

DISCLOSURE OF TAX AVOIDANCE SCHEMES: DRAFT REGULATIONS

SUMMARY OF RESPONSES TO CONSULTATION

BACKGROUND

1. The Chancellor of the Exchequer announced on 17 March 2004 new rules to require promoters and users of certain tax schemes and arrangements to disclose details of those arrangements to the Inland Revenue. Details of how the rules will operate in practice would be set out in Regulations.

2. On 17 May 2004, the Inland Revenue published three draft Regulations for consultation. The draft Regulations were:

- The Tax Avoidance Schemes (Information) Regulations;
- The Tax Avoidance Schemes (Promoter and Prescribed Circumstances) Regulations; and
- The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations.

3. The Paymaster General announced a number of changes to the Regulations on 22 June in light of comments received to that date. The consultation period ended on 30 June, and the final text of the Regulations was published on 9 July.

4. These Regulations are being laid before Parliament following Royal Assent to the Finance Bill 2004.

OUTCOME OF THE CONSULTATION

5. We received 40 responses from representatives of business and the financial, legal and accountancy professions. We also held numerous formal and informal meetings to discuss the Regulations in greater detail.

6. Some responses made comments about the Government's policy on disclosure in general terms. Others expressed concerns about the

consultation process itself. Those issues are not covered by the draft Regulations and are not dealt with in this document.

7. Substantive comments on the Regulations are summarised below, together with the Inland Revenue's response in italics. The comments also included a number of helpful drafting points that have been addressed in the final text of the Regulations.

THE TAX AVOIDANCE SCHEMES (INFORMATION) REGULATIONS 2004

8. Several responses sought greater clarity around the interaction between the disclosure rules and the Inland Revenue's existing statutory clearance process. The concern was expressed that advisors might be required to send details of a scheme twice, both to comply with the disclosure rules and to obtain a clearance on behalf of a client.

The Regulation has been revised to ensure that promoters can meet a requirement to make a disclosure at the same time as making a clearance application. The Regulation extends the time limit for disclosure where the promoter expects to submit a statutory clearance.

9. A concern expressed in a number of responses was that the 5-day time limit for making a disclosure was too short and would create significant difficulties for those required to comply with the rules. Time limits of 30 or 60 days were suggested as more practical alternatives.

It remains the Government's view that an extension of the 5-day limit would undermine the effectiveness of the disclosure rules. However, we believe the tightening of the definition of a promoter and clarification of the amount of information to be disclosed in the revised Regulations will have the effect of making the 5-day limit easier to meet.

However, the Government has accepted that there is a good case for extending the time limit when the rules first come into effect on 1 August 2004. Schemes with a relevant date on or after 1 August 2004 will need to be disclosed within a time limit of 5 days or 30 September, whichever is the later.

10. Several responses expressed the concern that the disclosure rules will require a disproportionate amount of information to be provided to the Inland Revenue.

In the final text of the Regulation, the amount of information to be disclosed has been reduced. The rules now focus on explaining the element of the arrangements from which the tax advantage is expected to be obtained.

11. Some responses pointed out a lack of clarity about the extent of the responsibilities of partnerships using schemes or arrangements.

The final Regulation incorporates minor changes which ensure that partners in partnerships which use disclosable schemes are required to inform the Inland Revenue of the scheme number on their tax returns, as well as in the partnership returns.

12. Some responses pointed out some inconsistencies of language in the Regulation which created uncertainty about the information required.

The language has been rationalised in the final text of the Regulation to ensure that the information requirements relate to 'proposals', 'arrangements' or 'transactions forming part of the arrangements', as appropriate.

THE TAX AVOIDANCE SCHEMES (PROMOTER AND PRESCRIBED CIRCUMSTANCES) REGULATIONS 2004

13. A number of responses made the case that the definition of a promoter was drawn too widely. A particular concern was expressed that advisors might be treated as promoters even in circumstances where their involvement was not directly related to a tax advantage arising from a scheme or arrangement. It was argued that promoters in such cases might find themselves under an obligation to make a disclosure when they would be unable to comply in practice.

We have revised the Regulation to restrict the definition of a promoter. The final draft of the Regulation excludes from the disclosure rules (i) anyone who, in providing services relating to taxation, is not involved in designing that part of the scheme or arrangement that gives rise to a tax advantage, (ii) anyone who does not provide tax advice in relation to the arrangements, and (iii) anyone who is not the sole designer of the part of the scheme or arrangement that gives rise to a tax advantage and has insufficient knowledge. It also excludes people responsible for organising or managing a scheme who do not have any connection with the designer of the scheme.

14. A further concern was that the disclosure rules have the effect of treating individuals employed by accountancy and other businesses as promoters in their own right when they give advice on schemes or arrangements.

This Regulation has been amended to ensure that only a business will be treated as a promoter, not its individual employees.

15. Some responses sought an exclusion of specific types of business, including building societies, charitable organisations and insurance companies from the disclosure rules. Others sought an extension of the exclusions for companies in a group to joint venture companies, dual listed companies and Limited Liability Partnerships.

The Government was not convinced of any argument for excluding specific businesses from the disclosure rules, nor of the case for extending the current exclusion for groups to other entities. We are aware of concerns that charities such as the Citizens Advice Bureau that provide advice on tax matters to people on low incomes might be subject to reporting requirements under the disclosure rules. But there is no question that the sort of routine advice provided by such organisations would fall within the rules.

16. A number of responses drew attention to a potential ambiguity in the Regulation dealing with the exclusion of groups from the definition of promoter. They pointed out that it was unclear whether a promoter was excluded where his obligations related to a proposed arrangement.

The Regulation has been amended to make it clear that a promoter who is a member of a group is excluded where his obligations relate to proposals or to arrangements.

THE TAX AVOIDANCE SCHEMES (PRESCRIBED DESCRIPTIONS OF ARRANGEMENTS) REGULATIONS

17. A number of responses expressed the concern that the tests proposed for schemes involving financial products were unnecessarily complex and would be too difficult to operate in practice. In addition, the tests were too wide and were likely to catch day-to-day tax planning advice.

This Regulation has been substantially revised following consultation. The final version has been amended to remove the mathematical formula which

would have required a comparison of the value of the tax benefit arising from the scheme with its economic benefit and cost of implementation.

In its place, new filters have been introduced which focus on the factors relating to the innovative use of financial products to gain a tax advantage.

Disclosure will only be required where:

- the arrangements contain features which create a tax advantage and a promoter of the arrangements could thereby obtain a fee which is abnormal or linked to the tax saving, or might wish to keep confidential from competitors; or*
- where a promoter is party to a financial product which is not offered on open-market terms.*

18. Some responses pointed out that the definition of derivatives contracts in the draft Regulations was defective in that it would not have worked correctly for non-corporate entities and would have excluded derivatives which were not taxed as income.

The definition of a derivatives contract has been changed to ensure that it catches all derivatives, however taxed and whatever the status of the user.

19. The consultation did not identify any major concerns with the Regulations dealing with employment product schemes and arrangements, although there were a number of points where respondents sought greater clarification.

Changes have been made to address these points.

20. Some responses identified an uncertainty about whether or not a tax advantage arising from an employment product needs to cover more than one tax period.

The draft Regulations have been amended to clarify that an employment product will be caught by the rules whether the tax advantage arises in the same or in a later tax period.

21. Other responses pointed out a similar uncertainty about whether or not the Regulations are intended to apply to an office holder as well as to an employee.

The definition of employment and related terms have been amended in the draft Regulations to make it clear the disclosure rules apply to office holders in the same way as they do to employees.