

# REGULATORY IMPACT ASSESSMENT FOR ENSURING COMPLIANCE WITH THE TAX AVOIDANCE DISCLOSURE REGIME

## Introduction

1. This full Regulatory Impact Assessment estimates the costs and benefits of the proposed measure providing HM Revenue and Customs (HMRC) with additional information powers to ensure compliance with the tax avoidance scheme disclosure regime. The measure is included in Finance Bill 2007 and will take effect from Royal Assent to the Bill. This full RIA updates the partial RIA issued on 18 December 2006.

## Purpose and intended effect of the measure

### *The policy objectives*

2. The objective is to counter non-compliance with the disclosure regime ("Disclosure"). The clause provides for powers for HMRC to require promoters of tax schemes to provide information (and in certain circumstances documents) in instances where there are reasonable grounds to believe that a scheme is notifiable. It also provides for HMRC to apply to the Special Commissioners for the issue of an order designating that a particular scheme is notifiable.
3. The main powers would be exercised through the Special Commissioners, to ensure consistent and proportionate application.

### *Background*

4. Tax avoidance costs the Exchequer lost revenues each year. It also undermines the Government's public spending objectives and brings unfairness into the tax system itself.
5. Disclosure is intended to provide HMRC, in as close to real time as possible, with the information necessary to identify and counteract avoidance schemes. This ensures that the Government can initiate legislation as quickly as possible to close any loopholes. Disclosure also normally provides information about the users of schemes that have been disclosed, which assists HMRC to initiate, where appropriate, enquiries and litigation.
6. Disclosure was introduced in 2004. Disclosure regimes now cover the whole of income tax, corporation tax and capital gains tax ("the main regime"), stamp duty land tax on commercial property and VAT. The main regime was extended and revised with effect from 1 August 2006 following intensive consultation with business. Regulations extending the main regime, insofar as it applies to income tax, to National Insurance

Contributions were laid before Parliament on 12 March 2007 and will come into force on 1 May 2007.

7. HMRC publishes details of the numbers of disclosures received since 2004. Details are published every six months for the periods ending 31 March and 30 September.
8. Disclosures informed many of the anti-avoidance provisions in Finance Acts 2005 (No.2) and 2006. They also informed many of the anti-avoidance measures contained in Finance Bill 2007.
9. The obligation to “disclose” (i.e. to provide information to HMRC about) a scheme (other than a VAT scheme) normally falls upon the promoter of the scheme. The time limit for the promoter to disclose is normally within five days of either making the scheme available for implementation, or first becoming aware of a transaction forming part of the scheme.
10. HMRC has powers to ask the Special Commissioners to impose penalties on a promoter who fails to disclose a scheme. The maximum initial penalty is £5,000. If a promoter fails to disclose after this initial penalty is imposed, then a further penalty of up to £600 may be imposed by HMRC for each day that the failure continues.
11. At present HMRC generally only takes action in respect of a failure to disclose a scheme once the scheme has been implemented and information about it can be obtained voluntarily from either the promoter or from third parties. HMRC has no power to obtain directly from a promoter documents or information in instances where there are reasons to believe that a promoter has not disclosed a scheme that is disclosable.

#### *The rationale for Government intervention*

12. HMRC monitors Disclosure on a continuous basis to ensure that the regime is working as intended. This includes monitoring disclosures received and developments in the market place for tax schemes - through published material, intelligence received and feedback from promoters. It also includes enquiries into the tax returns of scheme users.
13. The monitoring exercise indicates that although the majority of promoters comply conscientiously with their disclosure obligations, a significant minority do not. HMRC has identified over 100 entities where there is evidence of involvement in promoting schemes of a type that it would expect to be disclosed, but where there has been no disclosure.
14. Non-compliance not only undermines the purpose of Disclosure (to provide early information about avoidance schemes), it also creates distortions and puts those promoters who comply at a competitive disadvantage.

15. At present HMRC is limited in what it can do to tackle non-compliance because it has no specific powers to audit or investigate whether a promoter has complied with the disclosure regime. Disclosure is, for the moment, effectively a self-regulatory regime.
16. Promoters have no obligation to provide information concerning a scheme that is not notifiable. The problem is that at present there is little that HMRC can do to establish when a promoter has failed to disclose a scheme that is notifiable. Even where there are reasonable grounds to believe that a scheme should properly have been disclosed, HMRC has no powers to investigate further. HMRC may obtain evidence much later as a result of enquiries into tax returns of persons who are found to have used the scheme. But this is a long and uncertain process and at best the delay subverts the purpose of disclosure - to obtain information *early*.
17. HMRC does have the power to ask the Special Commissioners to apply a penalty to a promoter for failing to notify a scheme. But penalty proceedings are not a satisfactory way of resolving disputes as to whether or not a scheme is notifiable.

### **Consultation**

18. PBR 2006 announced that HMRC would be consulting on additional powers to tackle non-compliance with Disclosure. A Consultation Document – *Ensuring Compliance with The Tax Avoidance Disclosure Regime* – was published on the HMRC website on 18 December 2006. The Consultation Document included a partial RIA, a draft clause and draft Explanatory Notes. Comments were invited by 12 March 2007.
19. A Response Document summarising the main points raised by respondents and the way they have been deal with in the Bill has been published on the HMRC website. The formal consultation was supplemented by seminars with around 50 tax professionals and discussions with individual scheme promoters.
20. HMRC is extremely grateful to all of those who took part in the consultation process. The responses and discussions were extremely constructive and have led to a number of small but significant changes to the draft legislation. For example:
  - Powers allowing HMRC to require a promoter to provide information and documents to support a statement of reasons why a scheme is not notifiable have been placed under the supervision of the Special Commissioners;
  - Powers allowing HMRC to call for further information and documents to explain and support a purported disclosure which is incomplete have also been placed under the supervision of the Special Commissioners; and

- The legislation plugs into the Special Commissioners procedural regulations to ensure that hearings before the Commissioners are *inter partes* hearings in the same way as an appeal.
21. Within Government the Department of Constitutional Affairs has been consulted on ways of providing safeguards to the exercise of the powers proposed consistent with the proposals contained in the Tribunals, Courts and Enforcement Bill, currently before Parliament.

### **Options considered in drafting this legislation**

#### **Option 1 - *Doing nothing***

22. As now, HMRC would have no powers to enquire into a scheme, even when there was considerable evidence that a promoter should have disclosed the scheme. HMRC would be reliant upon finding out the details of the scheme through information obtained in the course of enquiries into tax returns. At best this information would be obtained many months after the scheme had been implemented, undermining the objective of Disclosure, which is to obtain information in close to real time.
23. The lack of an effective response to non-compliance with Disclosure would disadvantage the majority of promoters who have put systems in place to ensure compliance.

#### **Option 2 – *Increase the penalty for non-disclosure***

24. This option would require no new powers and only a minor change to existing legislation.

#### **Compliance**

25. There would be no need for any compliance provision over and above that already provided for by the disclosure regime in the Taxes Management Act 1970.

#### **Monitoring**

26. HMRC would continue to monitor and analyse both disclosures received and developments in the tax scheme market place, to identify whether the legislation was leading to a greater proportion of certain types of scheme being disclosed. If not, then HMRC would engage with stakeholders to consider what further changes might be necessary.

#### **Risk**

27. In order to be a real economic deterrent to non-compliance, the level of the penalty would normally have to be many times greater than the current maximum. Consultation with promoters suggests that it would have to be geared to either the fee income or the expected tax

advantage being proffered to clients. Calculating a suitable penalty in any particular case would be inherently difficult. Moreover, a very high maximum penalty would concern the compliant majority of promoters without necessarily deterring the non-compliant minority, who may be able to provide themselves with a “reasonable excuse” as to why a penalty should not be imposed. Respondents to the consultation generally agreed that higher penalties would not, in themselves, be a satisfactory solution.

### **Option 3 – Information powers for HMRC to enquire into non-disclosed schemes**

28. This option would be designed to strengthen HMRC’s capability to investigate notifiable schemes that have not been disclosed. It would be a useful tool against the non-compliant minority.

#### Compliance

29. This option would require a penalty for failure by a promoter to provide information to HMRC in response to a request under the powers proposed.

#### Monitoring

30. HMRC would continue to monitor and analyse both disclosures received and developments in the tax scheme market place, to identify whether the legislation was leading to a greater proportion of certain types of scheme being disclosed. If not, then HMRC would engage with stakeholders to consider whether further changes were necessary.

#### Risk

31. Some promoters might choose not to comply with an information request made under the proposed powers. They may calculate that the economic benefits of promoting the scheme outweigh the potential penalties. This risk would be monitored as described above. There is also a risk that HMRC might use the power too widely. This risk would be mitigated by making the main powers exercisable through the Special Commissioners.

### **Conclusions**

32. Providing HMRC with powers to enquire into non-disclosure of schemes is considered to be the right and proportionate course of action. Finance Bill 2007 includes a measure enabling HMRC:
  - To require a person it suspects to be promoting a particular scheme to explain why that scheme is not notifiable;
  - To apply to the Special Commissioners for an order requiring the promoter to provide information or documents in support of a statement of reasons why a scheme is not notifiable;

- To apply to the Special Commissioners for an order designating that a particular scheme either is notifiable, or is to be treated as notifiable; and
  - To apply to the Special Commissioners for an order requiring a promoter to provide information or documents in cases where they have purported to have made a disclosure, but the information is incomplete.
33. In general it is proposed merely to extend the existing penalties for failure to disclose (paragraph 10 above). In cases where the Special Commissioners have issued an order that a scheme is, or is to be treated as, notifiable, it is proposed to increase the maximum daily penalty from £600 to a maximum amount to be specified in affirmative regulations. HMRC will have further discussions with representative bodies about the amount. The maximum initial penalty will remain at £5,000.

### **Costs and benefits**

#### *Business sectors affected*

34. The businesses mainly affected will be those that promote tax schemes: primarily accountants, lawyers, banks and other financial institutions. The measure is intended to provide a level playing field for those groups.

#### *Benefits*

35. Tax avoidance reduces the Government's revenues and affects its ability to meet its spending objectives. The main effects of the measure will be to protect future revenues by providing information that will inform anti-avoidance measures.
36. The measure is also intended to provide promoters of tax schemes with a level playing field and to remove distortion of competition.

#### *Exchequer effects*

37. The aim of the proposed measure is to improve compliance with the Disclosure regime. It is estimated that the measure will yield £15 million in 2007/08 and £30 million a year thereafter arising through several broad effects. The measure would be expected to result in additional disclosures each year from those who are currently non-compliant. This would lead to additional detection by inspectors of failed avoidance schemes and some additional deterrence arising from the more targeted operation of the disclosure regime.
38. The main effect of strengthening Disclosure would be to provide information that would enable the Government to introduce measures closing loopholes and those measures would normally provide revenue yield.

## *Costs*

39. The proposal is not expected to impose any significant costs on compliant promoters or other businesses.
40. A compliant promoter might incur costs in responding to an initial request from HMRC to explain why the promoter believes a particular scheme is not notifiable by them. In addition there may be minor indirect costs to promoters and others in consulting with HMRC and familiarising themselves with the new information powers.
41. The measure would have a cost effect on those promoters to whom HMRC issues a request for further information, or in relation to whom HMRC seeks an order from the Special Commissioners. Such costs will vary according to the size and complexity of the business. HMRC could only take such action where it has reasonable grounds to believe that the promoter has failed to comply with the disclosure regime. It is expected that the power will be used in a very small number of cases.

## *HMRC costs*

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

## **Small Firms Impact Test**

43. The measure will affect non-compliant promoters of disclosable schemes and wherever non-compliant promoters are themselves small firms this measure will have an impact upon them. The number to be investigated is expected to be very small and to represent a tiny fraction of those small firms who provide taxation services.

## **Other Impacts**

44. No significant departmental or other impacts have been identified.

## **Competition assessment**

45. The competition filter test has been applied. The measure is designed to remove distortions in the tax-scheme market place and encourage fair competition among promoters.

## **Enforcement, sanctions and monitoring**

46. HMRC will update the published guidance on disclosures, to describe who will be affected by the information powers and how they will be exercised in practice. The main information powers will be exercised by the Special Commissioners on application by HMRC.

47. As discussed in paragraph 29 above, there would be penalties for failing to provide information as required under the proposed powers.

### **Implementation and delivery**

48. A promoter who seeks to comply fully with the disclosure regime may undertake some or all of the following activities:
- Consultation with HMRC;
  - Understanding the new rules;
  - Providing information to HMRC to explain why a particular scheme is not notifiable by them.

### **Post-implementation Review**

49. HMRC will continue to monitor the Disclosure regime as described in paragraph 12 above. The impact of the information powers will be included in the formal Policy Evaluation Review of the August 2006 extension and revision of the main disclosure regime. This review will take place within three years of August 2006 and will look at the accumulated evidence from the first full cycle of disclosures.

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**Statement of Ministerial Approval**

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

Signed by the responsible Minister:

Dawn Primarolo  
Paymaster General  
26 March 2007