

## Summary: Intervention & Options

Department /Agency:  
HM Revenue & Customs

Title:  
Identifying Users of Disclosed Tax Avoidance Schemes

Stage: Final Proposal

Version: 1.0

Date: 14<sup>th</sup> May 2008

**Related Publications:** Consultation Document: Tax Avoidance Disclosure Regime: Improving the Scheme Reference Number System; Consultation Stage Impact Assessment; Responses to the Consultation

### Available to view or download at:

<http://www.hmrc.gov.uk/better-regulation/index.htm> and <http://www.hmrc.gov.uk/consultations/index.htm>

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### What is the problem under consideration? Why is government intervention necessary?

Promoters of tax schemes falling within certain descriptions must provide information about ("disclose") the scheme to HMRC. Those descriptions target tax avoidance schemes. Tackling avoidance ensures fairness for all taxpayers. Users of disclosed schemes are identified by a scheme reference number (SRN), issued by HMRC via promoters, which the user reports on a tax return. HMRC has identified that a significant proportion of users of disclosed schemes do not report SRNs. This impairs HMRC's ability to identify users and target interventions at the greatest risks thereby inhibiting its ability to protect Government revenues by detecting and challenging failed avoidance schemes and closing legislative loopholes.

### What are the policy objectives and the intended effects?

Policy objective: to identify all persons who have used disclosed tax schemes in order for HMRC to target its compliance resources effectively and efficiently and at the greatest risks.

Intended effects: To reduce the incidence of users of disclosed schemes not reporting a SRN for tax periods ending after 30 September 2008 (although the first period to be affected will be a part year and the full effects will not be obtained until the following period).

### What policy options have been considered? Please justify any preferred option.

1. No intervention
  2. Non legislative option; e.g education campaign targeted at users
  3. Replace the SRN system with a new legislative system (replacement)
  4. Legislation to remove the weaknesses and impose obligations on promoters and others to pass on SRNs and other information to users (repair).
- Option 4 will be taken forward as the preferred option. Options 1 and 2 (in isolation) would not have cured the problem. Option 3 would have been totally disproportionate to the problem being addressed.

### When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

Expected three years from the date the regulations come into force.

### **Ministerial Sign-off** For final proposal/implementation stage Impact Assessment:

*I have read the Impact Assessment and I am satisfied that, (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs .*

Signed by the responsible Minister:

Jane Kennedy.....Date: 20 May 2008

## Summary: Analysis & Evidence

|                       |  |
|-----------------------|--|
| <b>Final Proposal</b> | <b>Description: Legislation to remove weaknesses and impose obligations on promoters and others to pass SRN and other information to users (Repair).</b> |
|-----------------------|--|

|  |  |  |                     |
|--|--|--|---------------------|
| <b>COSTS</b>   | <b>ANNUAL COSTS</b>  | Description and scale of <b>key monetised costs</b> by 'main affected groups' The expected impact overall is small as it affects only the limited number of tax advisory firms and taxpayers who are involved with disclosed schemes, though there will be some initial costs as promoters/taxpayers become familiar with the new rules. Since this measure brings greater certainty, it will reduce the time taken to decide on whether to report using a scheme. |                     |
|  | <b>One-off</b> (Transition) <span style="float: right;">Yrs</span> |  |                     |
|  | <b>£ Negligible</b>  |  |                     |
|  | <b>Average Annual Cost</b><br>(excluding one-off)                  |  |                     |
|  | <b>£ Negligible</b>  | <b>Total Cost (PV)</b>   | <b>£ Negligible</b> |
| Other <b>key non-monetised costs</b> by 'main affected groups' |  |  |                     |

|  |   |   |                     |
|--|---|---|---------------------|
| <b>BENEFITS</b>  | <b>ANNUAL BENEFITS</b>                                | Description and scale of <b>key monetised benefits</b> by 'main affected groups' The value of certainty to taxpayers would also apply but be difficult to quantify. |                     |
|  | <b>One-off</b> <span style="float: right;">Yrs</span> |   |                     |
|  | <b>£ Negligible</b>                                   |   |                     |
|  | <b>Average Annual Benefit</b><br>(excluding one-off)  |   |                     |
|  | <b>£ Negligible</b>                                   | <b>Total Benefit (PV)</b>   | <b>£ Negligible</b> |
| Other <b>key non-monetised benefits</b> by 'main affected groups' Fairness is increased, which is generally thought of as a positive outcome in compliance terms through more consistent reporting. The expected Exchequer impact is an increase of £20m a year by improved compliance on avoidance. |   |   |                     |

**Key Assumptions/Sensitivities/Risks** That there will be between an 80% and 90% compliance rate with the new rules by promoters and users. There is at present an estimated 60% compliance rate in terms of scheme users recording their scheme reference numbers as required.

|                      |                      |  |  |
|----------------------|----------------------|--|--|
| Price Base<br>Year 0 | Time Period<br>Years | <b>Net Benefit Range (NPV)</b><br><b>£ Neg</b> | <b>NET BENEFIT (NPV Best estimate)</b><br><b>£ Neg</b> |
|----------------------|----------------------|--|--|

|   |                  |                  |                   |                  |
|---|------------------|------------------|-------------------|------------------|
| What is the geographic coverage of the policy/option?                 |                  | United Kingdom   |                   |                  |
| On what date will the policy be implemented?                          |                  | 1 October 2008   |                   |                  |
| Which organisation(s) will enforce the policy?                        |                  | HMRC             |                   |                  |
| What is the total annual cost of enforcement for these organisations? |                  | £ Negligible     |                   |                  |
| Does enforcement comply with Hampton principles?                      |                  | Yes              |                   |                  |
| Will implementation go beyond minimum EU requirements?                |                  | No               |                   |                  |
| What is the value of the proposed offsetting measure per year?        |                  | £ n/a            |                   |                  |
| What is the value of changes in greenhouse gas emissions?             |                  | £ n/a            |                   |                  |
| Will the proposal have a significant impact on competition?           |                  | No               |                   |                  |
| Annual cost (£-£) per organisation<br>(excluding one-off)             | Micro negligible | Small negligible | Medium negligible | Large negligible |
| Are any of these organisations exempt?                                | No               | No               | No                | No               |

|   |      |                       |      |                                |
|---|------|-----------------------|------|--------------------------------|
| <b>Impact on Admin Burdens Baseline</b> (2005 Prices) |      | (Increase - Decrease) |      |                                |
| Increase of   | £ -- | Decrease of           | £ -- | <b>Net Impact</b> £ Negligible |

Key: Annual costs and benefits: Constant Prices (Net) Present Value

# Evidence Base (for summary sheets)

## Introduction

This Impact Assessment, made by HM Revenue & Customs, examines the costs and benefits of modifying the Tax Avoidance Disclosure Regime (“Disclosure”) to enhance the identification of users of disclosed schemes.

The Disclosure regime is summarised in the **Annex**.

## Policy Objectives

The policy objectives of Disclosure are to counter tax avoidance by:

1. getting early information about avoidance schemes and how they work - informing loophole blocking (legislation);
2. getting information about who has used a scheme - informing HMRC’s compliance activities (risk assessment, enquiries into returns and challenge by litigation).

This Impact Assessment is concerned with the second of these objectives.

## The rationale for Government Intervention

HMRC risk assesses and project manages enquiries into the tax returns of individuals and companies who have reported a scheme reference number (SRN).

HMRC also risk assesses the returns of other taxpayers to identify users of avoidance schemes who have not reported a SRN.

Despite generally successful results, there is evidence that a significant proportion of users of disclosed schemes are not reporting SRNs. HMRC has identified a number of loopholes and weaknesses in the system that result in users not being identified as the existing legislation intended they should be.

## Evidence from Analysis

- At April 2008 there were around 12,500 known users of disclosed schemes of whom around 80% are individuals carrying on a business as sole proprietors or partners. In 2007 between 5,000 and 6,000 of the above users reported a SRN (with some users reporting two or more).
- Other analysis of returns undertaken as part of our operational activities has led to the discovery of both completely undisclosed schemes and schemes which have been disclosed by the promoter but which have not been notified, or properly notified, to HMRC by the user.
- Of schemes disclosed before May 2005 where no users were known to have reported a SRN, research has shown that around 25% of those schemes did in fact have users.
- Evidence from correspondence issued by promoters to their clients’ shows that they have not always explained the relevance of the SRN and the obligations to notify HMRC.
- Analysis carried out in September 2007 for the tax year 2005/06 in relation to a sample of Limited Liability Partnerships indicated that around 40% of individual partners who have

been issued with a SRN by the promoter did not report it correctly. In other cases the number is reported, but not in the specified box on the return or the number may be transposed. Other analysis indicates that SRN reporting failures are not confined to individuals but extend to corporate users.

### **Proposal: Improving the existing system (Repair)**

The objective is to ensure that all users of disclosed avoidance schemes receive a Scheme Reference Number and report it to HMRC so that we can focus our compliance activities effectively.

The proposal would:

- remove loopholes in the primary and secondary legislation that prevent a SRN from being passed down the chain from a promoter to the end user (i.e. the person who uses the scheme to get a tax advantage);
- reduce the incidence of scheme users failing to report a SRN they have been issued with. It would do this mainly by requiring a promoter to pass on a SRN to clients using a new HMRC form containing guidance.

It would also make some additional, but less important, improvements to the SRN system as described below.

This proposal has been developed following a period of extensive consultation with promoters and representative bodies between November 2007 and February 2008. The consultation has enabled us to identify a number of areas where significant improvements could be made to the draft legislation and to the scheme reference number system.

This proposal involves making six main changes:

#### **1. Clarification around the use of the term “complies with” in Section 311 FA 2004**

HMRC is aware that some promoters interpret the issue of the SRN by HMRC as signifying compliance with all obligations. This change clarifies the position by making the issue of the SRN conditional on compliance, *or purported compliance*, with a person’s disclosure obligation.

#### **2. A new power for HMRC to withdraw the SRN**

HMRC currently has no power to withdraw a SRN. There may be occasions where, having issued the SRN, we decide that we do not want users to report that scheme or to continue to report that scheme indefinitely. This change will allow us to remove the obligation on promoters to pass withdrawn SRNs to their clients and on users of schemes to report the SRN to HMRC. Any withdrawn SRNs will be published on the HMRC website with the date from which the SRN has been withdrawn.

#### **3. Clarification of the time when the promoter is required to pass the SRN on to a client**

Under current legislation HMRC notifies the promoter of the SRN following disclosure of a notifiable arrangement or a notifiable proposal. The promoter is then required to pass the SRN on to their client(s) only in relation to a notifiable arrangement, i.e. when the scheme has been implemented by the client. However, it is the practice of some promoters to pass the SRN on to the client earlier when they make the scheme available. This change will recognise that a promoter *may* pass the SRN on to the client when the scheme is made available and that the client’s obligation to report the SRN to HMRC applies whether the promoter has issued the SRN at the proposal or implementation stage.

#### 4. New obligations for co-promoters and intermediaries

The purpose of the SRN system is to identify users of avoidance schemes, i.e. parties to the scheme who expect to obtain a tax advantage. The system envisages that a SRN will be passed from HMRC down the chain to the user(s). But in practice gaps may occur in the chain of transmission where:

- a **co-promoter** of a scheme provides a scheme to a client. Only one co-promoter of a scheme need disclose the scheme and only that co-promoter is issued with a SRN. Other co-promoters may also have clients different from those of the promoter who discloses the scheme and therefore those clients may not receive the SRN; and
- the client who is issued with a SRN by a promoter is an **intermediary** who is not the user, or the only user, of the scheme.

This change will amend existing legislation so that:

- a Promoter (P2) is only relieved of the obligation to disclose a scheme if:
  1. another promoter (P1) discloses the scheme, notifies HMRC of P2's details and passes a copy of the disclosure to P2. HMRC will then notify the SRN to P2; or
  2. P2 obtains the SRN from P1 along with a copy of P1's disclosure.
- the adoption of either of these options is not compulsory, but if a promoter adopts neither, then they must disclose the scheme and obtain the SRN from HMRC.
- a client who is an intermediary must pass on the SRN to other known user(s).

#### 5. A system to inform users of schemes of their obligations

At present there is no obligation on promoters to provide information to their clients on what they must do with the SRN. This creates uncertainty for promoters as to what information they ought to provide and for users as to what they have to do with a SRN. This change will require a promoter to pass on a SRN to clients on a new HMRC form that will provide key information on what to do with the SRN. HMRC will make a draft of the form available for comment before this change is implemented.

#### 6. Extension of the use of form AAG4

This change extends the circumstances in which users are currently required to notify the SRN on Form AAG4 to include claims for setting off losses against personal income or gains associated with a disclosed scheme. This change will be brought in following further discussions with respondents to the consultation about suggestions for simplification of the procedures whereby users report SRNs

#### **Exchequer Effects**

It is estimated that HMRC currently identifies about 60% of sole proprietors and partners using notifiable schemes and that the changes will, when fully operational, increase that proportion to at least a range of 80% to 90%. That is that some additional 2,000 users reporting a SRN in a full year. The additional users would be approximately 1,000 from increased compliance with the requirement to report the SRN and a further 1,000 from clarification of the co-promoter rules to report the SRN in respect of their additional clients.

Increasing the proportion to a range of 80% to 90% would yield approximately an additional £20m a year, after a transitional period, through the detection of avoidance schemes that do not work under existing legislation.

For Impact Assessment purposes, yield is treated as a transfer cost rather than as a cost or benefit.

## **Cost and benefits**

### ***Impact on HMRC***

The main impact on HMRC will arise from:

- an increase in the notification of SRNs; and
- the issue of the new form for promoters to pass to clients containing the SRN
- the issue of guidance on how to comply with the obligations.

The increased costs associated with these impacts are not expected to be significant. There will be a corresponding reduction in the costs currently incurred in trying to identify users of disclosed schemes who do not report SRNs.

### ***Impact on promoters and users***

HMRC currently receives disclosures from, and issues SRNs to, a pool of around 450 promoters, all of whom are businesses. Those promoters must pass on the relevant SRN to a client they know has implemented the scheme.

Promoters will be required to pass on the SRN to clients using a new HMRC form, which will be a form of targeted guidance to users. Promoters will already have systems in place for notifying clients of SRNs, but they may perhaps incur some additional recording costs.

HMRC expects an increase of around 1,000 users, mainly sole proprietors and partners, reporting a SRN in a full year as a result of the new form securing the reporting level envisaged in the original policy and compliance cost assumptions.

The co-promoter proposal will impose a new obligation upon a co-promoter to pass on a SRN to a client, and upon the client to report the SRN to HMRC. However, in practice the promoter who discloses a scheme is normally the person who makes the scheme available for implementation (i.e. the promoter with clients) and any co-promoters do not normally have their own clients. Consequently the number of co-promoters affected is expected to be very small.

Similarly the intermediary proposal will impose a new obligation upon a client who is an intermediary to pass the SRN to the end user(s) and for the user(s) to report it. The number of clients who are intermediaries is expected to be very small.

HMRC expects that the co-promoter and intermediary changes may lead to an increase of around 1,000 in the number of users, again mainly sole proprietors and partners, receiving and required to report a SRN.

The additional recording and reporting costs referred to above would perhaps be in the order of £12 per form or return according to the Standard Cost Model. Overall the net increase in the admin burden is assessed as negligible.

The impact of the individual changes is described in more detail below.

- **Promoters required to issue the SRN to the client on the new HMRC form**

Compliant promoters already have systems in place to fulfil their obligations to notify clients of SRNs. The cost to the promoter of using the new form to pass the SRN to his client is expected to be minimal relative to the number of clients. The form will be downloadable from HMRC's website. The explanatory nature of the new form is expected to ease the burden on clients and promoters by reducing the need for users to seek clarification of their obligations. This is assessed as a negligible net effect.

- **All promoters required to issue a SRN to clients**

A compliant promoter who invokes the co-promoter rule (P2) will already have in place procedures to be assured that the scheme has been disclosed by a co-promoter (P1). The change formally requires P2 to obtain certain information about the disclosure to ensure that he is entitled to invoke the co-promoter rule, and to ensure that he obtains the SRN, either from P1 or HMRC. However, the proportion of promoters who can invoke the co-promoter rule is widened by extending it to schemes that *are substantially the same* as a scheme already disclosed.

The change also requires P2 to issue the SRN to clients who implement the scheme. This is expected to result in an increase in the number of users receiving and required to report a SRN. We would expect the increase to represent about a 10 percentage point increase in the number of persons reporting a SRN in the first full year following the change. The actual number will depend upon the incidence of people using disclosed schemes in that year, which cannot be predicted with any certainty as the market for such schemes fluctuates.

- **Withdrawal of a SRN by HMRC**

The promoter would no longer have to issue the SRN to clients, or clients to report it to HMRC. Promoters may want to inform clients about a withdrawn SRN, but we will not to require them to do so. This change would represent a small reduction in admin burdens.

- **Intermediaries to issue the SRN to end users and end users to notify the SRN to HMRC**

This change will apply in the relatively rare circumstances where the promoter's client is not the person who will get the tax advantage (but is connected commercially to the person who is). We do not expect the number of such additional notifications or the associated costs to be significant.

Additionally, promoters and users will incur some transitional costs and costs associated with considering how they are affected by the changes.

To the extent that the changes create an obligation to issue or report a SRN where one did not exist before it extends the scope of potential enforcement action by HMRC.

Overall, we expect the changes described above to amount to a negligible net increase in administrative burdens and a negligible net cost for this proposal.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

| Type of testing undertaken | <i>Results in Evidence Base?</i> | <i>Results annexed?</i> |
|----------------------------|----------------------------------|-------------------------|
| Competition Assessment     | Yes                              | No                      |
| Small Firms Impact Test    | Yes                              | No                      |
| Legal Aid                  | No                               | No                      |
| Sustainable Development    | No                               | No                      |
| Carbon Assessment          | No                               | No                      |
| Other Environment          | No                               | No                      |
| Health Impact Assessment   | No                               | No                      |
| Race Equality              | No                               | No                      |
| Disability Equality        | No                               | No                      |
| Gender Equality            | No                               | No                      |
| Human Rights               | No                               | No                      |
| Rural Proofing             | No                               | No                      |

## ANNEX

### Overview of Disclosure

Tax avoidance costs the Exchequer significant lost revenue each year. It also undermines government public spending objectives and brings unfairness into the tax system disadvantaging the compliant majority.

Disclosure was introduced in 2004 and covers Income Tax, Corporation Tax and Capital Gains Tax (“the main regime”), Stamp Duty Land Tax on commercial property, National Insurance Contributions (NICs) and Value Added Tax (VAT).

The proposals in this Impact Assessment would only affect users of schemes falling within the main regime.

Disclosure is intended to provide HMRC with early information in order to identify and counteract avoidance schemes ensuring that the Government can legislate as quickly as possible to close any loopholes. Disclosure also provides information about users of disclosed schemes, which ensures HMRC has a consistent, effective and risk based approach to compliance activities.

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.

Where a person (usually the promoter) complies with a duty to disclose HMRC may allocate a scheme reference number (SRN) to the scheme and pass that number to the person who has made the disclosure. If the person who has made the disclosure is the promoter they must pass the SRN on to the client. The user of the scheme must in turn notify HMRC of the SRN and the period in which the tax advantage is expected to be obtained.

There are penalties for promoters and users of schemes who fail to comply with their obligations.