

REGULATORY IMPACT ASSESSMENT (RIA)

TACKLING TAX AVOIDANCE- DISCLOSURE REQUIREMENTS

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 planed 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.

Contact point

Ray McCann
Inland Revenue Cross Cutting Policy
Room S23
Somerset House
London
WC2R 1LB
Telephone: 020 7438 9145

Tim Plant
Inland Revenue Cross Cutting Policy
Room S12
Somerset House
London
WC2R 1LB
Telephone: 020 7084 5595

REGULATORY IMPACT ASSESSMENT

TACKLING TAX AVOIDANCE- DISCLOSURE REQUIREMENTS

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

Date 6 April 2004