the major regulatory bodies. It is generally carried out with a light touch and relies on voluntary submission by the agent firms to the monitoring process as part of their continuing membership rules and ongoing investment by firms to maintain their own standards in between formal monitoring. Sanctions are imposed for non-compliance with these standards, including financial penalties and exclusion from membership (which may be for a limited period).
- 2.9 Seeking to impose a single standard that did not recognise the individual disciplines and specialisms that exist within the tax agent community may not be in the interests of agents, taxpayers or their existing regulatory bodies. Beyond the practical difficulties of implementing a standard model there exists no single regulatory authority to oversee standards in the profession and the creation of

such a role and the subsequent monitoring function would add to costs that have to be absorbed through members' contributions and ultimately by clients.

Recognise the potential impact of powers on tax agents' businesses

- 2.10 HMRC recognises that the use of its powers has the potential to damage the professional reputation of tax agents if used inappropriately. Safeguards and clear internal rules are needed to ensure this does not happen. But HMRC also has to recognise that where its staff become aware that an agent has acted inappropriately in their representation of a client then there may be a question over the conduct of that individual or firm in relation to some or all of the clients they represent. Short of seeking to review in depth all the affairs of the client portfolio, HMRC might reasonably seek assurances, potentially from an external monitor, that identified errors or misconduct were not systemic across an agent's clients. Chapter 4 considers this and related issues in more detail.

Taxpayer confidentiality

- 2.11 Tax agents have duties to their clients of confidentiality and protection of personal data, and need to safeguard themselves from possible allegations that they have breached these duties. As such, professional bodies generally take the approach that information confidential to a client acquired in the course of professional work should not be disclosed to a law enforcement agency or similar body, except where consent has been obtained from their client. The exception is where there is a legal right or duty to disclose. In some circumstances (for example in respect of Money Laundering) seeking the consent of the client could even constitute "tipping off".
- 2.12 HMRC recognises that there is a need to ensure that confidentiality issues are respected, and would need to carefully consider any proposal which would reduce existing levels of client confidentiality. We are not, for instance seeking to diminish the safeguards associated with the normal compliance checks procedures by going to the tax agent directly.
- 2.13 Such issues may affect the room for making change. In any consideration of the effectiveness of current and any different powers, careful thought would need to be given to such factors as: the extent of information or documents to be sought; the timing and manner of their production; and what should be excluded (including privileged material). There would also need to be reference to existing legal powers and protections in place for obtaining such information.
- 2.14 HMRC proposes that the following specific design principles should apply in relation to tax agents:

- Reassure competent tax agents that any additional powers would be used appropriately
- Support professional standards and where appropriate work with professional and regulatory bodies
- Recognise that the use of any new powers could have an impact beyond ensuring that the correct amount of tax is paid i.e. the scope for reputational damage.
- Respect the confidentiality of client's data where it is not relevant to the tax risk.

1. Have we identified the correct design principles? In applying these principles, are there any other matters that we need to take account of?

Chapter 3: A changing environment

Changes in the market for tax advice

- 3.1 Like the rest of society the market for tax advice and support is changing. To support modern business and the drive to greater online filing of tax products, tax agent businesses are adopting varying levels of IT infrastructure. In 2009 a record number of ITSA returns were filed on-line, a significant majority of which were filed by professional tax agents. The software industry is playing its part in this transformation by offering products at all levels that allow tax agents to manage their offices, correspondence, billing, client risk assessments and compliance obligations through modular or complete packages.
- 3.2 The availability of simple to use software has broadened the market to allow agents with little or no financial or tax training to offer services. We know that the majority of tax agents restrict their role to providing advice on the four main taxes: ITSA, corporation tax self assessment (CTSA), Pay As You Earn (PAYE) and VAT. However, even within the provision of basic services there will be issues of complexity that may become quickly overlooked or where tax agents are stretched beyond their area of competence, while still promising an effective service. Taxpayers may be lured by low fees, especially in the current climate, but they may come to find that the cost of sorting matters out is considerable if HMRC check their tax returns.
- 3.3 A specific developing aspect of this low and restricted contact market is an emerging risk around tax agents who submit a high volume of repayment claims by advertising a service that claims to secure repayments from previous years' tax liabilities. If unchecked this can be a major threat to tax revenues, and can place a further strain on HMRC resource, particularly where individual agents submit thousands of claims in single batches, many of which have little or no merit.
- 3.4 There can also be a negative impact on claimants: HMRC may seek to verify the legitimacy of the claim and, where dissatisfied, recover the amount of tax over-claimed. Claimants will generally be charged a fee based on a percentage of the original claim, which they will not be able to recover from the agent if the claim is subsequently reduced or cancelled. The relationship between the client and their main agent if one is acting (who may be completely unaware of the involvement of the secondary agent) may also be undermined. Having said all this, HMRC fully recognises that repayment agents can provide a service which helps both claimants and HMRC.

Tax Avoidance

- 3.5 At the other end of the market are developments in the tax avoidance industry. This operates in a number of ways. At one end of the scale is the mass marketed, or off the shelf, scheme. A promoter develops a

complex artificial scheme which exploits reliefs or allowances in ways not intended when the legislation was drafted. The promoter markets the scheme to selected potential users, or more widely. At the other end of the scale a business may seek advice about how to achieve a commercial objective without incurring the tax consequences which would normally follow. The solution may again be a complex artificial scheme which produces a result not intended when the legislation was drafted. But whatever the origin of the scheme, it may lead to significant shortfall in the tax take.

- 3.6 The longer a scheme remains undetected by the authorities, the longer a user can continue to exploit the loophole, the longer the promoter can market the scheme to other potential users, and the greater the loss to the exchequer. In the UK the Disclosure of Tax Avoidance Schemes regime plays a vital role in providing early intelligence of avoidance schemes and assessing the levels of tax at risk. Promoters of avoidance schemes (or in certain cases the users) are required to disclose to HMRC details of schemes which fall within certain descriptions prescribed by the legislation. HMRC issue the promoter with a reference number which must be passed to the user of the scheme. Users of the scheme identify themselves to HMRC by reporting the reference number back, usually on their tax return. HMRC are thus in a better position to close down schemes earlier by legislation if necessary, or to challenge them by opening enquiries into users' returns. There are penalties for both promoters and users who fail to comply with obligations under the Disclosure regime, but a person who has a reasonable excuse for a failure to comply is not liable to a penalty.
- 3.7 Tax avoidance gives rise to a different range of relationships between taxpayers, their advisers and HMRC, and of course the Disclosure regime imposes a new range of duties on both promoters and users of schemes. The designer of a scheme may not be the person who markets it, and the promoter may well not be a taxpayer's normal tax adviser or tax agent. And avoidance leads to much greater involvement of the legal profession – promoters normally take legal advice, often from leading Counsel, both on the effectiveness of a scheme in law, and whether it falls to be disclosed under the Disclosure regime. However, sometimes the instructions to advise do not fully set out the details of the scheme, or misrepresent its purpose. Sometimes the advice obtained does not fully engage with the relevant legal tests, or does not adequately consider the level of risk that the scheme may not work, or may be disclosable. And sometimes the scheme as implemented by the user differs in important detail from the description on the basis of which the advice was obtained.

Changes to penalties

- 3.8 Schedule 24 to Finance Act 2007, which applies to returns due to be filed from 1 April 2009, made significant changes to the penalty regime for understatements in tax returns, or false or inflated repayment claims for ITSA, CTSA, PAYE and VAT. The regime extends to other taxes and duties from 1 April 2010. The legislation sets out the circumstances in which a taxpayer may be charged a penalty as a result of an action by their agent. It restricts these to careless actions by the agent (not deliberate ones). It also provides a caveat: if a person can satisfy HMRC that they took reasonable care to ensure the document is accurate, even though an agent failed to take care, no penalty will be due.
- 3.9 A taxpayer who goes to an ostensibly competent professional adviser, provides a full and accurate account of the facts, checks that advice to the limit of his or her ability and competence, and then follows the agent's advice (or signs the return prepared on that basis) has not been negligent. He or she has taken reasonable care. If it turns out that the agent has made a careless error in giving the advice or in preparing the tax return the taxpayer who has taken reasonable care will not be penalised. However, this raises the question whether in these circumstances there should be some sanction upon a tax agent who has not taken reasonable care.

Existing legislation relating to tax agents

- 3.10 There are some existing provisions relating to agents, which apply in respect of some tax regimes, but not others. For instance, the information powers under section 20A of the Taxes Management Act 1970 (TMA) and penalty provisions under section 99 TMA which apply for direct taxes, have no equivalent within indirect tax legislation. Section 99 TMA (which allows for a personal penalty to be charged on an agent, where they know a document to be incorrect) dates from the late 1980s. This reflected the traditional role of the accountancy practitioner who was expected to have a high degree of personal responsibility for their actions and a time when auditors had unlimited liability.
- 3.11 It is important that HMRC has such powers if it is to take effective action against any tax agent who facilitates a deliberate understatement in the tax liability of their clients. It makes sense that any such powers should be aligned across HMRC's range of taxes and duties. They should also be considered in the light of the work done to date to modernise powers and related safeguards.
- 3.12 Any review should take account of difficulties in the operation of powers and safeguards. For instance, where a tax agent has committed an offence, HMRC are unable to obtain working papers which are no longer in his or her possession or power. Under section 20A TMA, a

tax accountant is required to deliver relevant documents to HMRC that are in his or her “possession or power”, but this does not cover all circumstances. For instance, there have been cases where, because a convicted chartered accountant has ceased to be a partner in a practice, the clients’ files were beyond his “possession or power”. Qualified accountants have also been judged not to have “possession or power” where they are acting as employees.

- 3.13 Another difficulty that HMRC face operationally results from the innate circularity in the construction of sections 20A and 99 TMA. In order to access accountant’s records under section 20A, HMRC require proof that a tax accountant had actual knowledge (leading to a conviction or penalty under section 99). But to obtain that proof without being able to access tax accountants’ records in order to obtain evidence can be near impossible.

Where performance falls below an acceptable standard

- 3.14 The overwhelming majority of tax agents advise their clients appropriately and calculate the right amount of tax. They have good systems, processes and staff training in place leading to accurate returns. If this were not the case, the tax system as we know it simply would not function.
- 3.15 Inevitably, even in the best organised firms occasional mistakes occur despite every effort having been made to get it right. However, there are occasions when the performance of a small minority of tax agents may have fallen below the standards that clients seeking to make a correct return have a right to expect. This can lead to the risk of tax being lost or may be improper in other ways. These types of situation are explored in more detail in the following paragraphs with examples taken from actual cases.
- 3.16 For a variety of possible reasons, tax agents may not have kept their knowledge up to date, may not have implemented or maintained effective processes or may have failed in other ways to take reasonable care.
- *Example: A group of companies had been charging standard rate VAT on items that should have been zero-rated. A claim of over £3 million was made by the tax agent, on the basis of average percentage figures from one of the outlets which was atypical. This basis was not made clear in the claim. No sampling checks were made to test the validity of this claim before it was made. The claim was refused, and when sampling was carried out, the revised claim was for a refund of £700,000.*
 - *Example: A tax agent made a claim on behalf of a large company for VAT refunds relating to a particular sales practice. The claim was made back to 1973, even though the practice*

only began in 1989. The claim did not show the correct VAT rates for earlier years either.

- *Example: A medium-sized firm dealing with the tax affairs of a partnership overlooked adding back around £200,000 of depreciation, treated recharges differently for different accounting periods, and appeared to understand neither the difference between salaried partners and full equity partners nor the correct treatment of individuals becoming or ceasing to be partners.*
- *Example: A company claimed it had overpaid VAT because internal invoices had mistakenly been treated as turnover. The tax agents carried out analysis on the company's records and made at least four significant errors, including showing credits as debits, thanks to an altered format in a spreadsheet. All four errors had been made despite the spreadsheet being checked by three managers.*

3.17 Some tax agents may find it difficult to consistently maintain their objectivity when dealing with key clients.

- *Example: An accountant included approximately £1 million of private expenditure, the building costs of the director's house, in the company accounts, included as fixed assets. When challenged, he admitted the treatment was incorrect and sought to move it to work in progress. The company in question is not a building company. It appears that the accountant, who is qualified, allowed the Director to make all the decisions about how items should be dealt with in the accounts.*

3.18 Fraudulent elements have been included within avoidance schemes by their promoters.

- *Example: An agent promoted schemes which included, variously, the following features:*
 - *Back-dated or post-dated agreements: sometimes these involved companies which had not yet been incorporated.*
 - *Copies of the same profit share agreement with different signatures*
 - *Documents allegedly signed by officers of the company before they were appointed officers of the company.*
 - *Letters referring to supplying documents "to put the necessary compliance in place", when the scheme was already running.*
 - *Notes of a meeting held for a company which was not incorporated until 5 days after the meeting.*

- *Dividend switch operated on a company for which shares had not even been issued. – And the payroll then being reworked the following month to operate PAYE/National Insurance Contribution (NIC) properly.*
- *Dividends paid to spouses who were neither employees nor shareholders.*
- *Dividends paid to minors who were neither shareholders nor employees.*
- *Notes referring to “re-working” payroll for earlier years.*
- *Blank Companies House forms pre signed by directors ready for completion and dating by the payroll service centre.*

3.19 A tax agent may have knowledge that an incorrect return or claim has or will be submitted or have knowingly prepared or submitted an incorrect return or claim.

- *Example: A tax agent repeatedly stated that the client was not a director or shareholder of a company in the Bahamas until faced with overwhelming evidence to the contrary. This evidence was obtained from a third party who had received it from the director in circumstances which meant the agent must have been aware of it. The tax involved exceeded £500,000.*
- *Example: a promoter of an Stamp Duty Land Tax (SDLT) scheme, a tax outside the promoter’s normal field of expertise, sought legal advice on the basis of instructions which ignored obvious potential difficulties with the scheme and misrepresented the purpose of the scheme. The promoter then used carefully selected passages from the legal advice in material marketing the scheme.*

3.20 A tax agent may take responsibility for inaccuracies to protect clients from incorrect return penalties. There are instances where evidence has shown a tax agent, rather than the taxpayer, has taken responsibility for a careless error solely because the legislation only provides for a penalty on the taxpayer. This creates a potential injustice. A taxpayer who deals with his or her own tax affairs has no such avenue of escape.

Chapter 4: How HMRC might respond to risks

4.1 The examples in the last chapter represent exceptional behaviour for a tax agent. However, there is a duty on HMRC to address risks of the type discussed which lie with the tax agent rather than (or possibly as well as) the taxpayer. The response to the risk needs to reflect the underlying cause. Where a risk has not arisen deliberately, HMRC's main objective would be for the position to be put right and to have assurance that the risk will not reoccur in the future. The following paragraphs look at what might be proportionate responses from HMRC in respect of different circumstances. In addressing these issues we are mindful of the design principles in Chapter 2 that are of particular relevance to tax agents.

Assessing risks

- 4.2 HMRC will generally identify a risk in respect of individual taxpayers, and will address that risk in the context of those taxpayers (by taking corrective action and perhaps charging penalties). But a problem that recurs (or has the potential to recur) may flag up a risk involving the tax agent. HMRC will need to be able to assess the extent of this risk as well, decide upon the appropriate remedial action and take a view on whether or not it was the result of careless or deliberate behaviour on the part of the tax agent.
- 4.3 This could be achieved by undertaking a compliance check on a representative proportion or all of the tax agents' clients. Such an approach could have significant resource implications for the tax agent and their clients, as well as HMRC. It may also result in unnecessary cost for clients who have submitted correct tax returns. If the agent has a relatively close-knit body of clients it could undermine their confidence in him or her.
- 4.4 An alternative approach would be to seek to work with the tax agent to understand the extent of any risk, and where appropriate to agree the remedy. This would build on the evidence discovered as a result of compliance checks that had already been undertaken into one or more of the tax agent's clients. One option would be for HMRC to request that the agent commission an independent report assessing the extent and causes of the risk.
- 4.5 While this could often be done on a voluntary basis, if that were rejected, HMRC would need to be able to act more formally. This might include in appropriate cases obtaining access to the tax agent's working papers. HMRC recognises that accessing working papers can have serious implications for a tax agent's practice. Any such approach would require very strong safeguards – over and above a right of appeal – to assure tax agents that such powers would not be used inappropriately by HMRC. Safeguards would also be needed to protect the interests of the tax agent's clients.

4.6 Safeguards could include:

- appropriate authorisation;
- the degree of certainty required to demonstrate that the risk could apply to more than one or only a small number of cases; and
- an ability to demonstrate that there was reason to believe that the risk had been created, carelessly or deliberately, by the tax agent's actions.

While it is tempting to think of a behavioural test as a way of restricting an information power, in practice it may be impossible for HMRC to discover sufficient evidence about the behaviour given the current circularity in the existing information powers.

- 1. What is the most effective way of assessing the presence of a particular risk across a tax agent's client base?**
- 2. How can HMRC and professional bodies best work to ensure risks are resolved for the future?**
- 3. What safeguards would be needed?**
- 4. What guidance should HMRC produce for setting the standard of pre-return assurance work and therefore provide comfort to practitioners that adherence to a certain level of assurance would amount to a defence against either compliance checks or other action?**

Where a tax agent has made a mistake

4.7 Where HMRC has identified that tax is at risk due to the tax agent making mistakes HMRC would wish to:

- understand how this has occurred;
- ensure that the position was put right for relevant past tax periods; and
- ensure that the tax agent takes steps to ensure the mistakes are not made in future.

4.8 In addition, depending on how the risk occurred, HMRC may want to put the tax agent on warning that recurrence may be treated as a failure to take reasonable care.

Where a tax agent has failed to take reasonable care

- 4.9 Where HMRC has identified a tax risk due to the agent having failed to take reasonable care, which may include a pattern of mistakes, HMRC would wish to consider the position beyond the case or cases which gave rise to the risk. In addition HMRC would expect the agent to confirm conformance with specified standards across their entire client base. In significant cases this could possibly be backed-up by independent confirmation that the necessary changes had been made.
- 4.10 Such an approach could be reinforced in a number of ways. Following on from paragraph 3.9 above, one option would be to extend the provisions of Schedule 24 FA2007 to provide for a penalty to be chargeable on a tax agent, where it can be demonstrated that a taxpayer had taken reasonable care, but the agent had not. Such a penalty could be capable of suspension.
- 4.11 As an alternative, rather than charge a penalty that might be suspended HMRC might consider an enforcement notice requiring the agent to ensure that proper standards of care were taken in future and to rectify specific failings. HMRC would set certain conditions. For instance, a requirement to bring knowledge up to date.
- 4.12 If the tax agent refused to act under the terms of an enforcement notice, or agreed to it but failed to meet its terms, a financial penalty might be charged, and/or, where appropriate, a report made to the agent's professional body.

Where a tax agent has been deliberately non-compliant

- 4.13 Where there is sufficient evidence that the risk arose as a result of deliberate actions by the tax agent HMRC would have to consider its relationship with the practitioner. Options for HMRC could include:
- a requirement to put matters right for the past and the future plus
 - financial penalties, and/or
 - a report to a representative body, and/or
 - an appropriate period of monitoring.
 - a refusal to deal with the tax agent in future
- 4.14 Any financial penalties (whether resulting from careless or deliberate behaviour) could be calculated in a number of ways. They could for example be fixed or up to a certain amount; or they could be linked to the tax at risk or the fee income or relevant turnover.
- 4.15 Finally, there is a small minority of people who are determined not to pay tax or who set out to defraud the tax and credit system. At the extreme end organised criminal gangs make sophisticated attacks on

the system itself by making false claims to repayments or tax credits on a massive scale. It is essential that this criminal element (in whatever role they play) is effectively investigated and prosecuted. Criminal investigation is an important part of HMRC's overall enforcement strategy, and as such there will continue to be a need for an effective criminal sanction to enable prosecution in the most serious cases.

- 5. What methods would be appropriate for ensuring that a tax agent's past failings are remedied, and good standards adhered to in the future?**
- 6. Are there cases where it would be appropriate to charge behaviourally based penalties to tax agents?**
- 7. If financial penalties are appropriate, on what basis should they be calculated: fixed, up to a certain amount, or linked to the tax at risk, fee income or relevant turnover?**

Working with the professional bodies

- 4.16 Section 20(3) of the Commissioners for Revenue and Customs Act (CRCA) 2005 permits HMRC to lawfully disclose information to an agent's representative body. There is a "public interest" qualification that must be met in all cases and consequently any disclosure has to be signed off by two HMRC Commissioners².
- 4.17 The "public interest" qualification means that this disclosure process is reserved for the most serious cases of misconduct. One way forward would be to consider the possibility of creating a disclosure route (with appropriate safeguards) which would allow HMRC to disclose to professional bodies cases where it believed it had evidence of persistently careless or incompetent conduct.
- 4.18 In whatever form an enhanced disclosure facility might take, it would be necessary to consider who it should be applied to. Should it be the accountancy practice that is reported, or the individual within that practice or both? And where an employee of the taxpayer is a member of the professional body, should they be subject to the disclosure regime?
- 4.19 There is also no certainty that a professional body will necessarily take action that HMRC considers appropriate. Their focus may be on addressing the professional issues rather than the tax consequences that are relevant to HMRC or certain consequences might be precluded by their statutes. Moreover, a disclosure facility would do nothing to address problems identified by HMRC where the tax agent is not a member of a professional body.

² Section 20(1)(c) requires that "the Commissioners are satisfied that [disclosure] is in the public interest"

4.20 For these reasons the disclosure route would never constitute the only sanction available to HMRC. There may though be scope for the professional bodies to be involved in the wider set of options considered in this section. This could perhaps include a supervisory role in the setting and monitoring of conditions enabling a tax agent to return to compliance. Such a role could potentially extend to tax agents who are not their members, perhaps on a one-off basis.

- 8. Is there merit in seeking the power to disclose to professional bodies cases where HMRC are satisfied that there has been persistent careless or incompetent behaviour?**
- 9. What safeguards would be needed?**
- 10. Could there be a wider role for professional bodies working with HMRC to ensure that a tax agent's past tax failings are remedied, and good standards adhered to in the future?**

Chapter 5: Registration and definition of a tax agent

- 5.1 In some countries tax advisers are self-regulated, generally within a framework provided by professional bodies. In others the revenue bodies may have a regulatory role of some sort. The UK is an example of the first of these. The Organisation of Economic Co-operation and Development (OECD) Report "Study into the Role of Tax Intermediaries" published on 8 April 2008 states that "In most cases, the ethical standards set by professional bodies are supplemented and exceeded by the major international accounting and legal firms' own standards".
- 5.2 However, while professional bodies can provide such controls over their members, professional frameworks do not apply to unaffiliated agents. At least 12,000 tax agents in business in the UK are unaffiliated to any major professional body but that does not suggest their observance of standards and internal controls is any less rigorous.
- 5.3 Where tax authorities are involved in regulation, solely or in partnership with recognised professional bodies, it typically involves a registration process that allocates unique numbers which must be quoted in dealings with the tax authority. Registration requires a commitment to minimum standards, which can include a requirement for minimum relevant qualifications. Some tax authorities go further and monitor performance of the agent and where appropriate offer support or seek sanctions if the level of performance falls below agreed standards. Sanctions for more serious cases include suspension or termination of the tax adviser's registration, financial penalties or an injunction to prevent an entity engaging in certain activities
- 5.4 Tax agents may see advantages in being "accredited" but these would need to be considered against the costs of regulation, assessment and the impact of withdrawal. A system of registration allows a tax administration to ensure that minimum standards apply to all tax advisers, not just those connected to a professional body. And taxpayers should gain some assurance that the advisers they choose should be competent to deal with their tax affairs. However, any system of registration could be costly in terms of the tax authority's time and resources and would impose some costs on tax agents which may be passed onto clients.
- 5.5 HMRC is not convinced that there is a need currently to take the significant and possibly costly step that a full-blown scheme of registration would be. That said HMRC would be interested in views about whether there might be credible light touch alternatives and what their advantages might be. There may be benefits in seeking to define "tax agent", not least so that there is clarity about who would be subject to any information powers or sanction in tax law. There is at present no statutory definition of a tax adviser or tax agent. References to "tax agent" or similar terms can be wide ranging and their scope changes

over time. For example, the introduction of SDLT in 2003 has brought conveyancing solicitors within its embrace.

- 5.6 Defining who should be considered as a “tax agent” in their dealings with clients or HMRC would provide clarity, especially for those who may not see themselves as tax agents but are performing that function. Such a definition could include the level of involvement with a client’s return needed for someone to be considered a “tax agent”. For instance, would providing a valuation to be included as part of a tax return make that person a tax agent? Would preparing a tax return for a business under terms of employment make someone a tax agent? Would there be any circumstances within any tax regime where (say) a shipping agent, freight forwarder, haulier or warehousekeeper could fall within such a definition?
- 5.7 It would also be important to consider the nature of the relationship between HMRC, a “tax agent” and their clients, where the agent, and perhaps the clients too, are based overseas. For example, where a tax agent based in the European Union (EU) signs a claim for a VAT refund as complete and accurate on behalf of a client based outside the EU.
- 5.8 One option would be to follow closely an existing definition such as that of Accountancy Service Provider (ASP) in Money Laundering Regulations (MLR), which was developed in conjunction with the main professional bodies, who form part of the supervisory regime. Published MLR guidance³ includes the definitions below. More information on the MLR provisions is in Annex B.

What are Accountancy Services?

Accountancy services include the recording, review, analysis, calculation or reporting of financial information and covers professional bookkeeping services, preparing or signing accounts or certificates of financial information concerning a person’s or organisation’s financial affairs, and advising on tax.

What is tax advice?

Advice is widely interpreted and includes tax compliance services such as assisting in the completion and submission of tax or duty returns. Businesses assisting in the completion and submission of tax returns in relation to any tax will fall within the scope of the Regulations. Businesses providing advice relating to the liability of a particular commodity to a tax or duty or the amount of tax or duty due will also fall within the scope.

- 5.9 An alternative approach would be to define the concept of a “tax return preparer”. This is the approach taken in for example, the United States of America. Published Internal Revenue Service guidance⁴ includes

³ MLR9 Registration Notice para 7.1.2 and 7.1.3

⁴ Part of the IRSs guidance on Tax Information for Tax Professionals on <http://www.irs.gov/taxpros/>

the definition below. More information on the U.S. approach is at Annex C.

What is a tax return preparer?

A tax return preparer is any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of a tax return or claim for refund of tax imposed by the Internal Revenue Code. Only one individual associated with a firm is a preparer with respect to the same tax return or refund claim. A person who prepares a return or claim for refund for a taxpayer with no explicit or implicit agreement for compensation is not a preparer, even though the person receives a gift or return service or favour. A person who prepares a return or claim for refund of an employer by whom the person is regularly and continuously employed is also not a preparer. If an attorney or [Certified Public Accountant (CPA)] hires someone else to prepare one's own personal return, the attorney or CPA is the taxpayer and not a preparer for purposes of that return.

- 5.10 The definition of tax return preparer distinguishes a person who prepares a return for compensation from one that does not. As described in section 1, HMRC currently recognise 80,000 agents who act for less than five clients, including friends and family and supporting the not for profit community showed, many of which would fall outside a U.S. type "tax return preparer" definition.
- 5.11 A further consideration would be the provision of tax adviser services but in an "indirect" capacity, or where supplied to the main tax agent, rather than direct to the client. To what level of distinction should any definition be applied to those agents who do not submit information direct to HMRC on behalf of their clients but who act in all other regards, perhaps as a provider of specialist services or advice, for the benefit of the client?
- 5.12 A number of the options considered in the previous section looked at the role of professional bodies and their members. We may need to consider a legislative definition which embraces them. A useful model may be that of "relevant professional adviser", as referred to in section 330 of the Proceeds Of Crime Act 2002 (POCA), and defined in the following terms:

A "relevant professional adviser" is defined in the legislation as:

- an accountant, auditor or tax adviser who is a member of a professional body which is established for accountants, auditors or tax advisers (as the case may be); and which makes provision for:
 - (a) testing the competence of those seeking admission to membership of such a body as a condition for such admission; and
 - (b) imposing and maintaining professional and ethical standards for its members, as well as imposing sanctions for non-compliance with those standards.

- 1. Is a form of registration for tax agents needed in the UK?**
- 2. What benefits for tax agents and taxpayers could a registration system deliver?**
- 3. Would there be a benefit in defining “tax agent” in legislation? Should such a definition distinguish: those who do not offer their services for reward, or those that are members of a professional body, and should different provisions apply to them?**
- 4. How wide should the definition of tax agent be: should it embrace lawyers, valuers, shipping agents, payroll bureaux, and others? If so, for which functions and in respect of which tax regimes?**
- 5. What additional issues need to be considered in respect of tax agents who are not based in the UK?**

Annex A: Summary of questions for consultation

Chapter 2

1. Have we identified the correct design principles? In applying these principles, are there any other matters that we need to take account of?

Chapter 4

1. What is the most effective way of assessing the presence of a particular risk across a tax agent's client base?
2. How can HMRC and professional bodies best work to ensure risks are resolved for the future?
3. What safeguards would be needed?
4. What guidance should HMRC produce for setting the standard of pre return assurance work and therefore provide comfort to practitioners that adherence to a certain level of assurance would amount to a defence against either compliance checks or other action?
5. What methods would be appropriate for ensuring that a tax agent's past failings are remedied, and good standards adhered to in the future?
6. Are there cases where it would be appropriate to charge behaviourally based penalties to tax agents?
7. If financial penalties are appropriate, on what basis should they be calculated: fixed, up to a certain amount, or linked to the tax at risk, fee income or relevant turnover?
8. Is there merit in seeking the power to disclose to professional bodies cases where HMRC are satisfied that there has been persistent careless or incompetent behaviour?
9. What safeguards would be needed?
10. Could there be a wider role for professional bodies working with HMRC to ensure that a tax agent's past tax failings are remedied, and good standards adhered to in the future?

Chapter 5

1. Is a form of registration for tax agents needed in the UK?
2. What benefits for tax agents and taxpayers could a registration system deliver?

3. Would there be a benefit in defining “tax agent” in legislation? Should such a definition distinguish: those who do not offer their services for reward, or those that are members of a professional body, and should different provisions apply to them?
4. How wide should the definition of tax agent be: should it embrace lawyers, valuers, shipping agents, payroll bureaux, and others? If so, for which functions and in respect of which tax regimes?
5. What additional issues need to be considered in respect of tax agents who are not based in the UK?

Annex C

1. Are there any other international models that we should consider?

Annex B: Current legislative framework

Introduction

HMRC has general civil powers, deterrents and safeguards directed (as they should be) at the taxpayer. These have been updated and aligned in Finance Acts 2007 and 2008. These powers allow HMRC to tackle risk by allowing them to call for information and documents and apply appropriate remedies to deal with inaccuracy or failure. Where poor behaviour is established, HMRC is able to charge penalties at appropriate levels. These civil powers have built in taxpayer safeguards, which include ensuring appropriate levels of confidentiality between parties.

In respect of the more serious cases, HMRC has powers to disclosure breaches of professional conduct to representative bodies, which were introduced when HMRC was formed, and older specific provisions which apply in respect of some taxes only, to impose civil penalties on persons who assist in the preparation of incorrect returns, and to call for accountants' working papers. These are all discussed in more details below.

Information and inspection powers in FA2008 and how they impact on tax agents

The powers in Schedule 36 to FA 2008 enable HMRC to require information and documents from any third party, including a tax agent, in order to check a person's tax position. There are penalties for failing to comply with an information notice and for concealing, destroying or otherwise disposing of a document that is required by a formal notice. The penalties also apply where the person has been told that the document is likely to be the subject of a formal notice. In addition, it is proposed that penalties will apply where a person carelessly or deliberately submits incorrect information or documents.

The powers may be used in respect of a particular known tax or taxpayers, but also for persons or a class of persons whose individual identities are not known to HMRC. A notice in the latter category can only be issued with the approval of the Tribunal and serious loss of tax must be suspected. It is considered that such a notice could be used, for example, to obtain a list of clients of an agent known to have performed shoddy work on a particular client provided the information is not readily available from another source.

Penalties for inaccurate returns in FA2007 and how they impact on tax agents

The penalty provisions for incorrect returns (contained in Schedule 24 FA2007) provide that where a taxpayer engages a suitable agent, there can be no penalty where a return is incorrect where the taxpayer provides full information to the agent, and checks their work as far as they are able. In effect this means that no penalty can be applied where it is the agent who has been careless.

Amendments to these provisions in FA2008 provide for a penalty to be charged on a third party (other than the taxpayer) where the third party has deliberately provided false information to the taxpayer, or deliberately withheld information from them, intending to cause an error in the taxpayer's return. In the normal course of events, it is highly unlikely that these conditions would apply to a tax agent. Generally an agent receives information from the taxpayer and acts upon it, and in such a capacity, it would be highly unusual for the agent to give information to the taxpayer.

Only in the more serious types of case, would there be a question of a third party penalty applying to an agent.

Powers available for the most serious cases involving a tax agent

Criminal cases

HMRC does of course have criminal powers to deal with the most serious cases, but these are not generally appropriate for the majority of circumstances which HMRC encounters.

HMRC's criminal powers (which were modernised in Finance Act 2007) are designed for use by law enforcement agencies, so that tax crime is tackled in the same way as other crime. In England and Wales the powers are made available through the Police and Criminal Evidence Act 1984 (PACE); in Northern Ireland through the Police and Criminal Evidence (Northern Ireland) Order 1989; and in Scotland through the Criminal Law (Consolidation) (Scotland) Act 1995 and the Criminal Procedure (Scotland) Act 1995.

Some of the powers in PACE are modified for HMRC. For example, a search warrant may allow HMRC to search persons found on the premises without the need for arrest. This allows HMRC to search a bookkeeper who may have evidence in a briefcase or laptop when a company's premises are searched, but who is not considered a suspect.

Money Laundering Regulations 2007

All tax advisers carrying on business in the UK are covered by the Money Laundering Regulations 2007. The legislation imposes a duty on advisers to comply with anti-money laundering legislation by putting in place risk sensitive anti-money laundering policies and procedures to prevent their businesses from being used by money launderers and terrorists. They are required to report suspicious activity to the Serious Organised Crime Agency where they have reasonable grounds for knowledge or suspicion of money laundering including terrorist funding.

In addition, if a tax adviser is dealing in criminal property, including the proceeds of tax evasion, they will be committing a money laundering offence under the Proceeds Of Crime Act 2002 and liable to unlimited penalties or prosecution under that Act.

Twenty-two of the main professional bodies now have a supervisory role to monitor and secure their members' compliance. Those tax advisers who are not members of one of these bodies are supervised by HMRC and are required to register with HMRC.

Detailed guidance for all tax advisers be found in the anti money laundering guidance produced by the Consultative Committee of Accountancy Bodies at www.ccab.org.uk

Disclosure

Many tax agents will be members of professional bodies committed to maintaining high professional standards. There is an existing process by which serious breaches of professional conduct can be reported to the relevant professional body. Currently section 20(3) CRCA 2005 permits HMRC to lawfully disclose information to a tax agent's representative body. There is a "public interest" qualification that must be met in all cases and consequently any such disclosure must be approved by two HMRC Commissioners.

Civil penalties

HMRC also has some existing powers specific to individual tax regimes, for situations where it is the agent themselves that is the problem. Specifically section 99 TMA which applies to direct taxes only provides for an agent to be penalised where they have been personally involved in the preparation of an inaccurate return or other documents which he or she knows will be used for tax purposes, and knows to be incorrect.

Section 99 TMA has been little used by HMRC in recent years, and doubts have been raised in some quarters about the standard of proof required to do so. However the Courts have made clear that it is the civil standard of proof that should be applied.⁵

Comparable penalty provisions apply for some other taxes such as inheritance tax, but these have also been applied infrequently in practice.

Powers to call for accountants' working papers

Section 20A TMA allows HMRC to call for the papers of tax accountants where they have been convicted of a tax offence or had a section 99 penalty imposed upon them.

⁵ High Court decisions of HMRC v Khawaja [2008] EWHC 1687 (Ch)

Annex C: International Comparisons

Introduction

This annex describes the provisions which operate in respect of agents in the United States of America and Australia, both of which are in the process of making significant change.

They are considered under the following categories:

- The definitions applied to one or more categories of “tax agent”.
- Type of regulation or registration that exist (if any).
- Breaches subject to sanction.
- Types of penalty or other sanction that can be applied (including features such as a “safe harbour” where applicable).
- Provisions in respect of aggressive tax planning.
- Frivolous tax arguments (US only).

1. Are there any other international models that we should consider?

UNITED STATES

Responsible authority

The Office of Professional Responsibility (OPR) sits within the Internal Revenue Service (IRS) under the Deputy Commissioner, Services and Enforcement and is responsible for setting, communicating and enforcing standards of competence, integrity and conduct among tax practitioners.

Definitions of “tax practitioner” and “tax return preparer”

C230 defines “tax practitioner” as an attorney, or certified public accountant (CPA), who is in good standing, enrolled agent or enrolled actuary. Attorneys and CPAs are admitted to practice if they are in good standing with their state licensing authority. “Enrolled agent” status is achieved by those who demonstrate technical competence and pass a background check. In addition, he or she must practice before the IRS. Practice is broadly defined and Congress has clarified that it covers opinion writers, and thus could apply to those within large corporations offering corporate-law advice that impacts on the tax position.

As is described in a later section, penalties may be imposed on “tax return preparers”. Essentially, a tax return preparer is any person who prepares (or employs people to prepare) for compensation all, or a substantial portion, of a tax return or claim for refund of tax imposed by the Internal Revenue Code. Only one individual associated with a firm is a preparer with respect to the

same tax return or refund claim. A person who prepares a return or claim for refund for a taxpayer with no explicit or implicit agreement for compensation is not a preparer, even though the person receives a gift or return service or favour. A person who prepares a return or claim for refund of an employer by whom the person is regularly and continuously employed is not a preparer. If an attorney or CPA hires someone else to prepare one's own personal return, the attorney or CPA is the taxpayer and not a preparer for purposes of that return.

Regulation

The Code of Federal Regulations which governs practising tax practitioners is Treasury Department Circular 230. Its rules govern the recognition of a "tax practitioner", the authority to practice before the IRS, the duties and restrictions relating to such practice; and provide for sanctions and disciplinary proceedings in case of breach or failure. If a person is not allowed to practice before the IRS, then they may not represent a taxpayer unless they are related.

Breaches subject to sanction

Examples of what is not acceptable include:

- Failure to exercise due diligence.
- Providing false or misleading statements.
- Contemptuous conduct towards IRS personnel.
- Failure to meet requirements for covered opinions.
- Failure to meet personal tax obligations.
- Loss of state licence to practice law or certified public accounting.
- Conviction of a federal crime which reflects upon their fitness to practice.

Penalties and other sanctions

Sanctions for breaches range from a reprimand to disbarment. [Expand]

Tax return preparer penalty

Penalties may be imposed on tax return preparers who prepare returns taking positions that may not be fully supported by current law⁶. The provisions were amended in 2008 to extend the application of the income tax return preparer penalties to all tax return preparers and by raising the standard that preparers must meet to avoid a penalty. Further provisions are planned for 2009 to update the regulatory scheme governing tax return preparer penalties that has remained substantially unchanged since the late 1970s.

⁶ under section 6694 of the Internal Revenue Code

The first tier of the tax return preparer penalty provisions provides that a penalty may be charged where:

- a tax return preparer knew (or reasonably should have known) of the position;
- there was not a reasonable belief that the position would more likely than not be sustained on its merits; and
- the position was not disclosed as required, or there was no reasonable basis for the position.

The penalty for understatements is the greater of \$1,000 or 50% of the income derived (or to be derived) by the tax return preparer from the preparation of a return or claim with respect to which the penalty was imposed.

The second tier provides for an alternative penalty where a person prepares a return in any manner so as to wilfully understate the liability of tax on a tax return or claim for refund or in reckless or intentional disregard of rules or regulations. The penalty is then the greater of \$5,000 or 50% of the income derived (or to be derived) by the tax return preparer.

The regulations apply to tax returns or claims prepared in other countries.

Safe harbour

There is a de minimis “safe harbour” provision which provides that a tax return preparer will not be considered to have prepared a “substantial portion” of a return or claim for refund if the schedule, entry, or other portion of a return or claim for refund involves amounts of gross income, amounts of deductions, or amounts on the basis of which credits are determined which are

- less than \$2,000; or
- less than \$100,000, and also less than 20% of the gross income as shown on the return or claim for refund.

If there is no substantial authority for a position but there is a reasonable basis, the preparer must give the taxpayer a prepared tax return with a complete disclosure statement, or disclose the position on the return in accordance with the annual revenue procedure.

Aggressive tax planning

The IRS has become increasingly interested in the role of tax practitioners in aggressive tax planning and is increasing efforts to tackle the promoter or supply side of the market. A civil penalty was introduced into C230 in 2004 and is seen as a key factor in shifting the risk/benefit analysis that a tax practitioner undertakes before marketing a tax shelter and has also been linked with the need for tax practitioners to introduce greater internal-control and risk-management procedures.

A further amendment to C230 is proposed to preclude the use of contingency fees in original return filings and limit the use of such fees in other situations.

The rules relating to “covered opinions” are also relevant. A covered opinion is written advice that concerns federal tax issues whose purpose is to avoid or evade tax. There are specific requirements set out in C230 which must be followed where a practitioner is providing a covered opinion.

Frivolous tax arguments

The Internal Revenue Service has published material which discusses and rebuts many of the more common frivolous arguments made by individuals and groups that oppose compliance with federal tax laws. The document is regularly updated (every year or so) and explains many of the common frivolous arguments made in recent years and describes the legal responses that refute these claims⁷.

A penalty is chargeable where a person submits a tax return or other specified submission, and any portion of the submission is based on a position the IRS identifies as frivolous.

The penalty is \$5,000, and the courts may also impose penalties on those who pursue tax cases on frivolous grounds.

Persons who promote frivolous arguments and those who assist taxpayers in claiming tax benefits based on such arguments may also face various penalties including:

- a \$250 penalty for each return prepared by an income tax return preparer who knew or should have known that the taxpayer’s argument was frivolous (or \$1,000 for each return where the return preparer’s actions were wilful, intentional or reckless);
- a \$1,000 penalty for aiding and abetting an understatement of tax; and
- criminal felony prosecution for which the penalty is up to \$250,000 and imprisonment for up to 3 years for assisting or advising about the preparation of a false return or other document under the internal revenue laws.

Promoters who fail to comply with court orders run the risk of incarceration for contempt of court.

⁷ a 74-page document The Truth About Frivolous Tax Arguments is on <http://www.irs.gov/taxpros/>

The material published by the IRS includes examples of action taken in respect of tax practitioners:

Wetzel v. Commissioner, T.C. Memo. 2005-211, 90 T.C.M. (CCH) 266 (2005) – the court imposed a \$15,000 penalty against Wetzel, a professional tax return preparer, for making frivolous arguments because he knew or should have known the arguments were frivolous.

Takaba v. Commissioner, 119 T.C. 285, 295 (2002) – the court rejected the taxpayer’s argument that income received from sources within the United States is not taxable income stating that “[t]he 861 argument is contrary to established law and, for that reason, frivolous.” The court imposed sanctions against the taxpayer in the amount of \$15,000, as well as sanctions against the taxpayer’s attorney in the amount of \$10,500, for making such groundless arguments.

The Nis Family Trust v. Commissioner, 115 T.C. 523, 545-46 (2000) – concluding that the petitioners chose “to pursue a strategy of non-cooperation and delay, undertaken behind a smokescreen of frivolous tax-protester arguments,” the court imposed a \$25,000 penalty against them, and also imposed sanctions of more than \$10,600 against their attorney for arguing frivolous positions in bad faith.

Edwards v. Commissioner, T.C. Memo. 2002-169, 84 T.C.M. (CCH) 24, 42 (2002) – the court found that sanctions were appropriate against both the taxpayer and the taxpayer’s attorney for making groundless arguments. The court stated that “[a]n attorney cannot advance frivolous arguments to this Court with impunity, even if those arguments were initially developed by the client.” In a supplemental opinion, the court imposed sanctions against the taxpayer in the amount of \$24,000 and against the taxpayer’s attorney in the amount of \$13,050. Edwards v. Commissioner, T.C. Memo. 2003-149, 85 T.C.M. (CCH) 1357.

AUSTRALIA

Responsible authority

The Tax Practitioners Board (Board) has responsibility for registering tax agents and Business Activity Statement (BAS) agents, ensuring that agents maintain appropriate skills and knowledge, investigating complaints against agents and ensuring that unregistered entities do not hold themselves out to be agents.

Currently the main legislation concerning tax agents is in the Income Tax Assessment Act 1936. Section VII of this legislation is being repealed and replaced by the Tax Agent Services Bill 2008. This legislation is currently progressing through the Australian Parliament. The material that follows concentrates on the new provisions.

Definitions of “tax agent service” or a “Business Activity Statement (BAS) service”

To provide a tax agent service or a BAS service for a fee or other reward, an entity must be registered.

A tax agent service is any service that relates to:

- ascertaining or advising about the liabilities, obligations or entitlements of an entity under a taxation law; or
- representing an entity in their dealings with the Commissioner of Taxation (Commissioner),

that is provided in circumstances where it is reasonable to expect that the entity will rely on it to satisfy liabilities or obligations under a taxation law or to claim entitlements under a taxation law.

A Business Activity Statement (BAS) service is any service that relates to:

- ascertaining or advising about the liabilities, obligations or entitlements of an entity under a BAS provision; or
- representing an entity in their dealings with the Commissioner relating to a BAS provision,

that is provided in circumstances where it is reasonable to expect that the entity will rely on it to satisfy liabilities or obligations under a BAS provision or to claim entitlements under a BAS provision.

The definition of BAS provisions includes Australian indirect taxes. As taxation law includes BAS provisions, by definition ‘tax agent services’ include BAS services.

Both tax agent and BAS services only include those services that involve the application or interpretation of the law (and therefore require the provider to

have a certain level of knowledge and experience in the relevant laws), and those services which involve representing an entity in their dealings with the Commissioner.

Registration

Individuals (including those acting in the capacity of a trustee), partnerships and companies (including those acting in the capacity of a trustee) may apply to the Board for registration as a tax agent or BAS agent. The Board must grant registration where all eligibility requirements have been satisfied. To be eligible for registration, an entity must satisfy the Board that it has met the registration requirements, which broadly consist of the following two elements:

- a fit and proper person test; and
- prescribed qualifications and experience requirements (for individuals), or the requirement to have a sufficient number of individuals who are registered (for companies and partnerships).

The Board has a period of six months from receiving an application for registration in which to decide whether to grant or refuse registration. The Board may impose or vary a condition of registration. Any such condition limits the tax agent services that an agent may provide to an area of the taxation laws or a type of service for which:

- in the case of an individual, the agent has the prescribed qualifications and relevant experience; or
- in the case of a partnership or company agent, the registered individuals who work for the agent have the prescribed qualifications and relevant experience.

To obtain registration to provide tax agent services for a fee or other reward, a person will need to meet the fit and proper person test, have minimum educational qualifications and relevant experience requirements. The minimum educational qualifications and relevant experience requirements are set at a less demanding level for registration as a BAS agent than for registration as a tax agent, in recognition of the narrower scope of services provided by BAS agents.

The law specifies that a person is not a fit and proper person to prepare income tax returns and transact business on behalf of taxpayers in income tax matters if they do not hold the prescribed qualifications, are not a natural person, are not above 18 years of age, are not of good fame, integrity and character, have been convicted of a serious taxation offence during the previous five years or are under a sentence of imprisonment for a serious taxation offence.

To determine that a person is of good fame, integrity and character, the Tax Agents Board character references included with the person's application, and convictions (in particular those relating to fraud, theft or deception).

The obligations of tax agents include their responsibilities to clients. If the Board considers that an agent is neglecting the taxation affairs of their client, they may seek an explanation and they have the power to suspend or cancel their registration if not satisfied.

More generally, the Board has discretion to terminate the registration of a tax agent or BAS agent if:

- it no longer meets the registration requirements;
- it breaches a condition of registration; or
- if it is an individual or a company - an event affecting continued registration happens to the agent.

The majority of the decisions of the Board are reviewable by the Administrative Appeals Tribunal.

To allow for the registration of 'specialist' tax agents and BAS agents, the Board may impose conditions on registration. Conditions limit the scope of the services that an agent may provide to a single area of the taxation laws or a single type of tax agent service. These limitations correspond to the prescribed qualifications and relevant experience of an individual agent or, in the case of an agent that is a partnership or company, to correspond to the prescribed qualifications and relevant experience of the individuals who work for the agent.

Code of Professional Conduct (Code)

A Code of Professional Conduct (Code) governs the ethical and professional standards of tax agents and BAS agents. The Code is set out as a statement of principles and the Board may issue binding written guidelines for the interpretation and application of the Code.

Breaches subject to sanction

If a tax agent or BAS agent breaches the Code, the Board has a range of options. Examples of what is not acceptable include

- engaging in the following conduct without registration:
 - providing a tax agent service or BAS service for a fee or other reward;
 - advertising the provision of a tax agent service or BAS service; or
 - representing themselves to be a tax agent or BAS agent.
- making a false or misleading statement to the Commissioner of Taxation (Commissioner);
- employing or using the services of a deregistered entity; or

- signing a declaration or statement in relation to a taxpayer on a document that was not prepared by a registered entity or an individual under the supervision and control of a registered entity.

Penalties and other sanctions

If the Board finds that an agent has breached the Code, it may impose one or more of a range of graduated administrative sanctions. The sanctions the Board may impose include:

- cautioning the agent;
- requiring the agent to complete a course of training;
- subjecting the agent to specified restrictions when conducting their practice;
- requiring the agent to practise under supervision; and/or
- suspending or terminating the agent's registration.

The Board may also apply to the Federal Court of Australia for an order to pay a financial penalty for certain serious misconduct, or seek an injunction to prevent an entity from engaging in, or compel an entity to undertake, certain conduct.

Such a wide range of sanctions allows the Board to tailor its response according to the severity of the misconduct. The stated purpose of the sanctions is not primarily to punish tax agents and BAS agents, but rather to improve the performance of agents and maintain public confidence in agents' adherence to certain standards. For instance, in the case of isolated mistakes, the Board may take no specific action, or may issue a written caution. For repeated mistakes the Board may issue an order specifying that the tax agent or BAS agent must undertake further education or training in the particular area.

In more severe cases, where a tax agent or BAS agent has displayed a serious disregard for the Code, suspension or termination of registration may be appropriate. This is particularly so where a tax agent or BAS agent causes serious damage to their clients, or to the integrity of the tax system. Behaviour that calls into doubt the honesty, integrity or competence of a tax agent or BAS agent, or raises questions about their suitability to practise, may warrant more severe sanctions such as suspension or termination of registration.

Civil penalties

The maximum amount of civil penalties for individuals engaging in prohibited conduct ranges from 50 penalty units (currently AU \$5,500) to 250 penalty units. Bodies corporate are subject to a penalty that is five times the penalty imposable on an individual, and therefore ranges from 250 penalty units to 1,250 penalty units.

If a partnership contravenes a provision, each partner that was in the partnership at the time of the contravention is treated as though they have contravened the provision, unless they prove otherwise. The maximum amount of civil penalties for each individual partner is the same as for individuals for engaging in prohibited conduct. Similarly, the maximum amount of civil penalties for each corporate partner is the same as for bodies corporate for engaging in prohibited conduct.

Injunction

If the Board is satisfied that an entity is engaging in conduct that contravenes a civil penalty provision, for example, engaging in conduct that is prohibited without registration, it may apply to the Federal Court for an injunction to restrain or require certain conduct.

Safe harbour

Under safe harbour provisions, a taxpayer who uses a tax agent or BAS agent will benefit not be subject to a penalty in certain circumstances. In summary these are where a tax agents or BAS agent has failed to take reasonable care which has resulted in a return not being properly filed or where is contains a false or misleading statement. The taxpayer must be able to order to demonstrate that they have provided all relevant taxation information to their tax agent or BAS agent.

Where a tax loss arises in such cases, the agent may be referred by the Commissioner or the taxpayer to the Tax Practitioners Board (Board) for appropriate action.

Aggressive tax planning

Australia has promoter penalty laws which provide for civil penalties for, and injunctions to be used against, those that engage in the promotion of tax exploitation schemes. The Australian Taxation Office Commissioner has described these as being aimed at 'unscrupulous operators who peddle unsustainable arrangements'.

Annex D: The Government's Consultation Code of Practice

ABOUT THE CONSULTATION PROCESS

This consultation is being conducted in accordance with the Government's Consultation Code of Practice. If you wish to access the full version of the Code, you can obtain it online at:

<http://www.berr.gov.uk/files/file47158.pdf>

The Consultation Criteria

- 1. When to consult** - Formal consultation should take place at a stage when there is scope to influence the policy outcome.
- 2. Duration of consultation exercises** - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- 3. Clarity of scope and impact** - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- 4. Accessibility of consultation exercise** - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- 5. The burden of consultation** - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- 6. Responsiveness of consultation exercises** - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- 7. Capacity to consult** - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel that this consultation does not satisfy these criteria, or if you have any complaints about the process, please contact:

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