

REVIEW OF DOTAS AND THE TAX AVOIDANCE LANDSCAPE

Oxford University Centre for Business Taxation

Executive Summary

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In summer 2012 the National Audit Office (NAO) commissioned the Oxford University Centre for Business Taxation (OUCBT) to draw up an academic review of the Disclosure of Tax Avoidance Schemes regime (DOTAS) and the tax avoidance landscape. The academic review formed part of the evidence base behind the NAO's report: "Tax avoidance: tackling marketed avoidance schemes" (November 2012). The NAO's report "examines the effectiveness of the DOTAS regime and HMRC's response to marketed tax avoidance schemes, particularly those used by large numbers of individuals and smaller businesses."

The review produced by the OUCBT consisted of three papers on tax avoidance generally, DOTAS and the Tax Gap. They are being made available here as a matter of public record.¹

The OUCBT is an independent academic organisation that has no collective view. The academic review represents the view of the individual authors only: Professor Michael P. Devereux, Professor Judith Freedman and Dr. John Vella.² Nothing stated here should be taken to represent the views of the NAO. Details of the independent status of the OUCBT and its various sources of sponsorship can be found at <http://www.sbs.ox.ac.uk/centres/tax/about/Pages/Funding.aspx>

Paper 1: TAX AVOIDANCE

The first OUCBT paper attempts to disaggregate various activities that have all been labeled "avoidance" in the current popular debate on tax avoidance. The varying uses of the word has caused much confusion. We must distinguish different types of activity in order to be able to address them with well-targeted actions.

The paper suggests a working classification of so-called avoidance activities (all of which are legal). This categorization is an explanatory tool to be used in the further discussion and it is acknowledged that at the boundaries there can be classification issues.

- A. **Ineffective avoidance.** This can be combated under existing laws provided the activity is discovered and action is taken. This does not make the activity illegal but it makes it ineffective. In these cases the appropriate actions will lie in the area of adequate disclosure provisions and a properly resourced revenue authority.
- B. **Effective avoidance.** This is activity which reduces tax payable due to use of a defect in the legislation or other failure in the way that the legislation is written,

¹ Minor amendments and additions to the papers have been made since their submission to the NAO. In particular the papers have not been updated to reflect the new information released in the NAO report itself.

² The authors are grateful to Francis Ng for valuable research assistance.

that cannot be corrected by purposive interpretation. The effectiveness of this activity is not always predictable with certainty since it may depend on the approach taken by the courts to interpreting the particular statute in question. In these cases, the appropriate actions will be revision of the law in the shape of specific anti-avoidance rules and also a General Anti-Avoidance Rule or Principle which would help to undercut the cat and mouse game of legislation being followed by taxpayers devising new schemes relying on that legislation. More fundamentally, the best action to take would be improved tax policy-making translating into a more principles based approach to tax legislation.

C. Using legislation or the international tax system to one's advantage

Transactions and behaviour that reduce taxation either by using legislation that offers certain opportunities or by relying on the structure of the international taxation system. Although these cases have been described as avoidance in recent debates, in particular in relation to multinational companies, they do not involve the type of exploitation of defects in the implementation and presentation of legislation that come under category B above. If the basis of taxation is where property is located, for example, then provided the taxpayer genuinely has property in the relevant place, applying the law as it stands, the taxpayer should be able to rely on a tax system based on location of ownership of property. Supporting the right to rely on national and international tax rules does not mean, however that the paper argues that there is no problem with the outcome. There are widespread concerns about the way in which the international tax system works, concerns which many of those researching into taxation have been investigating for some time. There is a growing consensus that the only way to tackle the way the international tax system works is through reform of that system. This reform may need to be radical and would probably need international co-operation. The paper briefly notes some of the possible responses, such as unitary taxation, withholding taxes and destination based cash flow taxes, but notes that they present their own challenges.

This simplified classification is discussed and explained in more detail in the paper, as are phrases such as “intention of Parliament” and “spirit of the law”. The avoidance debate has often been framed in terms of “fairness” and taxpayers accused of engaging in avoidance have been labeled “immoral”. The paper argues that the proper place for these discussions is alongside other considerations, to inform the policy process. In this way the widespread view of morality can be embodied in the law through proper democratic and parliamentary processes.

Paper 2: THE DISCLOSURE OF TAX AVOIDANCE SCHEMES REGIME - “DOTAS”

The DOTAS regime introduced in 2004 requires promoters of certain types of tax avoidance schemes, or in some cases users of the schemes, to disclose them to HMRC. HMRC claim that the regime has been “highly successful”. This paper analyses the regime and considers claims as to its success in the light of the evidence that is available. It also raises a number of questions that require further investigation. This was designed to assist the NAO with its own investigations.

The DOTAS regime has two objectives:

- Information Objective: DOTAS ensures that HMRC become aware of potential avoidance as early as possible. It thus supports some of the forms of anti-

avoidance intervention discussed in Paper 1. By informing HMRC about transactions which fall in category A in Paper 1 (Ineffective Avoidance), DOTAS aims to allow HMRC to challenge such transactions quickly. DOTAS also brings transactions which fall in category B (Effective Avoidance) to HMRC's attention, allowing them to initiate a legislative response to counter them.

- Deterrence Objective: It is a positive outcome if DOTAS deters transactions which clearly fall under category A. Deterring category B transactions by the prospect of speedy legislation could also be positive but deterrence in this category could raise some issues. If the DOTAS regime starts to deter normal commercial and family transactions that would be upheld as valid in the courts, this would be a step too far.

Issues in design of the regime:

- In the light of these objectives, paper 2 considers whether the disclosure regime strikes the right balance between under and over-inclusiveness, to ensure adequate detection without undue cost to taxpayers or overload for HMRC making it harder to spot transactions they would have wished to counter.
- The paper also considers whether the disclosure regime is itself easily avoided.

Evaluation and questions:

- HMRC view DOTAS as being "highly successful". In its last section the paper seeks to evaluate DOTAS's impact on the basis of publicly available information. Unfortunately, the available information is limited making it hard to be certain whether HMRC's claims are substantiated.
- Overall, there is some anecdotal evidence and some limited statistical evidence, to support the view that the DOTAS regime is having a measure of success but HMRC's claims that this is highly successful have to be set against the frequency with which DOTAS is being amended to make it more robust against avoidance, which suggests some concern as to its scope and operation. Further information is required to make a more meaningful assessment. An appendix to the paper lists a number of questions which seek to elicit information towards this end. Questions are asked seeking information to assess the calibration of the regime, to assess compliance with the regime and to assess the impact the regime has had. Examples:
 - DOTAS allows HMRC to challenge transactions. To have a better sense of how successful it has been in this regard the paper suggests that the NAO should ask for the number of disclosures that led to litigation, the success rate in such litigation and the amount of tax recovered as a result of the litigation.
 - A frequently repeated claim is that DOTAS has closed off around £12.5 billion in avoidance opportunities. The paper asks for information as to how this estimate is made.

Paper 3: THE TAX GAP FOR CORPORATION TAX

The Tax Gap has become an important issue in the public debate on avoidance. HMRC provide an estimate of the tax gap, which they define as “the difference between tax collected and the tax that should be collected”. This paper focuses on a limited part of the tax gap as measured by HMRC, namely that for Corporation Tax.

There are issues with the behaviour being measured by HMRC in its tax gap estimates. In particular, the tax gap includes transactions which courts find to be compliant with the law (category B in Paper 1). Whilst they comply with the courts’ interpretation of the intention of Parliament (narrow parliamentary intention as discussed in Paper 1), these transactions do not comply with HMRC’s interpretation of the intention of Parliament (a colloquial concept of parliamentary intention as discussed in Paper 1), and are thus included in the tax gap. This exercise might be useful for HMRC’s internal purposes; however, it is deeply misleading to suggest that this behaviour represents non-compliance or a failure to pay tax which is due.

Apart from raising fundamental questions about the behaviour being measured, the paper also notes a number of technical issues about the methods employed in the estimation exercise.

HMRC estimates three separate tax gaps, for: businesses dealt with by the HMRC Large Business Service; other large and complex businesses; and small and medium enterprises. The paper attempts a comparison of the estimated tax gap for these different groups, however, this is difficult due to a discrepancy in the data on the underlying liabilities of each group.

An appendix to the paper considers a completely different approach to measuring the tax gap of corporations. This approach compares the difference between accounting profit declared in financial statements with taxable profit [the “book-tax gap”]. The major and fundamental problem with this approach is that the tax base for corporation tax differs from measures of profit in financial accounts. The book-tax gap thus necessarily reflects, at least to some extent, the deliberate differences between the definitions of profit for accounting and tax purposes.

One estimate of the tax gap using the book-tax difference claims that the largest 700 companies in the UK avoid £12 billion p.a. – roughly eleven times the comparable tax gap estimated by HMRC. Even if one were to set aside the general conceptual issues with the book-tax gap method highlighted above, this particular estimate is extremely problematic. The methodology used makes unreasonable assumptions, which undermine the results even on its own terms.