

## ***COMPLIANCE COST REVIEW***

### **Avoidance Disclosures Impact Assessments**

#### **1. Introduction**

##### **1.1 Background**

In line with Government commitments to reduce the compliance burdens that are placed on businesses, HM Revenue & Customs (HMRC) assesses the likely change in compliance costs whenever a policy is introduced or changed. The results of that analysis are published in a final Regulatory Impact Assessment (RIA) when the associated legislation is laid before Parliament. Where a consultation document is published during the analysis period, it is accompanied by a partial RIA.

This document summarises the outcome of a post-implementation review of the following three RIA's:

**a) TACKLING TAX AVOIDANCE- DISCLOSURE REQUIREMENTS (TAD)**

The final RIA for this measure was published in April 2004.  
A copy of this RIA can be found in annex A to this review.

**b) NATIONAL INSURANCE CONTRIBUTIONS BILL (NIC)**

The final RIA for this measure was published in October 2005.  
A copy of this RIA can be found in annex B to this review.

**c) THE STAMP DUTY LAND TAX AVOIDANCE SCHEMES (SDLT)**

The final RIA for this measure was published in July 2005.  
A copy of this RIA can be found in annex C to this review.

These three RIA's are being considered together because they relate to the same general policy area dealing with the tax treatment of avoidance schemes. In addition to this the findings of this review will feed into a wider evaluation report being carried out by HMRC into the work they have undertaken in respect of the tax treatment of avoidance schemes.

This review re-assesses the compliance cost analysis published in these different avoidance related RIA's trying to address the following two main questions:

- whether the estimates of compliance costs used in the RIA's were correct, with hindsight; and
- whether the processes used to estimate compliance costs were appropriate and reasonable, given the circumstances at the time.

HMRC intend to use this review to improve the RIA process, and also to assist in future policy development and evaluation work in general. As such, the emphasis is on identifying learning points for future assessment of compliance costs. The review does not revisit the original policy decision.

## **2. The published RIA's**

### **2.1 Tackling Tax Avoidance Disclosure (TAD)**

#### **2.1.1 Description of the policy change**

This regulatory impact assessment was published by the Inland Revenue in relation to the introduction of new rules on the disclosure of tax avoidance schemes by those who sell them and by those who use them.

It was designed to enable the old Inland Revenue to be able to manage the risks of tax loss from fraud, evasion, avoidance and error. It was further hoped that the Revenue would be able to increase its effectiveness in deterring and detecting tax lost through avoidance

#### **2.1.2 Anticipated compliance costs or savings**

It was thought that there would be no material impact upon the very large number of accountants and lawyers across the UK who merely assist their client understand the tax system and plan their business and other transactions appropriately.

Promoters would have to register details of the scheme or arrangement with the Revenue at an early stage. Promoters also had to advise their clients of the registration number provided. It was expected that the information required by the promoter to make the disclosure would be readily at hand as part of the arrangements around marketing the scheme and so will not involve significant additional cost. There may have been a small set up/learning cost associated with this change.

As the rules become more widely understood it was anticipated that compliance with them would become a standard feature of planning these types of schemes.

## 2.2 National Insurance Contributions Bill (NIC)

### 2.2.1 Description of the policy change

The objective of this Bill was to try and deter employers from using schemes to avoid paying National Insurance Contributions (NICs) on the rewards from employment, and where employers had not been deterred to have the power to close down avoidance schemes and to introduce NICs liability effectively.

The National Insurance Contributions Bill (hereafter referred to as the NICs Bill) has the following provisions: -

- ❖ A power to introduce NICs regulations, that may have effect from 2 December 2004, on payments treated as remuneration and earnings to mirror so far as possible anti-avoidance measures introduced into tax legislation. The Bill also included powers to allow amendments to the scope of NICs exemptions to mirror so far as possible anti-avoidance tax measures with effect from 2 December 2004 and for the making of consequential regulations for the purposes of contributions, contributory benefits and statutory payments. **(Measure A)**.
- ❖ Deem NICs agreements & elections null and void if applied to securities income that is affected as a result of the above NICs anti-avoidance regulations **(Measure B)**.
- ❖ Introduce NICs disclosure rules **(Measure C)**.

## 2.2.2 Anticipated compliance costs or savings

The combined impact of the measures in this Bill was thought not to impose significant additional burdens or costs on employers unless they engage in these types of avoidance schemes.

Employers that engaged in these types of activities had to submit supplementary end of year returns of NICs now payable. Estimates based on disclosures suggested that 500 employers and 10,000 employees (very tentative estimates) might have been affected by these changes, incurring additional costs estimated not to exceed around £3,000 (estimate of cost of revising and paying NIC liabilities and gaining additional professional advice).

The cost of processing these additional returns for HMRC is estimated to be £20,000 in additional manpower costs.

**Measure A** - The additional administration costs for business will be small. Most employers deterred from avoidance will simply be paying a larger amount via Pay as You Earn (PAYE) than they would otherwise have done in the normal way. This should generate zero additional compliance costs because employers will already operate PAYE and most remuneration avoidance schemes would already involve paying over some tax through PAYE anyhow.

**Measure B** - This measure was not considered to have any significant implementation costs for HMRC. It only applies where employers wish to put in place a scheme to avoid NICs with the added benefit of the NICs transfer mechanisms in case a liability does arise. Employers would then have the clear and unambiguous choice. That on implementing a NICs avoidance scheme they would face an employers' NICs liability charged on any employment income arising from it once the scheme or transaction is discovered and legislated against. The cost to them of this measure would be that they would not be able to recover that liability from the employee.

**Measure C** - In practice, since schemes normally cover tax and NICs, persons required to disclose will incur additional compliance costs as a result of this proposal only insofar as they are involved with NICs only schemes. It was thought that there would be very few of these types of cases and that the additional costs to be marginal.

## **2.3 Stamp Duty Land Tax avoidance schemes (SDLT)**

### **2.3.1 Description of the policy change**

This Regulatory Impact Assessment estimates the costs and benefits of the proposal to extend the rules requiring disclosure of information to H M Revenue and Customs (HMRC) about certain tax schemes. The new rules will take effect from 1 August 2005. It reflects the responses to the draft regulations published on 24 March 2005

The objective of this policy change was to counter the avoidance of stamp duty land tax on UK commercial property by requiring information about certain tax schemes and arrangements to be disclosed to HMRC. This would enable HMRC to tackle avoidance in a more targeted way and for the Government to more quickly counteract schemes which seek to defeat its tax policy objectives.

### **2.3.2 Anticipated compliance costs or savings**

It was thought that there would be no material impact upon the very large number of accountants and lawyers across the UK who merely assist their client understand the tax system and plan their business and other transactions appropriately.

Promoters would have to register details of the scheme or arrangement with HMRC at an early stage. Promoters would also have to advise their clients of the registration number provided. It was expected that the information required by the promoter to make these disclosures would be readily at hand as part of the arrangements around marketing these schemes and so will not involve significant additional cost. There may also be a small set up/learning cost associated with this change.

As the rules become more widely understood it was anticipated that compliance with them would become a standard feature of planning these types of schemes.

### **3. Conduct of the review**

Each compliance cost review is conducted individually, and the review process is adapted to suit the particular circumstances applying in each case. The emphasis is on making sure that the review itself - and any burden of consultation - are sufficient to meet the objectives of the review, but proportionate to the likely benefits.

In this case, the review was led by an HMRC project team supported by consultants. The staff in the review team were completely independent of those involved with the original policy change.

An essential element of the review was consultation with those actually affected, and consultants were commissioned to carry out a small number of targeted in-depth interviews with some of those businesses affected by this policy change. The research was not intended to deliver any degree of statistical robustness (to do so would have been costly and impractical) but instead to provide indicative findings. Coupled with the consultants' own knowledge and expertise, this has allowed the research to identify the major issues and any associated learning points.

The external research was complemented by an internal review of HMRC paperwork and electronic files.

#### 4. Were the original estimates of compliance costs accurate?

This section addresses two main aspects – the nature of the change in compliance costs (i.e. what did people have to do differently) and the monetary impact of that change (what did it cost or save them).

Question	Comments
Were the specific types of cost and benefit identified in the RIA (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.) incurred?	<p>The interviewees agreed that the costs identified in the RIAs were incurred.</p> <p>There were, however, costs incurred which were not included in the RIAs (see below for detail).</p>
Were costs/savings incurred at the expected time?	<p>The costs of implementation were generally incurred at the expected time. No savings were identified by the respondents.</p> <p>One of the respondents made the comment that, due to the numerous times the legislation was redrafted, its organisation did not incur costs at the expected time. In addition, this respondent noted the incurrance of additional costs because of the number of changes in legislation over the last few years.</p>
Were costs/savings incurred by the expected people?	<p>No comments arose from the interviews that would suggest that the costs/savings were not incurred by the expected people.</p>
Were any other costs/savings, not identified in the RIA, incurred?	<p>Not applicable.</p>
If the type of costs/savings varied from the original estimates, why was that?	<p>From the perspective of one of the interviewees, a significant area of compliance cost which was not included in any of the RIAs was the costs incurred in managing the ongoing compliance within an organisation. There are aspects of compliance which are relevant for a specific transaction; however significant time cost is incurred in ensuring that overall the organisation continues to remain compliant with the legislation.</p> <p>A common concern raised by the interviewees' relates to compliance costs which are incurred due to the way the legislation is drafted. It was the view of the interviewees that the legislation</p>

	<p>is drafted in such a way that tax planning outside the scope of what HMRC is principally concerned about often needs to be considered in detail, to determine whether disclosure is required. In some instances, for example where a contingent fee is charged in relation to a tax planning idea, a disclosure may need to be made, even though the arrangement does not fall within the scope of what HMRC is primarily interested in. Significant time costs are therefore incurred in complying with the law but are not necessarily related to the main purpose of the legislation.</p>
<p>Could such variances have been foreseen at the time?</p>	<p>When businesses were consulted about these policy changes they did not specifically raise the issues mentioned above.</p>
<p>What is the assessment now of the total value of costs and savings?</p>	<p>The interviewee feedback was that the types of cost described in the RIAs reasonably reflected the types of costs which were actually incurred.</p> <p>Some interviewees were of the view that it is inherently difficult to estimate the compliance costs for some subjects such as making avoidance disclosures. This is because it is difficult to estimate the extent of the time involved.</p> <p>Only two interviewees made attempts to estimate the compliance costs incurred in complying with the new legislation. One estimate was for between 20,000 and 25,000 staff hours to implement (one off costs). The other estimate was £50,000 to £100,000 in professional fees and staff time costs to implement (one off costs).</p>
<p>If different from the original RIA, what has caused the discrepancies?</p>	<p>The interviewees concluded that the RIAs accurately described the types of costs which were incurred in introducing and complying with the new legislation. Without actually including any estimates of the cost for each of these categories.</p>
<p>With hindsight, were the compliance cost estimates accurate?</p>	<p>The interviewees agreed that the overall assessment of the impact of the legislation, in terms of the categories of cost expected to be</p>

incurred, was appropriate. Most of the significant areas of costs to be incurred were identified as cost categories in the RIAs (with a few exceptions as noted above).

The interviewees generally found it difficult to estimate the expected costs to be incurred in implementing the new legislation in advance.

Indeed, most were not able to make a reasonable estimate of the costs incurred after the legislation had been implemented. This was mostly because the significant costs were people time, which is difficult to estimate without a formal time recording process. The interviewees had all spent a significant amount of time preparing for the implementation of the new legislation so it is understandable that they did not invest additional time in determining the extent of the costs incurred when they did not perceive this information to be of any value to them.

One of the interviewees also noted that if internally an organisation found it difficult to determine the extent of the expected compliance costs, it would be even more of a challenge for HMRC to do so as it does not have such an in depth understanding of how organisations operate.

HMRC may have been in a better position to provide the estimates in the RIAs if organisations had provided it with estimates but the interviewees did not provide such input. This was partly because of the difficulties of estimating the costs but also because undertaking such estimates was not considered to be a priority when under time pressures to undertake all the work required to implement the legislation.

**5. Was the process used to estimate compliance costs reasonable?**

Irrespective of whether the analysis turned out to be correct, the review has considered whether the original analysis was completed in a reasonable way.

Question	Comments
Who worked on the original RIA?	These RIAs were completed by tax policy experts, analysts and Better Regulation advisors. No problems have been identified.
Was an adequate audit trail maintained?	<p><b>TAD</b> - Yes. In so far as e mails are available showing the correspondence that arose once it was agreed to complete an Impact Assessment (IA).</p> <p><b>NIC</b> - Yes.</p> <p><b>SDLT</b> – Yes.</p>
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	<p><b>TAD</b> - Yes.</p> <p><b>NIC</b> - Yes. Also the Cabinet Office was consulted about the content and style of this IA.</p> <p><b>SDLT</b> – Yes.</p>
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	<p><b>TAD</b> - Impossible to tell. That being said the time scale available to complete this IA left little scope for detailed analysis. Also it seems reasonable in light of the very small change in reporting obligations.</p> <p><b>NIC</b> - Hard to say. Some thought and research went into obtaining the estimated cost per employer and the number of employers but no great detail was available on the surviving records.</p> <p><b>SDLT</b> - Impossible to tell but it seems reasonable in light of the very small change in reporting obligations.</p>
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	<b>TAD</b> - Internally yes. Externally it was not possible to consult widely due to time constraints and the fact that this was a budget

	<p>measure. That being said the views of Small Business Service (SBS) were sought.</p> <p><b>NIC</b> - Yes. Business, SBS, Cabinet office externally and a wide range of analysts, policy owners and better regulations advisors internally.</p> <p><b>SDLT</b> – Yes.</p>
<p>Did those who were consulted when the RIA was written express views on the reasonableness of the process?</p>	<p><b>TAD</b> – No.</p> <p><b>NIC</b> - No. Comments about content and style were given by the cabinet office and SBS.</p> <p><b>SDLT</b> – No.</p>
<p>Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?</p>	<p>The interviewees generally felt that the compliance cost process was reasonable. HMRC made a number of attempts to request input from relevant businesses at the time as to the extent of costs they expected to incur. However, few businesses provided such input.</p> <p>Despite not having such input, HMRC was still able to determine the types of costs expected to be incurred by businesses, but not ascribe associated numerical values. Due to the difficulty associated with preparing such estimates, this was a reasonable approach.</p>
<p>Were compliance costs estimated for all options mentioned in the RIA?</p>	<p><b>TAD</b> – A number of areas of possible change were mentioned in the IA but compliance costs were only available for the one option that appeared in the IA.</p> <p><b>NIC</b> - Compliance costs were estimated but not specifically quantified for each of the three measures shown in the IA.</p> <p><b>SDLT</b> – Three different options were mentioned in the IA but compliance costs were only available for the preferred option.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>The RIAs set out the groups HMRC expected to be affected by the introduction of the new legislation and how each would be affected. Although the respondents did not express a</p>

	<p>view on this point, the external consultants used considered the coverage of compliance costs by group to be reasonable. For instance, it was pointed out that the new legislation would have little impact on small businesses.</p>
<p>Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?</p>	<p>It would appear so as the relevant analysts were consulted throughout the process. That being said the majority of the analytical work on file seems to refer to the potential tax changes rather than to the compliance cost calculation.</p>
<p>Was there sufficient time to produce a robust assessment of compliance costs?</p>	<p>Yes, but in view of the uncertainty surrounding the estimation of compliance costs it was not possible to produce robust estimates of the likely compliance costs. The best that could be achieved was to highlight the types of costs that would be incurred for each of these three distinct policy changes.</p>
<p>Were any assumptions reasonable, given the circumstances at the time?</p>	<p>The interviewees agreed that the assumptions made were appropriate. For instance, it was assumed that the HMRC guidance would assist taxpayers to help alleviate the costs of understanding the new legislation.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>The RIAs included caveats such as “may reduce” and “likely to” in referring to costs. Respondents generally considered these caveats to be appropriate in the circumstances.</p>
<p>Were any risks correctly identified, addressed and explained?</p>	<p>There were no risks identified in the RIAs for consideration.</p> <p>Some of the risks which could have been considered in the RIAs include the risk that:</p> <ul style="list-style-type: none"> <li>- businesses would incur costs in preparing for the introduction of the new legislation which were essentially incurred again when the drafting changed; and</li> <li>- planning not within the purpose of the legislation would be caught (causing promoters to incur additional costs).</li> </ul>

<p>Were any disagreements identified and reflected appropriately (e.g. if the figures were disputed by businesses, or if more than one set of figures was available)?</p>	<p><b>TAD</b> – There does not appear to be any evidence of any disagreements in the available records for this IA.</p> <p><b>NIC</b> - No obvious disagreements recorded. However the views of interested parties were taken on board in the final amendments to this bill.</p> <p><b>SDLT</b> – No disagreements, but business views were reflected by making late amendments to this policy change.</p>
<p>Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?</p>	<p>Interviewees noted that in order to encourage input on expected compliance costs, HMRC could provide a clear basis for preparation of the cost estimates.</p> <p>For instance, HMRC could request that expected costs between two particular dates by man hours (or opportunity cost) be provided. In addition, HMRC could seek input on the types of costs that may be incurred as it can be difficult for it to know some of the background activities in businesses that occur in preparation for the introduction of new legislation.</p>

## 6. Learning points arising from the review

### 6.1 Learning points for future work in this policy area

- Improved guidance from HMRC will reduce compliance costs for business. By reducing staff training costs and clarifying exactly what types of tax planning arrangements are disclosable.
- The one off learning and professional education costs in relation to these new disclosure rules are not actually one off costs. As new employees will have to be trained all the time and existing employees will need to be retrained whenever there are changes to the interpretation of the existing disclosure legislation.
- The RIA's stated that it would not be necessary for promoters to provide an extensive amount of information to HMRC in relation to the arrangements so no costs should be incurred in this respect. This

is not entirely true as promoters will still incur some costs (even if they are minimal) in actually making these disclosures.

- The RIA's stated that promoters would have to register details of the scheme or arrangement at an early stage and that it was not expected that this would involve significant extra costs as the promoter should have the necessary information to hand. Whilst this is true, the short timeframe in which the disclosures need to be made could create additional costs for the promoters.

## **6.2 Learning points for the RIA and compliance cost process in general**

- Some interviewees felt that additional compliance costs are incurred due to the way the legislation is drafted. It was the view of the interviewees that the legislation is drafted in such a way that tax planning outside the scope of what HMRC is principally concerned about often needs to be considered in detail, to determine whether disclosure is required.
- Where appropriate and proportionate, RIAs should contain a full range of possible policy changes which should clearly demonstrate why the preferred option is best (It is not sufficient just to say what the non implemented options that were considered).
- An attempt to quantify the extent of the change in compliance costs associated with each of the possible policy changes should be made. If it is not possible to quantify these costs then the impact assessment should contain details of likely areas that would be impacted upon by each of these possible policy changes.
- More detail of what consulted stakeholders views were should appear in the final version of any published impact assessment.
- Generally there is a need for better background documentation to support the opinions/analysis used in the final version of all impact assessments.
- It is crucial that all stakeholders are involved as early as possible in the Impact Assessment process.

## **7. The way forward**

Comments are invited on any aspect of this report or the wider compliance cost review programme.

The learning points are being fed into the policy development process directly if particular to one RIA or policy area. More generic recommendations are being collated across the review programme overall, and will be used to create an action plan for HMRC to take forward to improve the RIA process and development.

## **8. Contact points for further information**

For issues relating to the taxation of avoidance schemes specifically:

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For issues relating to the compliance cost review programme generally:

Richard Bowyer  
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For issues relating to your own corporate tax affairs, please contact our Employer helpline:

Telephone: 0845-714-3143 (Mon-Fri 8am-8pm, Sat-Sun 8am-5pm).

# **ANNEX A: THE PUBLISHED REGULATORY IMPACT ASSESSMENT FOR TACKLING TAX AVOIDANCE- DISCLOSURE REQUIREMENTS (TAD)**

## **Introduction**

1. This document provides details of the regulatory impact assessment made by the Inland Revenue in relation to the introduction of new rules on the disclosure of tax avoidance schemes by those who sell them and by those who use them.
2. The Inland Revenue is modernising its approach to managing the risk of tax loss from fraud, evasion, avoidance and error. This re-evaluation will in particular ensure that the Revenue increases its effectiveness in deterring and detecting tax lost through avoidance.

## **Risk**

3. Tax avoidance costs the Exchequer substantial sums in lost taxes each year. It also undermines government objectives and brings unfairness into the tax system itself. Those who design and implement schemes do so in strict secrecy that is often intended to prevent the Revenue discovering the existence of the scheme. The Inland Revenue is therefore proposing the introduction of new rules that will require those who sell schemes and those who use them to disclose them to the Revenue.
4. Such rules are necessary to prevent a continuing loss of tax revenues. The law as it currently stands requires a taxpayer to make only a return of income and gains for each year of assessment (or accounting period for companies) for which he or she is liable to tax. There is in general no requirement on taxpayers to explain a particular entry on a tax return unless the Revenue has commenced an enquiry. Those who design and use schemes go to considerable lengths to ensure that the scheme is not detected by the Revenue and indeed in some cases the tax advantage may depend on the scheme being successfully hidden.
5. These new disclosure rules, which are part of an overall package of measures intended to reduce the tax lost from tax avoidance, form a central component in the Revenue's increasingly strategic approach to managing the risk to tax revenues from avoidance. They will help to maintain the integrity of the tax system and ensure that everyone pays their fair share of tax and so contributes to the UK's needs.

## **Objectives**

6. The objective of these rules is to introduce transparency in relation to the marketing and use of tax avoidance schemes and arrangements. This will in turn enable the Revenue to more quickly counteract schemes which seek to defeat the Government's tax policy objectives or which are intended to obtain tax advantages that Parliament did not intend or would not have intended had the transaction been put to it.
7. They are not intended to have any material impact upon the very large number of accountants and lawyers across the UK who merely assist their client understand the tax system and plan their business and other transactions appropriately.

## **The Options we have considered**

8. In deciding upon the current structure of these rules we examined similar arrangements in the United States and Australia. In the US disclosure rules on scheme promoters have been credited with reducing the levels of tax avoidance particularly those schemes that the Internal Revenue Service would consider most aggressive.

9. In contrast until now the traditional UK “plug and fix” approach to managing the risk of avoidance was no longer considered capable of, on its own, increasing the rates of compliance and deterring aggressive avoidance schemes. The “plug and fix” approach will remain a feature of UK law. However without some radical shift in approach the problems associated with tax avoidance would continue to grow.

10. So the UK proposal seeks to adopt the best practice evident from the US and Australian rules along with those of Canada and introduces for the first time measures that will allow the Revenue to better understand the supply side of the avoidance market and so better protect revenue flows from avoidance.

11. A pre transaction rulings system is not considered a viable option. Any such system would require a very much greater amount of information about the scheme or arrangement to be provided by the promoter or taxpayer thereby increasing the compliance burden. Equally the Inland Revenue would be unlikely to give a favourable ruling to the kind of schemes that the disclosure rules are aimed at here.

12. This proposal therefore introduces a new disclosure rule requiring production of details of the scheme at an early stage. To ensure the intended effect of this proposal it is necessary to identify and define who are the promoters, what schemes and arrangements should be disclosed and what information is required. It will be crucial that these areas are clearly defined and understood.

13. It is considered preferable to focus on areas of high risk and to construct the disclosure requirements narrowly by targeting particular types of avoidance thereby reducing the overall compliance costs to both promoters and taxpayers.

### **How the rules will operate**

14. As outlined in the Budget announcement the new rules are intended to ensure that large tax avoidance schemes are disclosed to the Revenue around the time they are first “sold”. For this purposes a range of criteria will determine the point of first sale.

15. As a first step the rules will apply to schemes intended to reward directors, employees and their associates in ways that avoid tax or result in artificially low effective rates of tax or in payments being made outside of the PAYE and other tax collection systems. The rules will also apply to certain kinds of financial products.

16. To decide whether a scheme etc must be disclosed the following tests will apply:

- Will the scheme etc give rise to a tax advantage?
- Will that advantage be a main benefit of the scheme etc?
- Is the scheme etc a Financial Product or Employment Product?

17. The rules will only apply where all of these tests are met and the products tests will be designed to ensure as far as possible that ordinary transactions do not need to be disclosed.

18. It is an important feature of the disclosure rules that disclosure of a scheme will have no effect on the tax position claimed to flow from the scheme. Whether or not the scheme achieves its intended tax effect will depend as now on the application of the law applying to the particular circumstances of the transaction.

19. Another important feature is that disclosure by a promoter will **not** require disclosure of the name or other information that would identify the client.

20. In two circumstances taxpayers will be required to disclose in place of promoters:

- Where the scheme is purchased from a promoter operating outside of the United Kingdom and the promoter does not disclose the scheme
- Where the scheme is designed without the involvement of a promoter

21. For promoter schemes disclosure must be made within a short time of the scheme being first sold.

22. The Revenue will **not** operate any system of rulings or advance clearance. Instead each scheme disclosed would be given a registration number that the taxpayer will be required in due course to include on his tax return.

### **Penalties**

23. A promoter who fails to disclose scheme etc will be liable to an initial penalty of up to a maximum of £5,000. Where after this initial penalty is imposed the failure continues then a further daily penalty of up to a maximum £600 per day will be imposed.

24. Promoters who fail to give a registration numbers to their client will also be liable to a maximum penalty of £5,000.

25. Taxpayers who fail to show scheme registration numbers on returns will be liable to an initial penalty of £100 rising to £500 for subsequent failures.

26. In respect of both promoters and taxpayers, initial penalties will be determined by the Special Commissioners and there will be a right of appeal against the imposition of the penalty.

### **The Regulatory Impact**

27. We have assessed the regulatory impact in relation to:

- the knowledge required to understand the rules
- the ease with which promoters and taxpayers can comply

### **Knowledge**

28. We expect that a detailed understanding of the rules will be required by:

- Large Accounting Firms
- Larger Law Firms (to the extent that they give assistance on the design of schemes)
- Larger Companies (who are able to design and implement schemes on their own)
- Some individuals (for example those who buy schemes from offshore promoters)

29. The rules are intended to have impact on the largest schemes and we will be closely monitoring the rules to ensure that happens. We expect the vast majority of the notifiable schemes to be planned by the larger accounting and law firms.

30. For smaller firms and sole practitioners we do not expect the rules to impact upon the everyday tax planning advice and support they give to their clients.

### **Ease of Compliance**

31. Promoters will be expected to comply by providing plain English description of the scheme etc. This does not mean that appropriate technical language cannot be used and it will not be necessary to provide explanation of common technical and legal terms.

32. In most circumstances taxpayers will only be required to include the scheme number on the relevant return. As now more information will be required should the Revenue enquire into the Return.

### **Benefits**

33. The benefit expected from the introduction of these rules will be to improve the Revenue's ability to detect and counteract tax avoidance schemes. This will ensure that the large majority of taxpayers who do not participate in abusive schemes see the system as operating fairly.

34. It will also reduce levels of tax avoidance and the cost to the taxpayer of Revenue resources spent finding them.

35. As an example, in January 2004 the Paymaster General closed a Gilt Strip scheme that was being used by very many individuals and which had resulted in severe loss of tax to the Exchequer. Despite the fact that the scheme was closed within weeks of being found we believe that a substantial number of transactions did slip through. The rules proposed would help ensure that in future such losses are prevented.

### **Customer implementation costs**

36. Promoters will have to register details of the scheme or arrangement with the Revenue at an early stage. Promoters will also have to advise their clients of the registration number provided. We expect that the information required by the promoter to make the disclosure would be readily at hand as part of the arrangements around marketing the scheme and so will not involve significant additional cost.

37. As the rules become more widely understood then we expect compliance with them to become a standard feature of planning the scheme. 38. As noted disclosure will not require any more information than is necessary to explain the scheme and it will not be necessary for promoters to supply documents such as sale agreements, accounts correspondence and so on. To some extent promoters could if they wish supply anonymised copies of the proposal however we expect that most may prefer to provide specifically created documents to comply with their obligations. A small number of promoters will we expect expend time and money in trying to disguise the scheme under layers of detail. The extra cost of such action is not in our view a legitimate regulatory cost and has not been recognised in this assessment.

39. We have also recognised there may be one off learning and professional education costs for promoters in the first year associated with understanding the requirements of the new rules. We hope that the guidance we produce will help alleviate the cost in this respect.

40. Taxpayers using a scheme or arrangement acquired from a UK promoter will have to enter the registration number of the scheme on their return when it is submitted at the normal due date. The additional cost of this should be minimal. Additionally there may also be the cost of obtaining further professional advice to ensure compliance, however, for the kind of schemes that the rules are aimed at we would expect such advice to be obtained irrespective of these rules.

### **Inland Revenue costs**

41. The Inland Revenue is in the process of setting up an Avoidance Intelligence Unit that will improve our understanding of the tax avoidance market and assist in “avoidance proofing” legislation. This Unit, that is planned to be operational later this year, will also have responsibility for handling disclosures made under these rules. The total gross annual running costs for this new unit are expected to be in the region of £1.5 million per year.

42. Start up costs to cover alterations to the IT system, amendments to returns to allow disclosure of the registration numbers and the cost of a targeted awareness campaign are expected to be in the region of £4 million for 2004-05.

### **Impact on Small Business**

43. Budget confidentiality prevented consultation prior to the Budget. However in our assessment there should be little impact on small business as the rules have been specifically designed to catch large avoidance schemes. We intend to monitor the position carefully to ensure this is in fact the case. The disclosure rules are targeted such that their primary impact is expected to be on large businesses.

44. It is acknowledged however that small businesses may be affected either as a promoter or user of avoidance schemes.

45. Some small businesses may themselves be promoters although it is anticipated this will be limited to a relatively small number of professional firms in the avoidance industry. Again to comply with these rules promoters could provide the Inland Revenue with copies of existing documentation, such as the planning document, which would involve minimal cost. However it is recognised that some promoters may prefer to provide specifically created documents to comply with their obligations and this choice will involve additional costs.

46. Some remuneration based schemes may be marketed across a range of businesses and this may inevitably mean that the requirement to disclose a scheme number upon a tax return will fall on a limited number of small businesses.

### **Unintended consequences**

47. The new rules may result in a number of “safety first” disclosures from Promoters and companies. We think that this may be unavoidable but will settle down as experience of the rules increases. There may also be some increase in the attractiveness for promoters to trade from overseas. However this is counteracted by reporting obligations switching to UK taxpayers who use schemes from offshore promoters and the risk is not considered significant.

### **Other impacts**

#### Devolution

48. Approved

### Human Rights

49. Leading Counsel is of the opinion that the proposed rules do not conflict with Human Rights legislation.

### E-policy, Environmental impacts and Rural proofing

50. No adverse impacts anticipated.

### **Competition assessment**

51. The competition filter test has been applied. There is considered to be a low risk of a significant detrimental effect on competition.

### **Securing Compliance**

52. There will be a targeted campaign to advise likely promoters and users of schemes and arrangements of the new disclosure requirements coupled to guidance on who will be affected and how the rules will work in practice. The disclosure itself will be through a simple registration system handled by a new dedicated unit within the Revenue.

53. Sanctions will be needed to ensure compliance and we have introduced a penalty regime for promoters and taxpayers that fail to disclose full details of a disclosable scheme by the due date. The maximum initial default penalty will be £5000 with continuing penalties of up to £600 per day for continued non-compliance.

54. Initial penalties will be decided by a Special Commissioner, continuing penalties by an officer of the Board. There is an appeals process against a penalty using an established appeals procedure.

### **Consultation**

55. As this is a Budget measure directed at tax avoidance consultation is not considered appropriate. We do however intend to work closely with the Accountancy and legal profession after publication of the Finance Bill to ensure that the rules are effectively targeted.

### **Monitoring and evaluation**

56. The monitoring and review of the policy, in terms of the number and nature of disclosures and the effectiveness of enforcing compliance, will be conducted on an ongoing basis.

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## **ANNEX B: THE PUBLISHED REGULATORY IMPACT ASSESSMENT FOR NATIONAL INSURANCE CONTRIBUTIONS BILL**

### **Background**

1. The Government is determined to ensure that all employers and employees pay the proper amount of tax and National Insurance Contributions (NICs) on the rewards of employment, however those rewards are delivered to the employee. Despite the efforts of successive Governments, there have been increasingly complex and contrived attempts to avoid paying tax and NICs on rewards from employment, particularly in relation to bonuses in the City.

2. In the most recent year for which figures are available, well-rewarded individuals have received bonuses of at least £1.5 billion in an attempt to avoid paying their fair share of tax and NICs. The disclosure rules contained in Finance Act 2004 revealed that this kind of avoidance is still rife. Without prompt and decisive action, up to £2 billion could have been paid in 2004-05 in bonuses on which the amount of tax and NICs properly due was at risk, as a result of increasing ingenuity and inventiveness of tax avoidance planning.

3. The Government has decided that avoidance on this scale cannot be allowed to continue. It is only right that everyone who should pay tax and NICs does pay, and that they pay their fair share when it is due. The overwhelming majority of employers and employees do pay their fair share. But some employers and employees with the benefit of sophisticated tax advice have sought to avoid their responsibilities and to pass more of a burden onto others.

4. Early attempts at avoidance in this area took the form of paying bonuses and salaries in gold bullion, diamonds and fine wines. When these routes were closed, employers started to pay bonuses through shares and share options to reduce the amount of NICs they had to pay, avoid their obligation to operate PAYE, and reduce employees' tax bills. When, in 1998, assets readily convertible into cash were brought within PAYE, and NICs, avoidance schemes moved on to more complex arrangements.

5. Despite extensive reforms to the tax legislation dealing with employment related shares and securities in 2003, employers and their advisers are continuing to devise and operate ever more contrived avoidance schemes. The objective of this Bill is to deter employers from using schemes to avoid paying NICs on the rewards from employment. And where employers have not been deterred to have the power to close down avoidance schemes and introducing NICs liability effective, if necessary, back to 2 December 2004 when the Paymaster General made her statement.

6. To this end, legislation in Finance (No.2) Act 2005 closed down avoidance schemes that used employment related securities, effective from 2 December 2004 that HMRC have identified. This Bill ensures that NICs can be charged on these schemes with effect from the same day.

7. However, it is not always possible to anticipate the ingenuity and inventiveness of tax avoidance. The Government's objective is clear in that it wishes to close this activity down permanently. This Bill will ensure that the Government can deal with any arrangements that emerge in future designed to frustrate its intention that employers and employees should pay the proper amount of tax and NICs on the rewards of employment.

8. Where the Government becomes aware of arrangements that attempt to frustrate this intention, it will introduce legislation to close them down, where necessary from 2 December 2004. This action will not affect employers and employees who organise their affairs in a

straightforward and transparent way - the vast majority. In particular, genuine employee share schemes and share option plans will not be affected.

### **The do nothing and non-regulatory option**

9. Doing nothing will indicate to those devising avoidance that the Government is not serious in its attempts to tackle NICs avoidance. It will also leave unchecked the contrived schemes identified through the tax avoidance disclosure rules, so that payments made in 2004-05 would continue to avoid NICs. The Government's view is that this option presents a significant risk to Government finances and is therefore not viable.

### **What the Bill does**

10. In Pre Budget Report (PBR) 2004 the Paymaster General (PMG) announced a new approach to tackling attempts to avoid tax and National Insurance Contributions (NICs) where that avoidance used schemes to disguise remuneration from employment. The new approach builds on income tax disclosure provisions and includes a commitment to introduce legislation to close down existing and any new avoidance routes, if necessary, from the date of the PBR – 2 December 2004.

11. The National Insurance Contributions Bill (hereafter referred to as the NICs Bill) has the following provisions: -

- A power to introduce NICs regulations, that may have effect from 2 December 2004, on payments treated as remuneration and earnings to mirror so far as possible anti-avoidance measures introduced into tax legislation. The Bill will also include powers to allow amendments to the scope of NICs exemptions to mirror so far as possible anti-avoidance tax measures with effect from 2 December 2004 and for the making of consequential regulations for the purposes of contributions, contributory benefits and statutory payments. **(Measure A)**.
- Deem NICs agreements & elections null and void if applied to securities income that is affected as a result of the above NICs anti-avoidance regulations **(Measure B)**.
- Introduce NICs disclosure rules **(Measure C)**.

### **Purpose and intended effect of measures in the Bill**

#### *The Regulation making power*

12. Overall, the purpose and intended effect of the measures and powers contained in the NICs Bill is to deter employers from engaging in NICs avoidance and stop the activity permanently.

13. Measures closing down loopholes in legislation exploited by avoidance schemes have become a regular feature in annual Finance Bills and NICs legislation. Current primary NICs legislation is limited in that it only allows NICs to be imposed by regulation from a date in the future (or in very limited instances back to the beginning of the tax year in which the regulations are made). A change to the NICs primary legislation is therefore needed to bring into an existing definition certain items that would otherwise fall outside of NICs liability in order to give effect to the announcement in PBR 2004. The changes will also ensure successful collection of that liability.

14. The general power to make regulations in future to counter avoidance will be restricted to responding to tax legislation which relates to the charge to income tax under the employment income Parts of the Income Tax Earnings and Pensions Act 2003.

15. This general power will be used in the first instance to introduce regulations to ensure that NICs liability will mirror so far as possible anti-avoidance tax measures in the Finance (No.2) Act 2005 relating to employment related securities that close a number of loopholes. These tax measures introduce purpose tests in various Chapters in Part 7 of the Income Tax (Earnings & Pensions) Act 2003 (ITEPA) to frustrate avoidance schemes which use employment related securities to deliver cash bonuses. They also bring new benefits from these securities into a tax charge or accelerate the occasion of the charge.

16. This RIA also covers the impact of the specific regulations that will be introduced to mirror the Finance Act measures concerning employment-related securities. The general regulation making power has no impact on business unless it is used again to reflect a tax provision introduced as a result of tax avoidance.

#### *NICs Elections*

17. The second measure concerns NICs Elections and Agreements that enable recovery of secondary or employers' NICs liability due on certain share based employment income. A provision will be introduced to ensure that the application of NICs elections and agreements does not extend to income, which arises as a result of regulations made under the Bill. As those regulations will be targeted at avoidance schemes this measure will effectively mean that the application of NICs elections and agreements is limited to non avoidance schemes only. It will void elections and agreements that have been put in place by employers for avoidance schemes where they consider no NICs liability arises but may be imposed in the future.

#### *NICs Disclosure Rule*

18. The third measure is introduced to redress the information gap on the use of avoidance schemes. In Budget 2004, the Government announced the introduction of new rules that would require either those who design or market potential tax avoidance schemes, or those who use them, to provide information about the schemes to the Inland Revenue. The Government announced that the initial scope would be restricted to two high-risk areas; employment and financial products.

19. The rules are restricted to new and innovative schemes and arrangements that::

- Concern income tax, corporation tax or capital gains tax; and
- Involve employment or the use of certain financial products.

20. The NICs Bill provides that the Treasury may make regulations providing that the rules in Part 7 of Finance Act 2004 and the corresponding regulations, which require the disclosure to HMRC of information about certain tax schemes, will also apply to NICs schemes. The tax rules apply to schemes that might be expected to give income tax, corporation tax or capital gains tax advantage as a main benefit and which concern either employment or certain financial products.

21. As there was no suitable vehicle at that time for the primary legislation needed for NICs, this Bill provides for regulations to align NICs with these disclosure rules in respect of employment related products that have the objective of NICs only avoidance.

## **Benefits**

### *Economic*

22. The most obvious economic benefit from effectively deterring much of NICs avoidance is that for given NICs rates, earnings limits, thresholds and employee earnings, the Exchequer raises more revenue to allocate to contributory benefits and improving the National Health Service in a less distortive way. For employers and employees who are unwilling or unable to engage in NICs avoidance, the main benefit of effective deterrence is that the total NICs burden on the economy is borne more fairly by all employers and employees.

23. Avoidance allows some employers and employees to reduce their effective NICs rates, which can generate unfair competitive advantages in product and labour markets through attainment of lower employment costs than more compliant competitors. Employers deterred from NICs avoidance should benefit from the resultant redirection of time and resources away from avoidance into activities that are more productive. There will be a direct saving to the employer in terms of not having to seek professional advice on, setting up and managing a complex avoidance transaction. In addition, employers will also save on costs associated with litigation by HMRC on doubtful cases.

### *Social*

24. These measures will help to prevent the undermining of the Government's public spending objectives. Avoidance reduces revenues that go towards the payment of contributory benefits and the funding of improvements to the NHS. These measures are also aimed at tackling the unfairness generated where more of the tax/NICs burden is borne by taxpayers unwilling or unable to engage in avoidance.

### *Environmental*

25. No environmental benefits are anticipated.

## **Policy and implementation costs**

26. The powers in this Bill will first be used to introduce NICs changes through regulations to mirror tax measures contained in Finance Act 2005 (No.2) that tackle avoidance through employment related securities. This measure is aimed at relatively small number of employers, perhaps as few as around 500, that are engaged in the use of contrived schemes using employment related securities, to avoid income tax and NICs. We estimate that around 10,000 employees may fall within the scope of this measure and that around £2 billion in bonuses could have been paid in 2004-05, with the aim of avoiding income tax and NICs.

27. The Regulations made under this power will require employers to incur marginally higher professional advice costs in learning of their liability and the remedy, and then re-calculate NICs for closed years by taking into account earnings already received with payments brought into liability by this measure. Employers affected will have to submit supplementary end of year returns to HMRC detailing the revised amounts of NICs paid. We refer in paragraph 29, that 500 employers and 10,000 employees may be affected by the measures in the Bill. Businesses that have chosen to take up these schemes will have factored into their cost benefit analysis for the schemes with their advisers, the risk of an HMRC response to close down the loopholes they aim to take advantage of.

28. The combined impact of the measures in this Bill will impose an additional burden or cost on those employers that continue to engage in contrived schemes to avoid NICs on remuneration paid to employees. Employers that do not engage in such activity will be

unaffected. Where employers are affected, we estimate that the combined cost of complying with the measures per employer will not exceed around £3,000 on average. This takes into account the administrative costs of revising and paying the NICs liability and allows for only those additional professional advice costs directly involved in establishing the employer is affected by any new regulations.

**Measure (A)** – Using the general power to make regulations and regulations that mirror tax measures related to employment based securities that take effect from 2 December 2004.

29. For employers who are deterred from trying to avoid NICs the cost will be that they operate PAYE and pay the NICs in full on the remuneration they would otherwise have channelled through an avoidance scheme. The true extent of the actual avoidance is always difficult to accurately assess. From the information we have, we conservatively estimate that around 500 employers and 10,000 employees are likely to be affected. This is a relatively small fraction of the total number employers and employees in the UK.

30. The additional administration costs for business will be small. Most employers deterred from avoidance will simply be paying a larger amount via PAYE than they would otherwise have done in the normal way. This generates zero additional cost because they operate PAYE already and remuneration avoidance schemes used of late have commonly involved paying over some tax through PAYE anyhow.

31. If employers are caught by the measures they may incur a small additional cost, where they have to submit a further end of year returns to account for the NICs. It is estimated that this element will involve HMRC in £20,000 additional manpower costs, but could rise depending on the number of cases. We estimate that there will be negligible additional HMRC IT costs associated with this measure.

32. The Bill also includes powers to make amendments to the scope of NICs exemptions to reflect similar changes to reliefs or exemptions for income tax that are exploited beyond their original intent and used for NIC avoidance. This is being introduced as a precautionary measure in case tax avoidance moved into tax reliefs and deductions where there was a parallel NICs disregard. Government will be able to act quickly and introduce NICs changes to mirror tax changes so far as possible. Similarly there are no additional costs to businesses that do not attempt to avoid paying NICs on remuneration using tax reliefs.

**Measure (B)** – Voiding NICs Elections and Agreements

33. Voiding of NICs elections and agreements to stop recovery of secondary NICs from the employee. This measure is not considered to have any significant implementation costs for HMRC. It only applies where employers wish to put in place a scheme to avoid NICs with the added benefit of the NICs transfer mechanisms in case a liability does arise. Employers will have a clear and unambiguous choice. That on implementing a NICs avoidance scheme now they will face an employers' NICs liability charged on any employment income arising from it once the scheme or transaction is discovered and legislated against. The cost to them of this measure is that they will not be able to recover that liability from the employee.

**Measure (C)** - NICs Disclosure Rules

#### *Business Costs*

34. Promoters of NICs schemes (or in some cases users) who are required to disclose information to HMRC may incur the following:

- one-off learning and professional education costs associated with understanding the new rules;
- set up costs in putting systems in place to identify schemes required to be notified; and
- compliance costs in having to provide information to HMRC.

35. Where a scheme affects tax and NICs, a single disclosure covering tax and NICs is all that will be required. The information contained will be substantially the same, as that presently required for tax disclosures.

36. In practice, since schemes normally cover tax and NICs, persons required to disclose will incur additional compliance costs at a result of this proposal only insofar as they are involved with NICs only schemes. We expect such cases to be very few and the additional costs to be marginal.

#### *HMRC Costs*

37. Anti-Avoidance Group (Intelligence) will handle disclosures received in HMRC. The amount of additional work generated will not be significant and the additional cost to the AAG will be marginal. There will be negligible costs associated with additional guidance and publicity.

#### **Transfers and Distributive Impacts**

38. As discussed above, the distributional impact of effective deterrence of NICs avoidance will be a more equitable sharing of the NICs burden and higher NICs revenues for a given distribution of employee earnings. Historically, NICs avoidance has been most acute around annual bonuses paid to a relatively small number of highly paid employees and directors, particularly in financial services. A fairer distribution of the NICs burden will be more equitable to the majority of employees who are further down the income distribution.

39. We estimate that this measure will secure an additional £95 million in NICs in 2004-05 and £240 million per annum thereafter. We have evidence that that some employers may have abandoned plans to channel bonuses through these schemes and instead paid cash bonuses following the Paymaster General's announcement of 2 December 2004.

#### **Small business impact**

40. The impact of the NICs Disclosure rules on small business mirror the tax disclosure provisions introduced in Finance Act 2004. Any small business affected in terms of administrative burdens by the need to disclose NICs avoidance arrangements will need to consider the tax avoidance rules as well. However, the marginal cost (in terms of learning and familiarisation with the rules) to these businesses will be negligible as the vast majority of employment schemes are intended to gain a tax and NICs advantage and so are already reportable.

41. Approximately 21,000 small accountancy and tax consultancy firms and a further 90,000 self-employed individuals in related professions, may need to familiarise themselves with the new legislation that is capable of creating a NICs charge that may take effect from 2 December 2004. The marginal cost (in terms of learning and familiarisation with the rules) to these businesses and individuals will be negligible as the vast majority of employment schemes are intended to gain a tax and NICs advantage and they will already have familiarised themselves with the equivalent tax legislation.

42. Additionally, tax professionals undertake Continuing Professional Development in order to keep up to date and refresh relevant skills and knowledge. This includes reading of general and specialist journals and this would be sufficient in terms of awareness unless the business is actively engaged in such schemes. Information will also be readily accessible on the HMRC website.

43. The avoidance targeted by the proposed Bill and FA (No. 2) 2005 measures is conducted mainly by firms in the City of London and some other large companies. Such taxpayers are invariably advised by larger or specialist accountancy firms. Any businesses specialising in devising these schemes will have factored into their risk analysis for the schemes, the likely response of HMRC in closing down the loopholes that they aim to take advantage. It is most likely to be the large accountancy firms that have the technical and legal resources to research and produce elaborate avoidance schemes.

### **Competition Assessment**

44. We have applied the competition filter to each of the NICs Bill measures and found that they are unlikely to harm the competitive process in markets. If anything, deterring NICs avoidance will be a spur to effective competition because the lower employment costs enjoyed by employers and employees who avoid NICs can distort to both product and labour markets. Employers and employees who engage in avoidance are able to gain a cost competitive advantage, which is unfair on those unwilling or unable to follow suit. By increasing the risks and curtailing the benefits of moving on to a new scheme once a current scheme has been closed down, the NICs Bill should have a pro-competitive effect. In fact, to the extent that the Bill deters avoidance, companies are likely to focus more effort on their primary business activities, rather than avoiding NICs, which will be beneficial for the economy.

### **Equality Impacts**

45. We have screened all the measures for equality impacts and do not believe that any of them suggest adverse impacts that would require a full equality impact assessment. We are also confident that the measures do not impact on any of the equality-based legislation such as the Human Rights Act or any of the Race Relations legislation (Race Relations Act 1976 & the Race Relations Amendment Act 2000 - RRA). We are confident that there are no implications on Sections 75 and 76 of the Northern Ireland Act 1998, which guarantee equality of opportunity in the Province.

### **Securing compliance**

46. Employers will be required to pay any NICs due under this measure by a specified date. Where NICs remain unpaid or are late paid after this date, penalties and interest will also be payable. This will be in line with the existing rules for unpaid or late paid NICs.

47. The existing guidance on disclosures will be revised with targeted publicity. The existing penalty regime for non-compliance with the tax disclosure rules will be extended to the NICs disclosure rules.

### **Consultation**

48. The draft clauses for the Finance Bill were published on 24 March 2005. This Bill also extends to NICs the tax disclosure rules, which were discussed with interested parties, and amended as a result of those discussions, before implementation. Draft regulations under powers in the Bill will be published a minimum of 12 weeks before they take effect for technical comment.

## Monitoring and Evaluation

49. In accordance with Government policy there will be a Post Implementation Review within two years of the measure coming into force and full evaluation of the measure within three years.

50. The aim of the Bill is to deter future NICs avoidance. There is already evidence that following the announcement of the Paymaster General on 2 December 2004, employers that were intending to use NICs avoidance schemes, did not in fact do so.

51. HMRC engages in regular forums with employers, their representatives and other tax and NICs experts. These provide a valuable source of feedback for issues arising. HMRC will continue to listen and respond appropriately to such representations. In addition, there will be a post implementation evaluation of the measures in the Bill as follows: -

52. **Measure (A)** - The measures are primarily a deterrent to employers and their representatives who use such arrangements to avoid paying their fair share of NICs on disguised remuneration. But for those that are willing to take the risk, we want to be able to act decisively and recoup any NICs that has been avoided. The effectiveness of this policy can be monitored by the number of avoidance schemes disclosed relating to employee remuneration following the 2 December 2004 announcement and how often legislation is introduced in the future to counter avoidance using the power in the Bill.

53. **Measure (B)** - Whenever a NIC liability is imposed affecting an NIC avoidance arrangement we plan to check the appropriate records to ensure the employers' NIC liability was not recovered from the employee. We do not anticipate a need to evaluate the measure beyond this routine information checking.

54. **Measure (C)** - Both our Business Support and Employer Compliance teams regularly visit employers who use NICs avoidance schemes and will be able to report back to our technical experts should there be problems in operating the rules, or if there is evidence of significant non-compliance. Further feedback will be received from promoters and employers. We do not anticipate a need to evaluate the measure beyond this routine information gathering.

## Summary

55. There has recently been repeated evidence of significant NICs avoidance through use of tax/ NICs avoidance schemes. The Paymaster General has indicated that where avoidance schemes are closed down, liability should also be applied to the date of her announcement. This Bill seeks a power to be able to introduce NICs liability through regulations to counter avoidance. The power will be used, in the first instance, to close down avoidance involving the use of employment-related securities.

56. The Bill also includes powers to make amendments to the scope of NICs exemptions to reflect so far as possible similar changes to reliefs or exemptions for income tax that are exploited beyond their original intent and used for NIC avoidance.

57. In addition the government has decided to extend the scope of the disclosure rules to NICs avoidance schemes to close a gap in the existing rules and to ensure that the HMRC has the information to counter NICs only avoidance. The overall costs to Government and employers of this Bill and the related regulations will be minimal. 58. The combined impact of the measures in this Bill will not impose significant additional burdens or costs on employers unless they engage in contrived schemes to avoid income tax and NICs on remuneration paid to their employees. Employers that do not engage in such activity will be unaffected.

59. To summarise, costs/benefits identified are: -

- Employers that have engaged in avoidance will have to submit supplementary end of year returns of NICs now payable and that we estimate 500 employers and 10,000 employees may be affected, incurring additional costs estimated not to exceed around £3,000 per employer.
- The cost of processing these additional returns for HMRC is estimated to be £20,000 in additional manpower costs.
- We estimate 21,000 small businesses, and potentially a further 90,000 self-employed persons, specialising in accountancy and tax will incur learning and familiarisation costs but these costs will be negligible.
- We estimate that this measure will secure an additional £95 million in NICs in 2004-05 and £240 million per annum thereafter.
- We have evidence that that some employers may have abandoned plans to channel bonuses through these schemes and instead paid cash bonuses following the Paymaster General's announcement of 2 December 2004.

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## **ANNEX C: THE PUBLISHED REGULATORY IMPACT ASSESSMENT FOR THE STAMP DUTY LAND TAX AVOIDANCE SCHEMES (SDLT)**

### **The Stamp Duty Land Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2005 (SI 2005/1868)**

### **The Tax Avoidance Schemes (Information) (Amendment) Regulations 2005 (SI 2005/1869)**

#### **Introduction**

1. This Regulatory Impact Assessment estimates the costs and benefits of the proposal to extend the rules requiring disclosure of information to H M Revenue and Customs (HMRC) about certain tax schemes. The new rules will take effect from 1 August 2005. It reflects the responses to the draft regulations published on 24 March 2005.

#### **Purpose and intended effect of the measure**

##### *The policy objectives*

2. The objective is to counter the avoidance of stamp duty land tax on UK commercial property by requiring information about certain tax schemes and arrangements to be disclosed to HMRC. This will enable HMRC to tackle avoidance in a more targeted way and for the Government to more quickly counteract schemes which seek to defeat its tax policy objectives.

3. The new rules are not intended to have any material impact upon the very large numbers of accountants and lawyers across the UK who merely assist their clients to understand the tax system and plan their property and other transactions appropriately.

##### *Background*

4. Tax avoidance costs the Exchequer lost revenues each year. It also undermines government public spending objectives and brings unfairness into the tax system itself. Measures closing down loopholes in legislation exploited by avoidance schemes have become a regular feature in annual Finance Bills.

5. One of the features of the tax system that provides avoidance schemes breathing space is the existence of information gaps. HMRC generally has powers to open enquiries into tax returns, but not to enquire into schemes in themselves. For some taxes (e.g. income tax or corporation tax) the filing date of the return is many months after the end of the period to which the return relates. So it may be long after an avoidance scheme has been used that HMRC receives a return and can open enquiries.

6. In order to redress this information gap, in Budget 2004 the Government announced the introduction of new rules that would require either those who design or market potential avoidance schemes, or those who use them, to provide information about the schemes to the Inland Revenue. The Government announced that the initial scope would be restricted to two high risk areas: employment and financial products.

7. Finance Bill 2004 contained the basic rules which were enacted as Part 7 Finance Act 2004 ("the Act"). In principle, the Act requires disclosure of schemes or arrangements where:

- Use of the scheme or arrangements might be expected to confer a tax advantage; and
- That tax advantage might be expected to be the main benefit, or a main benefit, of using the scheme or arrangements.

The Act applies to income tax, corporation tax, capital gains tax, stamp duty land tax, stamp duty reserve tax, inheritance tax and petroleum revenue tax.

8. However, much of the detail of the rules was contained in regulations laid before Parliament later in the year and, as announced at Budget 2004, these restricted the initial scope of the rule to schemes and arrangements that:

- Concern income tax, corporation tax or capital gains tax; and
- Involve employment or the use of certain financial products.

9. The Inland Revenue published the regulations in draft on 17 May 2004 and invited comments by 30 June. The regulations were eventually made and laid before Parliament on 22 July 2004, coming into force on 1 August 2004. They incorporated significant changes to the published drafts as a result of comments received in response to the consultation, in particular the use of 'filters' to ensure that the rules were targeted on new and innovative schemes.

10. The regulations have been amended twice. The first amendment, coming into force on 30 September 2004, added an additional filter to employment schemes in line with further suggestions made by businesses. The second amendment, coming into force on 14 October 2004, ensured that in circumstances where legal professional privilege prevents a lawyer from making a full disclosure, the obligation falls upon the client to make the disclosure (the client may, however, choose to waive privilege and allow the lawyer to disclose).

11. The current rules are summarised in the **Annex**.

12. Disclosures are risk assessed within HMRC by the Anti-Avoidance Group (Intelligence) ("AAG"). The AAG maintains guidance about the rules on the HMRC website. It also maintains a dialogue with tax advisers in which it has explained the rules and assisted promoters to comply.

13. To date, both the number and quality of disclosures provide strong indication that the rules are working as intended, targeting tax avoidance without affecting legitimate tax planning. HMRC has not received significant numbers of unnecessary "safety-first" disclosures, which some commentators had predicted.

14. Moreover, although the first disclosures were not due before 30 September 2004, the system has already begun to deliver its policy objectives. Disclosures have informed a number of anti-avoidance measures since the rules were introduced (for example measures, announced at PBR 2005 and included in the post-Election Finance Bill, closing down schemes intended to avoid payment of tax and NICs on employment income in the form of annual bonuses).

*The risk(s)/harm being addressed*

15. Stamp duty land tax was introduced in Finance Act 2003, replacing Stamp Duty in relation to land transactions. It is charged on land transactions involving any estate, interest, right or power over land in the United Kingdom. The rate of tax is a percentage of the chargeable consideration for the transaction. The current rate for transfers of land and

buildings where the consideration is not less than £500,000 is 4%. The rate for the rental element of new leases is 1% if the net present value of the lease is over (for non residential property) £150,000. Stamp duty land tax is payable by the purchaser who must file a land transfer return within 30 days of the effective date of the transaction. Payment is due with the return.

16. One of the main drivers for the introduction of stamp duty land tax was to counter avoidance and a number of anti-avoidance provisions were included in FA2003. Even so, The National Audit Office examined the operation of stamp duty land tax in 2003/04 and reported that the measures adopted to minimise avoidance had not fully closed all the known tax avoidance opportunities. The NAO recommended that the Inland Revenue continue to review the tax revenues still at risk and identify new ways of countering avoidance.

17. There is considerable evidence that stamp duty land tax is being avoided in relation to commercial property. Stamp duty land tax anti-avoidance measures were included in FA2004 and further measures, announced by the Government in Budget 2005, are included in the post- Election Finance Bill.

18. HMRC has been hampered in countering avoidance schemes by a particular form of the information gap referred to in paragraph 5 above. Stamp duty land tax avoidance schemes usually involve a series of transactions. One transaction (usually the first) may be a land transaction on which a claim to relief is made, or indeed for which no return at all is required. Any HMRC enquiry into that return is restricted to verifying that the right amount of stamp duty land tax has been paid on that particular transaction. However, the other transactions in the series are not land transactions at all (e.g. because the land is wrapped up in the sale of a company) and it is all the transactions taken together that effectively transfer ownership of the property to a third party without a charge to stamp duty land tax arising. Consequently, the normal return and enquiry system will often not provide HMRC with sufficient information to identify when a land transaction is part of an avoidance scheme, or the details of how that scheme works. This information gap inhibits HMRC from taking quick and effective action against such schemes.

## **Options**

### *Do Nothing*

19. Doing nothing would preserve the information gap described above and inhibit quick and effective measures against stamp duty land tax avoidance schemes involving significant amounts of tax revenues avoided. This is not acceptable.

### *A non-regulatory solution*

20. We could identify no non-regulatory option that was likely to improve the flow of information to HMRC about avoidance schemes. As noted above, it is in the nature of avoidance that promoters and users go to considerable lengths to maintain secrecy. There is no evidence to suggest that they would be prepared to provide information in the absence of a statutory obligation to do so.

### *Use pre-transaction rulings*

21. A pre-transaction ruling system would require a very much greater amount of information about the scheme or arrangements to be provided by the promoter or taxpayer thereby increasing the compliance burden on them.

### *Require more information on or with the land transaction return*

22. Requiring taxpayers to provide more information on or with returns would also place a considerable additional compliance burden on taxpayers. Moreover, because of the nature of the avoidance schemes (see paragraph 18 above) it would be difficult to obtain a full picture of a scheme by reference to a return for a single land transaction, and in some cases there might be no return at all.

#### *Extend the disclosure rules*

23. The existing disclosure rules were specifically designed to provide information about potential avoidance schemes. Although the initial scope was limited to the two highest risk areas, employment and financial products, the primary legislation applies across the direct taxes (see paragraph 7 above). So both legislatively and technically the existing rules are, in principle, capable of being extended and adapted to another high risk area. Moreover, the success of the existing rules (see paragraphs 13 and 14 above) demonstrates that disclosure is a practicable solution to the information gap problem.

#### *Conclusion*

24. Extending the existing disclosure rules was considered to be by far the best option. However, the existing rules require some adaptation to fit the particular circumstances of stamp duty land tax.

25. The existing rules provide HMRC with information about schemes that it would not normally have an opportunity to obtain until much later, when returns are submitted. The nature of stamp duty land tax avoidance (see paragraph 18) means that HMRC often lacks the opportunity to obtain information altogether and so has an incomplete picture of even established avoidance schemes. Consequently, the objective here is to acquire information about **both new and established schemes** that may be used to avoid stamp duty land tax.

26. The rules need to be able to obtain sufficient information about schemes to allow quick and effective counter-action. However, that objective must be balanced against the objective to keep the compliance burden upon businesses, especially small businesses, to a minimum. The proposal is therefore targeted at schemes to be used for non-residential property with a market value of at least £5 million. Following consultation, the proposal will also except certain schemes that HMRC has already been provided with information about by representative bodies. A person will be required to disclose what is substantially the same scheme once only.

27. A further adaptation is required because the existing arrangements, whereby HMRC issues a scheme reference number to a promoter, who issues it to a client, who includes it on a tax return, is not appropriate for stamp duty land tax. A land transaction return is due within 30 days of the transaction and in practice the return would be due before the taxpayer would have received the reference number. And in some stamp duty land tax avoidance cases there is no return. Consequently, the existing approach is not compatible with the land transaction return system.

28. We therefore considered three specific stamp duty land tax disclosure options. In this paragraph “promoter” includes those users required to disclose details of a scheme where either there is no promoter or the promoter is not required to disclose (see paragraph 3 of the Annex)

- Option 1 was to require the scheme user to always make the disclosure. This option would provide information about the schemes, enabling loopholes to be closed. It would also identify the users, allowing compliance action to be targeted. But the compliance burden would fall

upon users whereas promoters are generally more readily able to comply. Many promoters are already familiar with the disclosure regime.

- Option 2 was to require a promoter to make the disclosure but not to use a reference number. This option would provide information about the schemes and keep the compliance burden on users to a minimum. However, it would not normally allow HMRC to identify who has used the schemes.
- Option 3 was to require a promoter to disclose, to issue a reference number and to require the client to report the number and other information – but separate from any land transaction return. This option would provide information about the schemes and identify the users. However it would add a further layer of reporting to users.

29. On balance we believe Option 2 is the most proportionate means of attaining the main policy objective. Respondents asked for AAG to issue number to promoters even though there will be no obligation for the promoter to issue the number to a client, or for the client to disclose the number to HMRC. This request has been accepted. The reference number will allow promoters to identify both internally and externally that any particular scheme has been notified to HMRC, thereby reducing the possibility of the same scheme being notified a number of times by the same promoter or by its copromoters.

### **Business sectors affected**

30. The measure will primarily affect accountants and lawyers who devise and promote tax planning schemes for commercial property valued at £5 million or more. There are currently around 1000 transactions a year, reported for stamp duty land tax purposes, for commercial property of this value. 99% of commercial property transactions are below £5 million. The measure does not apply to schemes used only for residential property. The evidence indicates that tax planning schemes for this type of property are typically bespoke schemes, rather than marketed schemes, designed by medium to large size accountants and solicitors.

31. It will also affect businesses buying and selling commercial property who either design a scheme in-house, or who buy a scheme from an offshore promoter. We expect these to mainly be the larger property companies or other businesses that have a substantial property portfolio, who we also expect to be familiar with stamp duty land tax. It will also affect clients of promoters, where those promoters are lawyers who are prevented from making a full disclosure by legal professional privilege.

### **Issues of equity and fairness**

32. The proposed measure does not conflict with Human Rights legislation. It is intended, by tackling avoidance, to promote fairness for taxpayers.

### **Benefits**

#### *Economic*

33. Tax avoidance reduces the Government's revenues and affects its ability to meet its spending objectives. The main effect of the measure will be to protect future revenues by providing information that will enable the Government to take early action to close loopholes in the legislation.

34. Tax avoidance also distorts the market and allocates resources to economically unproductive activities. By helping to reduce the incidence of stamp duty land tax avoidance on commercial property, the measure will benefit the efficiency and transparency of the property market.

*Social*

35. No social benefits are expected.

*Environmental*

36. No environmental benefits are expected.

## **Costs**

*Economic*

*Business Costs*

37. Promoters will incur costs associated with:

- Learning;
- Set up; and
- Compliance

In this section the term “promoter” again includes those users required to disclose details of a scheme where either there is no promoter or the promoter is not required to disclose (see paragraph 3 of the Annex).

38. There may be one-off learning and professional education costs for promoters in the first year associated with understanding the requirements of the new rules. We expect that the guidance we produce will help alleviate the cost in this respect. The larger firms of accountants and solicitors are expected to be already familiar with the existing disclosure regime (for employment and financial product schemes) and for those promoters the additional learning costs associated with the stamp duty land tax regime will be marginal.

39. Promoters will incur set up costs in putting systems in place to identify those schemes required to be disclosed and disclosing them, within the time limits, to HMRC. Again, we expect that the larger promoters will already have put systems in place to comply with the existing disclosure rules and for them the additional costs of the new measure will be marginal.

40. Promoters will also incur compliance costs in having to register details of the scheme or arrangement with HMRC at an early stage. We expect that the information required by the promoter to make the disclosure would be readily at hand as part of the arrangements around designing and implementing the scheme and so will not involve significant additional cost.

41. Promoters will be expected to comply by providing plain English description of the scheme etc. This does not mean that appropriate technical language cannot be used and it will not be necessary to provide explanation of common technical and legal terms.

42. Disclosure will not require any more information than is necessary to explain the scheme and it will not be necessary for promoters to supply documents such as sale agreements, accounts correspondence and so on.

43. Businesses using a scheme or arrangements may incur a cost of obtaining additional professional advice to ensure compliance. However, for the kind of schemes that the rules are aimed at we would expect such advice to be obtained irrespective of these rules.

44. Promoters may also incur some additional marginal operational costs in talking to, or meeting with, the AAG to discuss disclosures made.

45. As the rules become more widely understood then we expect compliance with them to become a standard feature of planning the scheme.

#### *HMRC costs*

46. The AAG will handle disclosures received in HMRC. HMRC expects to be able to carry out the additional work by prioritising existing anti-avoidance resources. The additional cost will be marginal.

47. There will be negligible costs associated with additional guidance and publicity.

#### *Social*

48. No social costs are expected

#### *Environmental*

49. No environmental costs are expected

### **Small Business impacts**

50. In our assessment there should be little impact on small business. Users of stamp duty land tax schemes will not be affected unless there is not a promoter required to disclose the scheme, and even then a user will only have to disclose if they are to use the scheme for commercial property with a market value of at least £5 million. We expect that the purchaser of a £5m + property will not generally fall within the small business size.

51. Some small businesses may be promoters of stamp duty land tax schemes. However, this is a specialised area and we would not expect scheme promoters to fall generally within the small business size.

### **Competition assessment**

52. The competition filter test has been applied. There is considered to be a low risk of a significant detrimental effect on competition.

### **Securing compliance**

53. There is a targeted campaign to advise likely promoters and users of notifiable schemes about of the rules (for example, information will be made available via the Land Registry). We will also update the published guidance on disclosures, to describe who will be affected and how the rules will work in practice. Drafts of the guidance have been exposed for

comment to representative bodies and the main practitioners in this area. The disclosure itself will be made through the already existing system, operated in HMRC by the AAG.

54. Sanctions will be needed to ensure compliance and the existing disclosure penalty regime (described in paragraph 7 of the Annex) will apply to promoters and taxpayers that fail to disclose full details of a notifiable scheme by the due date. The existing penalties in relation to reference numbers (paragraphs 8 and 9 of the Annex) will not apply.

### **Consultation**

55. The Chancellor announced the measure in his Budget on 16 March 2005. Draft legislation was published on 24 March and comments on the detail of the regulations invited by 29 April. Comments were received from accountancy and law firms. We also received comments from, and had meetings with, representative bodies. The final rules have been amended to reflect comments. In particular:

- A list of excepted arrangements has been included. These are arrangements that HMRC does not require to be notified of because details of the schemes have already been made available to us during the consultation process. Listing should not be taken to read that HMRC finds the arrangements acceptable, or considers them to work under existing law;
- The commencement provisions have been changed so that there is no need to disclose a scheme where any part of the arrangements falls before 1 August 2005;
- The application of the £5 million market value test has been clarified; and
- We have accepted representations to issue a reference number to the promoter (see paragraph 29).

### **Monitoring and evaluation**

56. The measure is designed to provide information about existing stamp duty land tax avoidance schemes and it should become apparent relatively quickly whether or not it is working as intended. Disclosures received will be monitored and analysed by the AAG and technical experts within HMRC and compared with wider intelligence. An initial evaluation of the rules will be made no later than six months after they come into effect. Further evaluation will be decided upon in the light of the initial evaluation.

### **Summary and recommendation**

57. There is evidence of significant avoidance of stamp duty land tax on commercial property and the HMRC's ability to counter that avoidance is affected by an information gap attributable to the nature of stamp duty land tax and the return system. The most proportionate means of closing that gap is by extending the existing rules requiring disclosure of potential tax avoidance schemes to schemes that concern commercial property of a value of at least £5 million.

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## Annex

### THE DISCLOSURE RULES

#### Scope

1. FA 2004 requires promoters and, in some cases, users to disclose details of direct tax schemes and arrangements that might be expected to obtain a tax advantage as one of the main benefits. The legislation applies across the direct taxes (income tax, corporation tax, capital gains tax, petroleum revenue tax, stamp duty land tax, stamp duty reserve tax and inheritance tax).

2. Regulations limit the initial scope to notifiable arrangements that concern income tax, corporation tax or capital gains tax and involve either employment or certain specified financial products. Filters are used to restrict disclosure to new or innovative avoidance schemes and avoid affecting ordinary tax planning. The two main filters are “confidentiality” and “premium fee”.

3. Normally it is the promoter of the scheme who is required to disclose. But there are three circumstances in which the taxpayer must disclose:

- “in-house” schemes, i.e. where there is no promoter;
- where the promoter is offshore;
- where the promoter is a lawyer who is prevented from making a full disclosure of the required information by legal professional privilege (LPP). The client may, however, waive privilege, in which case the lawyer is required to disclose.

#### Timing of disclosures

4. In general, disclosure must be made within five working days of the scheme being made available for implementation or when the first transaction to use the scheme takes place. However, users of in-house schemes are generally allowed to disclose on their tax returns.

#### Reference numbers

5. The rules provide that the HMRC may issue a reference number for any scheme disclosed within 30 days of receipt of the disclosure. Where HMRC issues a number to a promoter, the promoter must provide this to clients within 30 days of the later of:

- Becoming aware of the first transaction to use the scheme; or if later
- Receipt of a reference number from HMRC.

#### Further obligations on users of a disclosed scheme

6. A person who uses a scheme who has been issued with a reference number, either by the promoter or directly by HMRC, must declare that number on each return that is affected by the scheme.

## Penalties

7. A promoter who fails to disclose scheme etc will be liable to an initial penalty of up to a maximum of £5,000. Where after this initial penalty is imposed the failure continues then a further daily penalty of up to a maximum £600 per day will be imposed.

8. Promoters who fail to give a registration numbers to their client will also be liable to a maximum penalty of £5,000.

9. Taxpayers who fail to show scheme registration numbers on returns will be liable to an initial penalty of £100 rising to £500 for subsequent failures.

10. In respect of both promoters and taxpayers, initial penalties will be determined by the Special Commissioners and there will be a right of appeal against the imposition of the penalty.