

PAPER 2

THE DISCLOSURE OF TAX AVOIDANCE SCHEMES REGIME

Oxford University Centre for Business Taxation

3rd December 2012

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>

Table of Contents

1. Paper Objective
2. DOTAS Regime Outline
3. Publicly Available Information on DOTAS
4. DOTAS Regime Objectives
 - i. Information Objective
 - a. Challenge/Litigation
 - b. Legislative Intervention
 - c. Administrative Intervention
 - ii. Deterrence Objective
5. Critical Issues
 - i. Is DOTAS calibrated correctly?

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.

- a. Calibration: general issues
 - b. The calibration of DOTAS
 - c. Evidence
 - ii. Is DOTAS easily avoided?
 - a. Information powers
 - b. User information
 - c. Finance Act 2010 package
 - d. Reasonable Excuse
 - e. Conclusion
- 6. Measuring DOTAS' Impact
 - i. Information Objective
 - a. Challenge/Litigation
 - b. Legislative Intervention
 - c. Administrative Action
 - ii. Deterrence Objective
 - iii. Conclusion

Appendix 1: Questions

Appendix 2: Major landmarks in the development of DOTAS

1. PAPER OBJECTIVE

We have been requested by the NAO to produce a paper examining the Disclosure of Tax Avoidance Schemes (DOTAS) regime. Our sources have been primary sources such as legislation and case law, government and HMRC publications, practitioner publications and journal articles. In addition we have conducted discussions with business and practitioners engaged in the work of bodies which represent the tax professions.

This paper analyses the DOTAS regime and considers claims as to its success in the light of the evidence that is available. Accompanying papers examine the question of tax avoidance and the context for the DOTAS legislation (Paper 1) and the tax gap (Paper 3).

The task for this paper is to evaluate the DOTAS regime. In order to do this the ideal would be to assess the impact of the DOTAS regime on collection over time by examining trends in revenue and in the tax gap but in our view it is unlikely that the impact of DOTAS could be isolated sufficiently to put any reliable figure on this impact. There are many other legal factors which are operating in parallel to the DOTAS regime to change the amount of revenue collected over time, including other legislative and case law changes over the relevant period, as well as significant economic variations as well as societal and culture changes. Together these can be seen as creating a trend away from the most artificial

forms of tax avoidance in the commercial sphere, especially with public companies. Anecdotal evidence suggests that High Net Wealth individuals continue to be sold schemes. One person we consulted noted that the tighter the rules ‘the wackier the schemes’. In other words, whilst some react by greater compliance, others consider it a challenge to defeat the new rules. There are known advisers who work in this space. Many more conservative practitioners are puzzled at why these firms and individuals have not been the subject of a more sustained attack by HMRC.

The DOTAS regime is a relatively new addition to HMRC’s armoury.³ Rather than seeking to make certain forms of behavior ineffective to save tax, it works by increasing transparency which supports the different approaches towards tax avoidance such as challenge/litigation, counteracting legislation and administrative action. DOTAS may also have a more general deterrent function. As explained in the accompanying tax avoidance paper (Paper 1), DOTAS is actually a misnomer under some definitions of avoidance, because it not only addresses transactions and schemes that could be successfully challenged in the courts, but also reveals activity that might succeed in the courts if challenged, though it may be that the government is likely to wish to take steps to prevent such behaviour in the future.

The DOTAS regime was introduced in the UK in 2004 following disclosure regimes then in existence, particularly that in the United States.⁴ Similar mandatory disclosure schemes are also in operation in Canada, Portugal and Ireland. The Canadian regime is currently under review.⁵ Her Majesty’s Revenue and Customs (HMRC) claim DOTAS as a successful part of their multi-pronged strategy for dealing with tax avoidance. In 2011, for example, Dave Hartnett, then Permanent Secretary for Tax, described DOTAS as “...our key and crucial tool for dealing with avoidance.”⁶ However, assessing the success of anti-avoidance measures presents several difficulties, which we shall describe below. We also suggest, in Appendix I, some areas where further information is needed if a proper evaluation is to be made.

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 a highly successful have to be set against the

³ Further new developments in other jurisdictions which justify more study include: promoter penalties, especially penalties linked to disclosure rules; additional financial reporting requirements; the co-operative compliance programme; and the use of questionnaires. It would also be useful to undertake comparative work with disclosure regimes adopted in other jurisdictions.

⁴ Inland Revenue, “Regulatory Impact Assessment – Tackling Tax Avoidance – Disclosure Requirements”, 2004, p. 2 [IR 2004]. See also, OECD, “Tackling aggressive tax planning through improved transparency and disclosure”, February 2011.

⁵ Centre for Tax Policy and Administration, OECD, “Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure”, February 2011 (OECD 2011).

⁶ House of Lords Select Committee on Economic Affairs, 4th Report of Session 2010–12 The Finance Bill 2011, HL Paper 158, 17 June 2011, p. 33.

frequency with which DOTAS is being amended to make it more robust against avoidance, which suggests some concern as to its scope and operation.

2. DOTAS REGIME OUTLINE

The DOTAS regime introduced in 2004 essentially requires promoters of certain types of tax avoidance schemes, or in some cases users of the schemes, to disclose them to HMRC. The regime has been subject to several changes in its brief existence. The scope of the regime has been broadened gradually so it now covers the whole of Income Tax, Corporation Tax, Capital Gains Tax, and certain arrangements relating to Stamp Duty Land Tax and Inheritance Tax. The regime also applies, with necessary modifications, to National Insurance contributions and Value Added Tax. Unless otherwise stated this paper refers to the main regime which applies to Income Tax, Corporation Tax and Capital Gains Tax. The conditions for the schemes related to other taxes have been tailored to the characteristics of those taxes. Changes have been introduced over the years which have gradually broadened the requirements of the regime and there are proposals currently being consulted upon which will make further changes in the 2013 Finance Act.

Under the current regime for Income Tax, Corporation Tax and Capital Gains Tax⁷ a “notifiable arrangement” or a “proposal for an arrangement” (as defined) must be disclosed to HMRC within five days of certain triggers. The disclosure, which includes some explanation of how the scheme is intended to work, is generally to be made by “promoters” of a scheme. In practice, promoters are accountants, solicitors, banks and financial institutions and small firms of specialist promoters known as “tax boutiques”.⁸ In certain circumstances, such as where the scheme was developed internally, the promoter is resident outside the UK or the promoter is unable to provide relevant information to HMRC because of legal privilege, the scheme must be disclosed by the user. Unless lawyers are “marketing” schemes, they are only obliged to disclose schemes if a client unambiguously waives legal privilege.⁹

An Income Tax, Corporation Tax, Capital Gains Tax scheme is to be disclosed if:

- i. it will, or might be expected to, give a taxpayer a tax advantage, and
- ii. the tax advantage might be expected to be the main benefit or one of the main benefits of using the scheme, and
- iii. the scheme falls within one of a number of descriptions contained in regulations (often referred to as “hallmarks”)

⁷ The regime for the other taxes is similar but contains a number of modifications.

⁸ HMRC, “Lifting the Lid on Tax Avoidance Schemes - Consultation Document”, 23 July 2012, p. 31, [HMRC 2012].

⁹ On this issue see The Law Society, “Disclosure of Tax Avoidance Schemes”, 11 May 2011, available at: <http://www.lawsociety.org.uk/advice/practice-notes/disclosure-tax-avoidance/>

Other taxes have other conditions suited to their own characteristics.

Once a disclosure is made by a promoter, HMRC allocate a Scheme Reference Number (SRN) to the scheme, which is passed on by the promoter to its clients who intend using the scheme. Clients who use the scheme must report the SRN and other information to HMRC generally on their tax return. Promoters must also provide HMRC quarterly “client lists”, being lists of clients to whom they issued an SRN. Failure to comply with these various obligations attracts a penalty.

BOX 1

The rules on DOTAS are found in a number of Acts and Regulations.

The primary legislation is found in Part 7 of Finance Act 2004 (as amended).

The regulations include:

- The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations – SI 2006/1543 (as amended)
- The Stamp Duty Land Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations –SI 2005/1868 (as amended)
- The Tax Avoidance Schemes (Promoters and Prescribed Circumstances) Regulations – SI 2004/1865 (as amended)
- The Tax Avoidance Schemes (Penalty) Regulations 2007 - SI 2007/3104 (as amended);
- The Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2011 - SI 2011/170
- The Tax Avoidance Schemes (Information) Regulations 2012 - SI 2012/1836
- The National Insurance Contributions (Application of Part 7 of the Finance Act 2004) Regulations 2012 - SI 2012/1868.

Further information on the operation of the regime can be found in HMRC’s Guidance: “Disclosure of Tax Avoidance Schemes”, February 2012.

It is crucial to note that neither the requirement to disclose, nor indeed, disclosure itself, in any way affect the validity of a scheme in the eyes of the law.

3. PUBLICLY AVAILABLE DATA ON DOTAS

This section summarizes the data compiled by HMRC and made available to the public. Much of this data is discussed further at different points in the paper. The data offers interesting glimpses into the operation of DOTAS and allows a general view to be formed. In many respects, however, it is insufficient to allow for a proper assessment of the regime.

A list of questions aimed at eliciting the data required to make a fuller assessment is found in Appendix 1.

i. Number of Disclosures¹⁰

The following tables are reproduced from HMRC, “Disclosure Statistics: Data for the period from 1 August 2004 to 31 March 2012”. It is important to note that they show the total number of individual schemes reported and attempt to eliminate multiple disclosures of the same scheme, but some of the schemes may be similar to each other and be focused on the same legislation.

¹⁰ A new set of statistics was published in November 2012 to cover the period to 20 September 2012. In this latest set the column showing the total number of disclosures has been removed. For this reason, the previous tables are reproduced here. These statistics can be found at: <<http://www.hmrc.gov.uk/avoidance/stats.pdf>>

a. Direct Tax Disclosures

			Financial	Employment	Main Regime & NI Hallmark	SDLT	IHT	Total
Total								
To 31 March 2006			434	191	0	485	n/a	1,110
To 31 July 2006			451	198	0	517	n/a	1,166
To 30 September 2006			451	198	34	560	n/a	1,243
To 31 March 2007			463	198	125	670	n/a	1,456
To 30 September 2007			463	198	206 (12 N)	706	n/a	1,573
To 31 March 2008		**	465	198	330(23 N)	740	n/a	1,733
To 30 September 2008			465	198	379(24 N)	754	n/a	1,796
To 31 March 2009			465	198	432 (25 N)	768	n/a	1,863
To 30 September 2009			465	198	484(29 N)	800	n/a	1,947
To 31 March 2010			465	198	548(31 N)	829	n/a	2,040
To 30 September 2010			465	198	592(38 N)	833	n/a	2,088
To 31 March 2011			465	198	645 (41 N)	850	n/a	2,158
To 30 September 2011			465	198	695 (54 N)	858	1	2,217
To 31 March 2012		p	465	198	762 (58 N)	863	1	2,289
Financial Year								
1 August 2004	31 March 2005		340	163	0	0	n/a	503
1 April 2005	31 March 2006	a	94	28	0	485	n/a	607
1 April 2006	31 March 2007		29	7	125	185	n/a	346
1 April 2007	31 March 2008	**	2	0	205 (23 N)	70	n/a	277
1 April 2008	31 March 2009		0	0	102 (2 N)	28	n/a	130
1 April 2009	31 March 2010		0	0	116 (6 N)	61	n/a	177
1 April 2010	31 March 2011		0	0	97 (10 N)	21	n/a	118
1 April 2011	31 March 2012	p	0	0	117 (17 N)	13	1	131

b. VAT Disclosures

			Listed	Hallmark	Total
Total					
To 31 March 2006			388	383	771
To 30 September 2006			406	401	807
To 31 March 2007			428	408	836
To 30 September 2007			442	409	851
To 31 March 2008			452	413	865
To 30 September 2008			460	417	877
To 31 March 2009			462	419	881
To 30 September 2009			465	422	887
To 31 March 2010			469	424	893
To 30 September 2010			474	427	901
To 31 March 2011			477	429	906
To 30 September 2011			477	431	908
To 31 March 2012		p	480	433	913
Financial Year					
1 August 2004	31 March 2005		341	339	680
1 April 2005	31 March 2006		47	44	91
1 April 2006	31 March 2007		40	25	65
1 April 2007	31 March 2008		24	5	29
1 April 2008	31 March 2009		10	6	16
1 April 2009	31 March 2010		7	5	12
1 April 2010	31 March 2011		8	5	13
1 April 2011	31 March 2012	p	3	4	7

ii. Legislative Intervention

- DOTAS has informed 60 measures in Finance Acts.¹¹
- Legislation has been changed in relation to the following number of disclosed schemes:¹²

	<i>No.</i>
1 June 2005 - 31 May 2006	224
1 June 2006 - 31 May 2007	177
1 June 2007 - 31 May 2008	104
1 June 2008 - 31 May 2009	40
1 June 2009 - 31 May 2010	15
1 June 2010 - 31 May 2011	9

iii. Compliance

- 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.¹³
- By the December 2006 HMRC had identified over 100 entities where there was evidence of involvement in promoting schemes of a type that it would have expected to be disclosed, but had not been.¹⁴
- 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

¹¹ HMRC 2012, p. 7.

¹² This data results from a written answer by the Exchequer Secretary to the Treasury, David Gauke MP. The written answer was originally given on 19 October 2011 [Official Report, 19 October 2011, Vol. 533, c. 967-8W] and was corrected on 17 April 2012. Available at <http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120417/corrtext/120417c0001.htm>

¹³ HMRC, "Responses to the Consultation Document The Tax Avoidance Disclosure Regime: Improving the Scheme Reference Number System", 28 May 2008, p. 16, [HMRC 2008].

¹⁴ HMRC, "Ensuring Compliance with the Tax Avoidance Disclosure Regime", 18 December 2006, p. 15, [HMRC 2006 A].

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.¹⁵

- 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).¹⁶
- In 2008 the compliance rate of scheme users recording their SRNs as required was estimated at 60%.¹⁷
- As at May 2008, HMRC received disclosures from, and issued SRNs to, a pool of around 450 promoters, all of which it described as “businesses”.¹⁸
- Between May 1 2010 and October 19 2011: 78 promoters disclosed schemes under DOTAS.¹⁹

iv. Impact

- The Exchequer Secretary has stated that DOTAS “closed off £12.5 billion in avoidance opportunities”.²⁰

4. DOTAS POLICY OBJECTIVES

A recent consultation document lists 3 policy objectives for the DOTAS regime:

- “to provide early information to HMRC about tax avoidance schemes to allow the risk they pose to be assessed, and to inform legislation to close loopholes;
- to identify the users of those schemes to inform HMRC’s compliance work;
- to reduce the supply of avoidance schemes by altering the economics of avoidance, reducing the returns to promoters and users as schemes are closed down more quickly”.²¹

We can divide these into two categories: (i) the information objective and (ii) the deterrence objective.

¹⁵ HMRC 2008, p. 16.

¹⁶ HMRC 2008, p. 15.

¹⁷ HMRC 2008, p. 14.

¹⁸ HMRC 2008, p. 18.

¹⁹ Ibid. The question asked to the Exchequer Secretary to the Treasury is not entirely clear: “how many promoters HM Revenue and Customs (HMRC) has required to disclose tax avoidance schemes since May 2010”. It might have been directed at the use of the information powers introduced in Finance Act 2007 discussed in section 5 (ii)(a) below.

²⁰ David Gauke MP, “Where next for tackling avoidance”, speech by Exchequer Secretary to the Treasury on 23 July 2012.

²¹ HMRC 2012, p. 31.

i. The information objective

DOTAS aims to reduce some of the obvious information asymmetries between taxpayers and revenue authorities. The information acquired through DOTAS is useful for at least three reasons.

- First, it ensures that a potentially offensive scheme does not go completely undetected. As the Inland Revenue (HMRC's predecessor) explained at the time DOTAS was introduced:

“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.”²²

- Secondly, it ensures that HMRC become aware of schemes as early as possible thus allowing them to react expeditiously. As HMRC explained:

“HMRC generally has powers to open enquiries into tax returns, but not to enquire into schemes themselves. For income tax and corporation tax the filing date of the return is many months after the end of the period to which the return relates. So it may be long after an avoidance scheme has been implemented before HMRC can learn about a scheme by receiving returns and opening enquiries into them.”²³

- Thirdly, DOTAS facilitates information aggregation thus making it easier for HMRC to determine how many schemes an individual taxpayer is undertaking and also how widespread a scheme is. This helps inform HMRC's decision as to how to respond to the scheme.

The information disclosed under DOTAS can be used by HMRC in addressing avoidance through one of the three routes listed below. It is in this sense that the DOTAS regime can be said to have a primarily supportive role.

a. Challenge / Litigation

Schemes that purport to avoid tax might not actually do so on technical grounds [if so they would fall under category A – Ineffective Avoidance - in the classification adopted in Paper 1). DOTAS ensures that HMRC become aware of these schemes thus allowing them to decide whether they would like to challenge the validity of the schemes under the law, if need by proceeding to

²² IR 2004, p. 1.

²³ HMRC, “Regulatory Impact Assessment – The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543) and The Tax Avoidance Schemes (Information) (Amendment) Regulations 2006 (SI 2006/1544)”, p. 1, [HMRC 2006 B].

litigation.

Using the information received through DOTAS towards this end did not appear to be a priority when the regime was introduced.²⁴ However, in a recent consultation document, HMRC noted, that:

“[m]ore robust legislation has led to both a reduction in the quantity and ‘quality’ of avoidance schemes being marketed. Fewer schemes are now being sold and more are being challenged operationally, rather than through a change in the law, because it is clear that they do not work and simply do not deliver the tax advantages advertised by those who promote them.”²⁵

“HMRC wants to know about such schemes so that it can challenge the users operationally”.²⁶

b. Legislative intervention

The information provided through DOTAS can reveal defects or other failures in the way existing legislation is written which can only be corrected through legislative intervention (these could be exploited by transactions which fall under Category B – Effective Avoidance – in the classification adopted in Paper 1).²⁷

Specific legislation in response to particular schemes can often lead to complexity and length of legislation and piecemeal rather than well designed reforms. The increased complexity may even create new opportunities for avoidance as advisers can use the carefully drafted provisions to achieve a result other than that intended. The UK tax system already suffers from these characteristics and dealing with avoidance by responding with specific legislation as a response to a DOTAS disclosure, is not helping to improve the design of the system. An influential report noted that DOTAS has contributed to “an increasingly fragmented and reactive system” which “both the government and taxpayers appear to recognise ... is not a sustainable approach going forward”.²⁸ Detailed legislation and Targeted Anti-Avoidance Rules (TAARs) “have generally been carried out on a reactive basis: as and when HMRC becomes aware of unacceptable tax avoidance, the legislation is modified or a TAAR is introduced. As a result, the tax legislation has become extremely long and complex”.²⁹

²⁴ Rebecca Bland, “Hallmarks and the direct tax disclosure regime”, (2006) *British Tax Review* 653, p. 664 [Bland 2006].

²⁵ HMRC 2012, p. 6.

²⁶ HMRC 2012, p. 13.

²⁷ Recent examples include sections 22 (Treatment of the receipt of manufactured overseas dividends), 23 (Loan relationships: debts becoming held by connected company) and 46 (Plant and machinery: long funding leases) of Finance Act 2012. The Explanatory Notes accompanying these three provisions when first presented in draft form all explain that they are meant to stop avoidance schemes which had been disclosed under DOTAS.

²⁸ Tracey Bowler, “Countering Tax Avoidance in the UK: which way forward”, Institute for Fiscal Studies TLRC Discussion Paper No. 7, (February 2009), para. 2.9

²⁹ *Ibid.*

These are arguments for using legislative intervention as a way to combat avoidance sparingly, and not to do so if there is a strong case that can be litigated (i.e. a strong case that the transaction falls under category A).

Ideally tax systems would be designed in such a way that fewer legislative repairs were needed. This would need to start with good clear tax policy and arguably also involve methods of drafting, such as principles based and or purposive drafting, which would leave fewer possibilities for avoidance. It might also be said by some to require a general anti-avoidance rule (GAAR), as has now been proposed by the UK government for probable introduction in the Finance Bill 2013. If the GAAR is introduced the aim will be for it to catch some of the transactions which might currently be disclosed and which might be difficult to litigate against successfully. If the GAAR does cover these transactions, they will cease to be effective and this reduces the need of legislative intervention in dealing with disclosed schemes (the GAAR would thus move some transactions which are currently in category B to category A). This does, however, depend on the GAAR being given full effect by the courts and on HMRC being prepared to rely upon it rather than introducing specific legislation and a belt and braces exercise. These approaches are discussed further in Paper 1.

Even if there is some specific legislation on which HMRC believes it could rely, it may decide to pursue legislative intervention. Litigation can be uncertain and take time, so that the decision to legislate can be understood.³⁰ Nevertheless there are downsides to using legislation to respond to schemes in addition to increasing the length and complexity of the legislation as noted above. These are that:

- prospective legislation will not affect the disclosed arrangements
- anti-avoidance legislation can have unintended consequences, including the creation of new avoidance opportunities
- by addressing a scheme through legislative change the impression is given that schemes targeting similar legislative provisions which have yet to be changed are valid at law.

No doubt this explains why not all the schemes disclosed result in changes to legislation. This may be a perfectly sensible strategy: it may be more effective and desirable to litigate against some of these schemes (and of course some may prove to be unobjectionable). There seems to be a reduction in the percentage of

³⁰ For a recent example see the Explanatory Note accompanying the amendment concerning manufactured overseas dividends introduced in Finance Act 2012. The Draft Explanatory Notes explain: "An avoidance scheme has recently been disclosed in which it is claimed that any tax for which DTR is denied should be treated as income tax and eligible for relief or repayment. It is not accepted that the scheme has the effect claimed. However the Government is changing the MOD tax rules with effect from 15 September 2011 to put it beyond doubt that any tax for which DTR is denied is not to be treated as income tax." HMRC, "Manufactured Overseas Dividends: Anti-Avoidance", 15 September 2011.

schemes disclosed resulting in legislation. If this is true, it may be because HMRC feels confident that it has other tools with which to deal with some of these later schemes.³¹

At times HMRC both challenge an arrangement on the ground that it does not comply with the law (i.e. it falls under category A) and also intervene legislatively to ensure that such arrangements are not successful at law going forward. This strategy raises similar issues to those discussed above, in particular the creation of further complexity in the legislation and concomitant unintended consequences.

In some circumstances it might be deemed necessary to defeat disclosed schemes through retrospective legislation. Such interventions are likely to be employed only in exceptional circumstances.³² A more likely approach would be that an announcement would be made that legislation would be introduced in the future but would take effect from the date of the announcement. In this way, by having notice of an arrangement soon after it is offered by a promoter to a client, it is possible that HMRC might be able to make a legislative intervention before the scheme was actually implemented, thus rendering it ineffective. In some cases it might not be possible for legislative intervention to take place before a particular arrangement is implemented; however, having early warning of the arrangement allows legislative intervention to take place before the arrangement is adopted by other taxpayers. Another possibility is that the tax benefit resulting from the arrangement may be of a continuing nature and, therefore, legislation could cut short the life of the arrangement.

c. Administrative intervention

Risk management techniques allow revenue authorities to allocate resources according to risk. They are becoming increasingly popular and are approved by the OECD. Arguably the process of risk rating also provides benefits to taxpayers who are low risk as they enjoy less intrusion in their affairs; thus there is an incentive for taxpayers to become low risk.³³ Disclosures under DOTAS could play a role in providing information for risk rating purposes.

ii. The deterrence objective

The deterrence objective follows on from the information objective. A taxpayer might be deterred from entering into a scheme if he believes it will not stand up

³¹ J. Kaffash, "Taxman more secure against tax avoidance schemes" *Accountancy Age*, 27 Oct 2011.

³² This possibility is acknowledged by HMRC in its Guidance: HMRC, "Guidance: Disclosure of Tax Avoidance Schemes, August 2011 para 2.2. See Philip Baker, "Retrospective tax legislation and the European Convention on Human Rights" 2005 *British Tax Review*, 1, 1-9 and Anthony Sealy, "Retrospective taxation: earlier debates", House of Commons Library, SN04369, 18 July 2012.

³³ See for example HMRC, "Tax Compliance Risk Management Manual" available at <http://www.hmrc.gov.uk/manuals/tcrmanual/index.htm>.

to challenge by HMRC, if he believes HMRC will shut down the scheme legislatively before it is implemented or if he believes it will negatively affect his risk profile, with the consequences that follow. In such circumstances, DOTAS can have a deterrent effect. More importantly, DOTAS might have the effect of deterring promoters from creating and marketing schemes, because they know that they will have a short shelf life and will not be as lucrative as they once were. On the other hand, this may have the effect in some cases of pushing up the price of the schemes rather than deterring their creation. Anecdotal evidence suggests that some promoters view the DOTAS regime as a challenge and react to every new provision by trying to get around it, much as they do with substantive tax provisions. This does seem to be the behavior of a minority, and not of the larger and more established law and accounting firms, but the numbers are hard to assess without more data.

The deterrent effect of DOTAS raises a number of questions which are briefly discussed in section 5 i. below.

5. CRITICAL ISSUES

Regimes that provide revenue authorities with timely information about potentially abusive schemes are of undoubted utility.³⁴ They have a place in the modern armoury of a revenue authority committed to the reduction of avoidance activity. However, disclosure regimes do raise a number of issues. To properly assess a particular regime, one must have a closer look at its detail to determine how these issues are dealt with.

i. Is DOTAS calibrated correctly?

a. Calibration: general issues

The success of a disclosure regime is contingent on its scope being set correctly. In Paper 1 we discuss what is meant by avoidance and the different descriptions of it. Suffice it to say here that a disclosure regime needs to cover a wider range of transactions than those that could be successfully challenged under current law (i.e. transactions under category A). It needs to catch transactions which could withstand a challenge under current law, and which the revenue authorities might thus wish to counter through a change in the law (i.e. transactions under category B).

Care must be taken, however, not to extend too far into the category of transactions that could withstand a challenge under current law. This is for two reasons. First, although neither the requirement to disclose nor disclosure itself affects the validity of a transaction before the law, DOTAS could have the consequence of deterrence. A taxpayer might not pursue a disclosable transaction which he believes to be in line with the law because of fears that it might result in a more robust approach by HMRC in his regard. Whilst this is one

³⁴ OECD 2011.

of the objectives of the regime, and might be thought of as a good outcome in the case of certain transactions that the possibility of new legislation or challenge through litigation might deter, it could be in tension with the right to rely on tax legislation.³⁵ It would be particularly worrying if it deterred normal, commercial or family tax planning (transactions which might fall only under category C in the classification adopted in Paper 1), in so far as it cast doubts over the transaction or increased its cost. That could begin to affect the certainty and competitiveness of the tax system.

The second problem with over-inclusion is a practical one. It might seem sensible to err on the side of more rather than less information, thus ensuring the regime covers all transactions the authorities would be interested in, even if a few others which they are not interested in are also caught. This would, however, be counter-productive. Not only would costs increase for taxpayers, with all the negative consequences that would bring about, but just as importantly, the revenue might be swamped with disclosures of unobjectionable transactions. Given that there are limited resources to process such material speedily, the disclosure regime would become a less useful tool and the purpose of the regime might be defeated.

Designing a regime which strikes the right balance between over and under-inclusiveness is thus not without difficulty. We turn to the UK disclosure regime to assess how this balance is struck.

b. The calibration of DOTAS

The UK disclosure regime for Income Tax, Corporation Tax and Capital Gains Tax employs two tests to determine which transactions require disclosure. Arrangements are notifiable if they:

“enable, or might be expected to enable, any person to obtain an advantage in relation to any tax that is so prescribed in relation to arrangements of that description, and

are such that the main benefit, or one of the main benefits, that might be expected to arise from the arrangements is the obtaining of that advantage.”³⁶

This test is broad. It does not merely catch arrangements that enable taxpayers to obtain a tax advantage but also those that *might be expected* to do so. The tax advantage need not be the main benefit that arises or might be expected from the arrangement but merely *one of the main benefits* and whether this is the case is

³⁵ The principle that a taxpayer is entitled to arrange his tax affairs in any way that complies with the law was set out in *IRC v. The Duke of Westminster* [1936] A.C. 1, at pp. 19-20. This principle has never been overruled although its application has been modified by later case law as explained in Paper 1 and will be subject to the GAAR, when that is introduced. A similar underlying principle to that in the Duke of Westminster’s case can be found in most jurisdictions, although almost always modified by a GAAR or similar.

³⁶ Finance Act 2004, s. 306 (1) (b) and (c).

to be determined on an objective basis.³⁷ Tax advantage is also defined broadly in section 318 of Finance Act 2004.³⁸ The definition used here draws on definitions found in other parts of tax legislation³⁹ which have been interpreted by the courts in a number of cases. In their guidance HMRC refer to the points emerging from these cases and explain that they expect section 318 to be construed widely.⁴⁰

This test acts as a first filter for the regime. Given its breadth it allows a fair number of unobjectionable transactions through. For example, a husband who has used up his capital gains tax allowance transfers assets pregnant with capital gains to his wife, so that she can dispose of them and utilise her own allowance. This transaction will pass through the first filter – the transaction had as one of its main objectives a tax advantage, namely the utilisation of both husband and wife’s capital gains allowance. However, this is a ‘scheme’ which has been deliberately allowed to married couples by section 58 of the Taxation of Chargeable Gains Act 1992 (TCGA). As well as not being abusive (quite the opposite, it is exactly what was envisaged by statute), it is also extremely common (due to being entirely legal and politically acceptable).

Thus although the first filter serves to remove some clearly unobjectionable arrangements from the ambit of the regime, a second test is required to narrow down the ambit of the regime further. The second test is that the arrangement must fall within the ambit of one of a number of descriptions of arrangements, known as hallmarks.⁴¹ The hallmarks for the main regime, which are found in secondary legislation,⁴² are:

- wishing to keep the arrangements confidential from a competitor
- wishing to keep the arrangements confidential from HMRC
- arrangements for which a premium fee could reasonably be obtained
- arrangements that are standardised tax products
- arrangements that are loss schemes
- arrangements that are certain leasing arrangements
- arrangements for certain pension benefits⁴³

The hallmarks narrow down the arrangements which satisfy the first test considerably. They leave within the scope of the regime arrangements that, either because of their particular characteristics or the area of law they relate to, suggest to the authorities that they *might* be objectionable. As noted above, whilst erring towards over-inclusiveness might be justified, there are noted dangers in going too far. In their Guidance HMRC allude to the difficulty entailed

³⁷ HMRC Guidance 2012, op. cit., p. 29. This is in line with case law on similar provisions. See, for example, *Crown Bedding v IRC* 34 TC 107 and *Marshall Castings v IRC* 34 TC 122.

³⁸ Section 318 Finance Act 2004.

³⁹ ITA 2007 s. 687 and CTA 2010 s. 732.

⁴⁰ HMRC Guidance, p. 28.

⁴¹ Finance Act 2004, s. 306 (1) (a).

⁴² The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543).

⁴³ This hallmark is effectively now redundant. See HMRC 2012 p. 19.

in calibrating this second test properly. They acknowledge that the test might be over-inclusive, and thus arrangements will be caught by the hallmarks which HMRC do not find objectionable.⁴⁴

Whilst possibly over-inclusive, the hallmarks are currently deemed to be under-inclusive too. They have been amended on previous occasions and a 2012 Consultation Document proposes further changes:

“HMRC has identified a number of avoidance schemes which have not been disclosed because they are outside the existing hallmarks, or at least the matter is not free from doubt.”⁴⁵

The Consultation Document explains, for example, that a number of schemes which HMRC would have expected to have been disclosed under hallmark 1 (confidentiality when promoter involved) have not been disclosed because some promoters interpret the tests laid down in the hallmark differently to HMRC. The Consultation Document thus proposes changes to the hallmark to make it clear that such schemes are disclosable.⁴⁶

The DOTAS regimes for other taxes have similar problems, even though they do not use these hallmarks. So, for example, the SDLT and IHT regimes have an exclusion from the disclosure requirement where there is ‘grandfathering’ or what is known as the ‘old technology’ exception. Schemes are exempted from the disclosure requirement if they either fall within a list or were first made available before a certain date by any promoter, for implementation. In the case of SDLT, there has now had to be a carve out from the grandfathering rules for certain schemes involving sub-sales,⁴⁷ but experience suggests that promoters may find other ways to use the grandfathering rules that remain intact to their advantage.

HMRC are conscious of the need to update the hallmarks to keep abreast with market developments which result in objectionable transactions falling outside their ambit and thus the regime.⁴⁸ Placing the hallmarks in regulations allows them to be altered with greater ease than if they were found in primary legislation. There is then, however, the danger of a cat and mouse dance taking place over the hallmarks or other tests found in the regimes for other taxes, which simply shifts the anti-avoidance activity from the substantive law to the DOTAS regime and exhibits all the same problems.

⁴⁴ HMRC Guidance, p. 31. It also interesting to note that a recent proposed change to the hallmarks was deferred partly because of concerns expressed during the consultation that they were too wide and thus would catch “a significant amount of ordinary tax planning.” HMRC 2012, p. 14.

⁴⁵ HMRC 2012, p. 13.

⁴⁶ HMRC 2012, pp. 14-16.

⁴⁷ The Stamp Duty Land Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) (Amendment) Regulations 2012

⁴⁸ HMRC Guidance, p. 31. “It is expected that the range of hallmarks will change over time, such as to test perceived changes in the avoidance market place or the effectiveness of an anti-avoidance measure.”

c. Evidence

In a 2006 document HMRC argued that:

“To date, both the number and quality of disclosures received indicate that the regime is targeting tax avoidance *without affecting legitimate tax planning*. HMRC has not received significant numbers of unnecessary “safety-first” disclosures, which some commentators had predicted.”⁴⁹

The claim that “legitimate tax planning” was not affected by DOTAS appears to have been overstated here. Indeed, it is somewhat inevitable for there to be transactions which are caught by the regime but are not deemed objectionable by HMRC. As seen, HMRC now admit to the possibility of over-inclusiveness in their Guidance. The difficulty is establishing the extent of over-inclusiveness.

As of March 2012 there have been 3302 disclosures but DOTAS is said to have informed only 60 measures in Finance Acts. Also, in the period 1 October 2005 to 31 March 2011 there were 1,312 disclosures however the number of schemes in relation to which legislation was changed in the period 1 June 2005 to 31 May 2011 was 569.⁵⁰

At first glance these figures might be deemed indicative of over-inclusiveness. The seemingly low number of legislative measures relative to the number of disclosures made and the percentage of disclosed schemes in relation to which no legislative change was made could be taken to mean that a considerable number of disclosures concerned legitimate tax planning. However these figures do not necessarily lead to this conclusion:

- A measure might have been informed by more than one disclosure, since many schemes may utilize similar ideas and the same legislation. This may give a different complexion to the number of measures which have been informed by DOTAS;
- Disclosed arrangements which are deemed to be avoidance by HMRC might have been challenged rather than countered legislatively;
- Disclosed arrangements which are deemed to be avoidance by HMRC might have involved low sums of tax and thus were deemed not to warrant intervention.

To properly assess the extent to which the regime is over-inclusive it would be useful to have information on these issues.

The total number of disclosures made is not, of itself, very informative. There is

⁴⁹ HMRC 2006 B, pp. 2-3 (emphasis added).

⁵⁰ Written answer by the Exchequer Secretary to the Treasury, as corrected on 17 April 2012. The available data does not allow a comparison over identical time periods.

no objective scale against which one can easily determine whether this amount is high or low. However, a high number of disclosures could be indicative of a number of issues. It could indicate that the regime is over-inclusive catching a considerable amount of legitimate tax planning. The scope of the regime might be uncertain or the penalties might be too high thus leading to many unnecessary disclosures driven by caution. Finally, it could indicate that promoters and taxpayers are willfully disclosing more than they should so as to overload the revenue authority thus rendering the job of identifying avoidance more difficult. Whilst it is hard to determine whether the number of disclosures is too high, one notes that HMRC have not raised the issue of overdisclosure, unlike the Internal Revenue Service in the United States.⁵¹ Blank notes that in the United States:

“Government officials have frequently discussed the overdisclosure problem in presentations at meetings of corporate tax directors, bar associations, and other public events, pleading publicly with those in attendance to reduce their overdisclosure of ordinary business transactions.”⁵²

ii. Is DOTAS easily avoided?

In 2006, soon after the introduction of the regime an HMRC document noted:

“There is a risk that the disclosure regime could simply ratchet up the tendency for promoters to create ever more complex schemes intended to avoid anti-avoidance measures themselves. But HMRC does not believe that this has been the outcome. Rather, various strands of intelligence and information strongly suggest that there has been a sharp decline in marketed tax avoidance schemes.... HMRC’s assessment is that disclosure has been an important contributory factor to that decline, although clearly there are others in play (e.g. corporate governance issues).”⁵³

However, in the same document HMRC explain that:

“The available evidence indicates that those weaknesses have contributed to the non-disclosure of a number of schemes of the type that the regime was intended to capture.”⁵⁴

As a result, a number of changes were proposed to make the disclosure rules more robust against avoidance. Since then, the rules have been revisited on several other occasions. On each occasion HMRC express their satisfaction with the regime but acknowledge the need to make it more resistant to avoidance.⁵⁵

⁵¹ See Joshua Blank, “Overcoming overdisclosure: toward tax shelter detection”, 56 *UCLA Law Review* (2009) 1629 [Blank 2009]. Blank (at p. 1643) notes, for example, that for the tax years 2005 and 2006 the New York State Department of Taxation and Finance received over 28,000 reportable transaction disclosure statements from individual and corporate taxpayers.

⁵² Blank 2009 p. 1670.

⁵³ HMRC 2006 B, p. 3.

⁵⁴ HMRC 2006 B, p. 4.

⁵⁵ See HMRC 2006 B, pp. 3-4; HMRC, “The Tax Avoidance Disclosure Regime: Improving the Scheme Reference Number System”, 20 November 2007, pp. 6-7 and 20[HMRC 2007 A]; HMRC,

Some of the changes related to the hallmarks. These changes were in response to concerns that the hallmarks were under-inclusive, thus missing arrangements HMRC would find objectionable. Other changes related to different aspects of the regime. Three examples are considered very briefly here.

a. Information powers

Finance Act 2007 vested HMRC with a number of powers to be employed when they believe that a disclosable scheme has not been disclosed or only partially disclosed.⁵⁶ They include the power to apply to the tribunal asking for a scheme to be declared notifiable.⁵⁷ A tribunal will make such an order if it is satisfied that HMRC have taken all reasonable steps to establish whether the scheme is notifiable and they have reasonable grounds for suspecting that the scheme is notifiable. By virtue of this section, therefore, a scheme becomes notifiable not only if it falls within the scope of the regime, but also if HMRC have reasonable grounds to suspect that it does.

These changes were meant to address the concern that a “significant minority” of promoters was not complying with the regime.⁵⁸ It was estimated that they would yield “£15 million in 2007/08 and £30 million a year thereafter arising through several broad effects.”⁵⁹ It is not known if that estimate has been checked but there is reason to doubt the effectiveness of this particular set of powers. As has been noted,⁶⁰ for these powers to be exercised HMRC must have information about arrangements which have not been disclosed. In cases where no disclosure is made at all, it is not entirely clear, how this information will be acquired to allow for these powers to be exercised. By the time they do know of the scheme, HMRC might feel that it is better to spend its resource on attacking the scheme itself. It would be valuable to know whether there is any instance, and if so how many, of HMRC using these powers. Interviewees were not aware that they had done so.

b. User information

Finance Act 2008 introduced a number of changes to the regime relating to the Scheme Reference Number (SRN).⁶¹ HMRC explained the rationale for these changes in the following terms:

“Disclosure of Tax Avoidance Schemes (DOTAS) Consultation Document”, 9 December 2009, p. 6 [HMRC 2009]; HMRC 2012, pp. 6-7 and 11.

⁵⁶ Finance Act 2007, section 108. See Rebecca Bland, “Finance Act notes: disclosure of tax avoidance schemes – section 108” (2007) *British Tax Review* 584.

⁵⁷ Finance Act 2004 s. 306 A.

⁵⁸ HMRC 2006 A, para. 3.2. HMRC could find about schemes it suspected were disclosable only when it opened enquiries into the tax returns of taxpayers who used the schemes, however as HMRC noted “this is a long and uncertain process and at best the delay subverts the purpose of disclosure – to obtain information *early*.” *Ibid.* para. 3.6.

⁵⁹ HMRC, “Regulatory Impact Assessment for ensuring compliance with the tax avoidance disclosure regime – Technical Note and Draft Tax Clause”, 2007, para. 37, [HMRC 2007 B].

⁶⁰ Bland 2006.

⁶¹ See Lynne Oats and David Salter, “Finance Act notes: disclosure of tax avoidance schemes – section 116 and Schedule 38”, (2008) *British Tax Review* 505.

“[d]espite 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”.⁶²

HMRC explained that their analysis suggested the existence of disclosable schemes which were not disclosed and disclosed schemes which were not reported by users. The compliance rate in terms of scheme users recording their SRNs as required was estimated at 60%. The new rules were expected to improve this percentage and they were estimated to have a positive Exchequer impact of £20 million per year by improved compliance on avoidance.⁶³ However, in a later consultation document HMRC explained that despite the changes introduced in Finance Act 2008 two weaknesses remained in the system. It did not provide estimates of the new compliance rate merely noting that “ it was estimated that the 2008-2009 improvements to the SRN reporting system would improve SRN reporting to 90%.”⁶⁴ This new consultation led to an obligation being imposed on promoters to provide periodic client lists in Finance Act 2010.⁶⁵

Again, however, this does not seem to have fully addressed concerns in this area. A fresh consultation on DOTAS was launched in July 2012 which highlighted areas of concern, including these client lists.⁶⁶ The consultation document explained, once again, that further changes are required to ensure that HMRC receive sufficient information to identify end users.

There may also be a need to check the technology used by HMRC to ensure that all returns giving an SRN are picked up. In a recent case it was found that a tax return giving an SRN was not investigated on time due to administrative errors and because the SRN had been given it was held by the tribunal to be too late for HMRC to re-open that case.⁶⁷ This is an instance of DOTAS actually proving to be an impediment if not used properly by HMRC, although the result for the taxpayer in this particular case is not unreasonable.

c. Finance Act 2010 package

Finance Act 2010 introduced a package of measures, including an enhanced penalty regime, which had been considered but rejected in earlier consultations. The Impact Assessment for this package of measures estimated the increased yield from improved detection to be in the region of £25 m for 2010/11 and £50 m per year thereafter. It also estimated that the measures “will protect revenue

⁶² HMRC 2008, p. 15.

⁶³ HMRC 2008, p. 14.

⁶⁴ HMRC 2009, p. 14.

⁶⁵ Now section 313 ZA Finance Act 2004. See Lynne Oats and David Salter, “Notes on the Finance Acts: section 56 and Schedule 17 of the Finance Act 2010: disclosure of tax avoidance schemes” (2010) *British Tax Review* 458.

⁶⁶ HMRC 2012, pp. 10-11.

⁶⁷ *Charlton and two Others v HMRC* [2011] UKFTT 467 (TC) discussed at <http://blog.rpc.co.uk/tax-law/is-the-tide-turning-hmrc-lose-discovery-assessment-appeal#page=1>

in the region of £200m per year”.⁶⁸ It would be helpful to know if HMRC believe that these estimates have proved to be correct. A 2012 consultation document explained that:

“[h]igher penalties and increased powers have been helpful in securing compliance from certain promoters. But others do not disclose and HMRC then becomes involved in a protracted enquiry in order to establish that the scheme was discloseable.”⁶⁹

As a result, once again, further measures are currently being considered with the objective of ensuring that “those persons, primarily promoters, who are required to disclose a tax avoidance scheme meet their obligations and at the correct time”.⁷⁰

d. Reasonable Excuse

The 2012 Consultation Document on DOTAS reveals HMRC’s persisting concerns with compliance with the regime. Indeed, one of HMRC’s objectives in the consultation is “to ensure that those persons, primarily promoters, who are required to disclose a tax avoidance scheme meet their obligations and at the correct time.”⁷¹ The Consultation Document explains that a number of promoters are relying on the “reasonable excuse” defence to avoid compliance.

Section 118 of the Taxes Management Act 1970 provides:

“...where a person had a *reasonable excuse* for not doing anything required to be done he shall be deemed not to have failed to do it unless the excuse ceased and, after the excuse ceased, he shall be deemed not to have failed to do it if he did it without unreasonable delay after the excuse had ceased” (emphasis added)

If challenged promoters often rely on a legal opinion that the schemes were not disclosable in raising “reasonable excuse” as a defence for their failure to disclose. HMRC are clearly of the view that not all legal opinions can or should insulate promoters in this manner. Interviewees were aware of a few counsel who were prepared to take very bullish positions and this is not popular with the more conservative tax advisers who consider that it is unhelpful to the professions and that it undermines the level playing field for tax advisers. To put the matter beyond doubt the Government is considering raising the hurdle for a “reasonable excuse” in cases of failure by a promoter to disclose a scheme.⁷² They do not, at this stage, appear to be going as far as proposing promoters’ penalties, which are found for example in the USA, Australia and New Zealand.

e. Conclusion

⁶⁸ HMRC, “Impact Assessment of Strengthening and Revising the Disclosure of Tax Avoidance Schemes (DOTAS) regime”, 15 March 2010.

⁶⁹ HMRC 2012, p. 11.

⁷⁰ HMRC 2012, p. 11.

⁷¹ HMRC 2012, p. 11.

⁷² HMRC 2012, pp. 11-12.

HMRC produce publicly available data on the number of disclosures made. This number has fallen steadily since the introduction of the regime. As seen in 3(i) (a) above, the number of disclosures drops after an initial flurry of activity when the new regime is introduced. From a high of 607 in the financial year 1 April 2005 to 31 March 2006, the number of direct tax disclosures has fallen to 131 in the year 1 April 2011 to 31 March 2012. In the past 4 years the number of disclosures was 130, 177, 118 and 131.

This drop in disclosures could be due to a reduction in avoidance schemes. It could also be due to a correction after an initial period of cautious over-reporting or to avoidance of the regime. The frequency with which the regime has been altered to make it more robust against avoidance necessarily suggests that avoidance is part of the explanation. Indeed, Sue Walton, Head of the Anti-Avoidance Group at HMRC, is on record saying:

“[w]e also see people applying their ingenuity to getting round the disclosure requirement just as much as they do inventing tax avoidance schemes.”⁷³

The information currently available to the public is limited and patchy. Without more information, it is not possible to determine the extent of the problem. It would be helpful to know if HMRC believes its estimates of the impact of the different measures proved to be correct. It would also be helpful to have more general information on the measures introduced. For example: how often has HMRC employed the power introduced through Finance Act 2007 section 108 to ask for more information when a suspicion arises that a disclosure has not been made? When this power was exercised, how often was the arrangement found to have been disclosable and/or objectionable? How often have penalties been imposed? Such information would assist in getting a better picture of the extent of the problem and whether attempts at countering it have been successful.

6. MEASURING DOTAS' IMPACT

As of July 2012, it has been stated that DOTAS informed over 60 measures in Finance Acts⁷⁴ and “closed off” around £12.5 billion in avoidance opportunities.⁷⁵ Clearly HMRC view DOTAS as being “highly successful”.⁷⁶ Whilst anecdotal evidence might provide some support for this view,⁷⁷ it is not entirely

⁷³ House of Lords, Select Committee on Economic Affairs, 4th Report of Session 2010–12 The Finance Bill 2011, HL Paper 158, 17 June 2011, p. 33.

⁷⁴ HMRC 2012, p. 7.

⁷⁵ David Gauke MP, “Where next for tackling avoidance”, speech by Exchequer Secretary to the Treasury on 23 July 2012.

⁷⁶ OECD 2011.

⁷⁷ HMRC 2009, p. 6: “There is considerable anecdotal evidence that DOTAS has changed the economics of avoidance”; Richard Collier-Keywood, “Widening the disclosure regime”, *Tax Journal*, Issue 837, 11 (May, 2006): “There has undoubtedly been a change in behaviour in the market place...”

evident what the £12.5 billion actually represents or how the broader success of the regime is measured.

The difference between estimates of tax lost through avoidance before and after the introduction of DOTAS cannot be taken as a measure of tax collected as a result of the regime since other changes took place during this period.

As discussed in section 3 DOTAS has different objectives and supports different forms of intervention. It is useful to disaggregate DOTAS' impact through these different routes.

i. Information objective

Once HMRC receives the disclosed information it can pursue one of three routes.

a. Challenge/Litigation:

HMRC can challenge a scheme which, but for DOTAS, it might have missed. If the challenge is successful, tax will be collected which might otherwise have been avoided. The tax collected through this channel can be estimated.

b. Legislative Intervention:

Legislative intervention can prevent tax leakage through avoidance, however four different situations ought to be distinguished.

- If legislation is introduced between the promotion and implementation of a scheme, the amount of tax saved through legislative intervention informed by DOTAS can be estimated.
- If legislation is introduced to cut short the life of a scheme, the amount of tax saved through legislative intervention informed by DOTAS can be estimated.
- If retrospective legislation is introduced after disclosed schemes are implemented the amount of tax saved through legislative intervention informed by DOTAS can be estimated.
- If prospective legislation is introduced after a scheme is implemented the legislative intervention would lead to tax being collected which might otherwise have been avoided, however one cannot estimate this amount with any certainty. Tax would be collected in this case because the legislative intervention ensures that the scheme does not become more widespread. Taxpayers who might have adopted the scheme are denied this possibility. Estimating this amount, however, requires assumptions to be made as to how many taxpayers might have adopted the scheme were it not shut down legislatively and how much tax they would have saved as a result. Furthermore, the taxpayers might simply adopt a variation on the scheme, meaning the amount of tax collected is not increased.

c. Administrative Intervention

The information collected through DOTAS can be used to improve the allocation of resources according to risk. This process might lead to improved compliance work by HMRC and thus a reduction in tax leakage through avoidance. The risk allocation process could also provide incentives to taxpayers to reduce the aggressiveness of their planning and thus enjoy the benefits of being low risk. The tax collected as a result of this administrative intervention cannot easily be estimated.

ii. The deterrence objective

Estimating the tax collected because arrangements were not undertaken requires several assumptions to be made. As noted the number of disclosures has fallen since DOTAS was introduced in 2004, however this need not necessarily be due to its deterrent effect.

iii. Conclusion

Certain effects resulting from DOTAS can be estimated but others cannot unless several assumptions are made. HMRC are not clear as to what the figure of £12.5 billion represents. As a start, it would be helpful to have more clarity on this figure. A 2009 Consultation Document appears to suggest that it represents tax “saved” through legislative intervention which stops the prospective use of schemes.⁷⁸ If this were the case, it would be helpful to know the assumptions made in reaching this figure. Sparse light is shed on the performance of the regime without knowing what these assumptions are.

Estimating the tax collected as a result of certain interventions, such as challenging schemes on the ground that they fall foul of the law, should pose less difficulty. These figures would be useful in assessing the impact of the regime.

⁷⁸ “DOTAS has proved to be highly successful and the Government has used information from DOTAS to introduce a range of anti-avoidance measures every year since 2004 - a total of 49 measures, closing off over £12 billion in avoidance opportunities. There is considerable anecdotal evidence that DOTAS has changed the economics of avoidance.” HMRC 2009, p. 6.

Appendix 1: Questions

The information publicly available at present does not allow for a proper assessment of DOTAS' impact. The information sought through these questions would help provide a more complete picture.

A. Calibration of DOTAS

1. How often has a measure in a Finance Act been informed by multiple disclosures? Are there figures showing disclosures linked to remedial legislation?
2. Has action ever not been taken following the disclosure of an arrangement on the ground that the tax at issue was not large enough to warrant an intervention?
3. If the answer to question 2 is yes, how often has this occurred?
4. If the answer to question 2 is yes, what was the amount of tax at issue in these cases?
5. Has action ever not been taken following the disclosure of an arrangement on the ground that it involved legitimate tax planning in the eyes of HMRC?
6. If the answer to question 5 is yes, how often has this occurred?

B. Compliance with DOTAS

7. A 2006 HMRC document referred to "a significant minority" of promoters not complying with DOTAS. How was this assessment arrived at?
8. How has the percentage of promoters who do not comply with DOTAS changed over the years? What are their reasons?
9. A 2008 HMRC document estimated that 60% of scheme users recorded their SRNs as required. How was this estimate made?
10. The 2008-2009 improvements to the SRN reporting system were estimated to improve SRN reporting to 90%. Was this achieved?
11. How has compliance with the reporting requirement changed over the years?
12. Impact Assessments often contain estimates of the increased yield as a result of proposed legislative changes designed to make DOTAS more robust against avoidance. For example, the package of measures introduced in Finance Act 2010 was estimated to produce an increased yield from improved detection in the region of £25 m for 2010/11 and £50 m per year thereafter. It was also estimated that the measures "will protect revenue in the region of £200m per year". How are these estimates made?
13. Impact Assessments often contain estimates of the increased yield as a result of proposed legislative changes designed to make DOTAS more robust against avoidance. How accurate have these various estimates proved to be?
14. How often has HMRC employed the power introduced through Finance Act 2007 section 108 to ask for more information or notifiability when a suspicion arises that a disclosure has not been made?

15. When the power mentioned in question 14 was exercised, how often was the arrangement found to have been disclosable?
16. When the power mentioned in question 14 was exercised, how often was an arrangement deemed to be avoidance in the eyes of HMRC?
17. When the power mentioned in question 14 was exercised, how often was action taken against such schemes, and what form did this take?
18. If the power mentioned in question 14 has not been exercised why was this the case?
19. How often have penalties been imposed?
20. If penalties were imposed, what was their magnitude?
21. Does HMRC systematically search for promoters who are not or arguably are not complying with their duties under DOTAS, for example through searches on the internet?

C. Measuring DOTAS' Impact

22. The 60 measures informed by DOTAS have “closed off” around £12.5 billion in avoidance opportunities. How is this estimate made?
23. How often have disclosed arrangements been challenged by HMRC on the ground that they fail as a matter of law without resorting to litigation?
24. What is the success rate of such challenges?
25. How much tax has been collected as a result of such challenges?
26. How many disclosures have led to litigation?
27. What is HMRC's success rate in such litigation?
28. How much tax has been recovered through such litigation?
29. How often has the disclosure of an arrangement led to both challenge/litigation on the ground that the arrangement fails as a matter of law and also legislation to block the arrangement going forward?
30. Has legislation been introduced between the promotion and implementation of a scheme?
31. If the answer to question 30 is yes, how much tax was recovered through such legislative interventions?
32. Has legislation been introduced to cut short the life of a scheme?
33. If the answer to question 32 is yes, how much tax has been collected through such legislative interventions?
34. Has retrospective legislation been introduced after disclosed schemes are implemented?
35. If the answer to question 34 is yes, how much tax has been collected through such legislative interventions?
36. Has HMRC produced estimates of the amount of tax which would have been lost through avoidance if prospective legislative measures informed by DOTAS had not been introduced?
37. If the answer to question 36 is yes, what are they and how were they made?
38. Has HMRC produced estimates of the amount of tax collected as a result of DOTAS' deterrent effect?
39. If the answer to question 38 is yes, what are they and how were they made?

Appendix 2: Major landmarks in the development of DOTAS

This appendix provides an overview of the development of DOTAS. It is not intended to provide an exhaustive account of amendments in DOTAS.

- 1st August 2004 – Finance Act 2004 Part 7 came into force, introducing DOTAS. The original DOTAS was targeted at two specific ‘scheme descriptions’ – those seeking to avoid taxation of employment income, and those seeking to avoid tax through the use of certain financial products - and applied to IT, CGT and CT. A parallel disclosure scheme was established for VAT which remains separate.
- 1st September 2004 – First amendment came into force, adding an additional filter to employment schemes.
- 14th October 2004 – Second amendment came into force, obliging clients protected by Legal Professional Privilege to disclose the scheme themselves.
- 1st August 2005 – A limited extension to DOTAS applying to schemes related to SDLT on commercial property worth at least £5mn came into force. It did not initially include the SRN system.
- August 2006 – The current ‘hallmark’ system was introduced, replacing the previous ‘scheme descriptions’ and extending DOTAS to all schemes relating to IT, CGT and CT.
- The Finance Act 2007 (FA 2007) gave HMRC a tranche of investigatory powers to combat non-disclosure, including powers to require promoters to disclose reasons for non-disclosure (along with supporting documents), and the power to apply to the Tribunal for an order that a scheme be treated as notifiable. The penalty for non-disclosure was also increased to a maximum £5,000 per day.
- FA 2007 also extended DOTAS to NICs
- The Finance Act 2008 (FA 2008) reformed the SRN system, requiring promoters and intermediaries to provide clients with their SRN. They only applied to IT, CT and CGT, not to SDLT.
- November 2008-April 2009 – The SRN procedure was simplified and extended.
- The Finance Act 2010 (FA 2010) empowered tribunals to impose penalties of up to £1mn on promoters for non-disclosure. FA 2010

empowered HMRC to demand information from 'introducers' of schemes involved in their marketing rather than execution.

- 1st April 2010 – the DOTAS rules for SDLT are more closely aligned with those for the other DOTAS schemes. DOTAS for SDLT is extended to residential property worth more than £1mn. The SDLT DOTAS scheme does not apply to schemes developed before 1st April 2010, which are 'grandfathered'.
- 1/1/2011 – minor revisions to hallmarks come into force. Promoters are required to provide quarterly 'client lists' to HMRC of those to whom they are required to issue the SRN.
- 6th April 2011 – DOTAS was extended to 'new or innovative' IHT schemes seeking to reduce the entry charge payable upon transferring property into trust. IHT schemes developed before 6th April 2011, or those 'substantially the same' as schemes developed before that date are 'grandfathered' and are thus not subject to disclosure requirements.
- September 2012- amendments to SDLT DOTAS to remove 'grandfathering' rules for schemes involving sub-sales and to remove the property valuation thresholds for disclosure.
- Proposed changes in 2012 Consultation Document:
 - The government has begun consulting on further reforms. Canvassed reforms include requiring more detailed disclosures and client lists, further investigatory powers to compel disclosure of other parties to a scheme, imposing a more stringent 'reasonable excuse' test, powers to impose more rigorous reporting requirements on promoters who incur a penalty, and imposing obligations upon end users to ensure DOTAS compliance by promoters in certain instances.
 - The consultation also considers the modification of existing hallmarks, the establishment of new ones targeted at specific schemes, offshore transactions, and specific parties, and the removal of the now redundant 'pensions' hallmark.