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Dear Sir

Re: Disclosure of Tax Avoidance Schemes (DOTAS)

We are grateful for the opportunity to comment on the above consultation document dated 9 December 2009.

By way of background, the City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Revenue Law Committee.

Our comments on the consultation document are as follows.

Preliminary

We understand the Government's desire to make rapid legislative change when it becomes aware of avoidance schemes. However, we would urge the Government not to lose sight of the importance of not overburdening UK business with complex compliance. The first line of defence against tax avoidance should be effective drafting of the relevant legislation in the first place. If this is achieved – and here we would emphasise the need to achieve this in the law, rather than (as too often) enacting widely drawn law and then reducing its scope by guidance – the scope for avoidance is greatly reduced. Conceptually, the DOTAS regime should be seen as a back up for when statutory drafting has failed. It is not, and should not be, the front line in the defence against avoidance.

The existing DOTAS regime has proved relatively trouble free to operate now it has bedded in. We do not feel it is unduly burdensome. Although there are some (probably inevitable) areas of uncertainty, HMRC's published guidance is in this case appropriate and helpful.

Most importantly, the existing rules coupled with the guidance in most cases make it fairly clear both whether a scheme is disclosable, and if so when it must be disclosed. Our view is that retaining this clarity is absolutely essential. Especially where it is also proposed to drastically increase penalties for non-compliance with the DOTAS regime, it is critical that all parties' obligations can be clearly identified.

Many of the proposed new measures are targeted specifically at abuses which can only arise with mass marketed schemes (eg the sudden implementation of a large number of schemes for pre-identified clients who were not previously told full details of them). Our view is that these specific measures (which we have identified in our comments below) should only apply to mass-marketed schemes. We wonder whether it might be appropriate to consider whether the wider DOTAS regime should apply to bespoke structures? Given that such structures are unlikely to lead to prioritised legislative change (since by their nature they are not readily repeatable) we wonder whether DOTAS has proved useful in such cases. Certainly from the practitioners' perspective, we find the most difficult questions in the operation of the DOTAS regime arise in relation to tax planning carried out as part of a wider set of transactional instructions.

We now turn to the proposed measures and questions raised in the consultation document. Please note that all comments are without prejudice to the possible effect of legal professional privilege on disclosure obligations.

Measure 1: a change to the time when a promoter must disclosed a marketed scheme to HMRC

Question 1: would the proposal be effective and prevent some promoters from organising schemes in a way that deliberately delays disclosure?

We would anticipate that the proposal would be effective. However, for the reasons set out below in the answer to question 2, we do not believe that it should be implemented in its current form due to the side-effects that would result.

Question 2: would the proposed earlier trigger for disclosure of a marketed scheme either (a) cause practical difficulties or (b) lead to a significant number of disclosures of schemes that are never implemented?

We think the proposal would have both these effects. As drawn, it does not merely have the effect of a timing change – it creates a substantive change in what must be disclosed. Under the current rules, with the most common trigger being "making the proposal available for implementation", there is no disclosure obligation until a scheme considered workable by the promoter has been put to a client (HMRC's guidance refers to the promoter having a "high degree of confidence in the tax analysis").

As currently drafted the proposal will require disclosure prior to this point. If a promoter tells his client that he has had the germ of an idea, and although it needs work it may lead to a tax saving, that would appear to be a "marketing contact" – especially given the extremely wide formulation of "communicating the general nature of the proposal" - and so at that point if the promoter has "prescribed information" (likely, given the width of the definition, even in a relatively undeveloped scheme), a disclosure obligation will be triggered.

This would appear unhelpful to all parties. HMRC will inevitably receive disclosures of outline schemes which either (a) are ultimately determined by their promoters to be technically ineffective, or (b) are technically effective but give rise to insurmountable commercial issues which make them unimplementable. HMRC will need to evaluate these disclosures in considering whether to legislate, and by their nature this will involve much more time and effort than is the case at present where disclosures are of fully formed schemes. And from the advisers' perspective it will be more difficult to determine whether disclosure is appropriate.

One solution might be to amend the new s.308(2)(za) FA 2004 to confine it to notifiable proposals which are capable of being made available for implementation. This would mean that promoters could not defer their disclosure obligations when they had fully formed schemes in relation to which they were deliberately withholding key elements from clients, but it would prevent the obligation to disclose arising at a time when it was still unclear whether any workable scheme would exist.

Additionally we are of the view that this measure should only apply to mass marketed schemes. The mischief against which it is targeted is the lining up of a large number of potential users of a new scheme and suddenly implementing it several times over – by definition this would never be a problem with a bespoke scheme. Limiting the measure in this way would mitigate many of the practical problems as a scheme launched in this manner would by definition be ready to use.

Measure 2: a power to require persons who introduce potential clients to a promoter to provide information about the promoter

Question 3: is the proposed power to require scheme introducers to provide HMRC with information about who provided them with the scheme a proportionate response to the problem described?

We are very concerned at any proposal which places responsibility for a person's compliance with tax legislation on any entity other than HMRC and the person in question. Our view is that such measures should only be implemented in extremely limited cases (we would highlight the various anti-money laundering rules, which although extremely burdensome for the professions, are at least targeted at high-level crime and therefore justifiable).

We do not believe that such a measure is a proportionate response to the problem identified. The construction and promotion of an avoidance scheme cannot be assumed to involve any breach of the law – it may involve a contestable interpretation of the law, but this is far from the same as evasion. If any tax rule is being breached such that this proposed measure might help it is presumably the promoter's obligation to disclose the scheme in question. HMRC already has enforcement powers in relation to this issue, and is proposing a significant increase in penalties for non-compliance (which as will be apparent below we support).

We believe that this measure should be shelved. At the very least, assuming that penalties for non-compliance with DOTAS are significantly increased as proposed, we consider that that measure should be given a chance to change behaviours before imposing duties on introducers in respect of the tax compliance of others.

Were the proposal to be adopted despite our reservations, we would make the following specific points in relation to the draft legislation:

- "Where HMRC suspect" at the outset of the new s.313C FA 2004 should be changed to "Where HMRC have reasonable grounds to believe", in order to bring it into line with the TMA 1970 standard for HMRC information powers.

- The wording at the end of s.313C(1) goes far beyond the definitions of "promoter" and "introducer". It should be narrowed so it only catches those persons.

- Is the reference to "proposer" in the draft s.313C(2) a typographical error for "promoter"? If not, what is intended?

We would also note the proposed s.307(1)(a)(ii) which would seem to include introducers within the definition of promoters. This does not appear to reflect the policy as described in either Measure 1 or Measure 2, since the Measure 1 policy discussion is silent as to introducers and Measure 2 appears intended to impose a lesser set of obligations on them than is the case for promoters. On the basis that including introducers within the definition of promoters goes beyond the stated policy objective, we would recommend deleting this provision.

Measure 3: increased penalties for failure to disclose a scheme

Question 4: would the model be effective in deterring promoters from delaying making a disclosure, or are there circumstances in which it would not be sufficient?

As a body representing City law firms it is difficult for us to comment in too much detail, as we do not believe that any of our member firms would deliberately disregard a tax obligation in order to obtain a commercial benefit in the manner which has been described. Sadly, however, we find it easy to believe that this is a problem which needs to be addressed.

Many studies of criminal behaviour indicate that even significantly increased penalties do not act as a deterrent in cases where wrongdoers do not believe that they will get caught. However, we do not consider that non-compliance with DOTAS is such a situation. There is a material chance that promoters will get caught where they are deliberately failing to make disclosures, since their clients will eventually start filing returns reflecting the implementation of schemes. At that point HMRC may pursue the issue.

In cases such as this we would expect non-compliant promoters to make a rough calculation of the expected cost of non-compliance, which (in pure mathematical terms) would be a multiplication of the perceived probability of being caught and the likely penalty if they are. Where such promoters are also members of professional bodies (such as accountants and solicitors) they would also have to factor in the likelihood of professional disciplinary action if they are shown to be deliberately non-compliant with tax legislation.

So in conclusion we think the measure would be effective as a deterrent as long as the potential penalties were sufficiently high that promoters could not run the risk of deliberate non-disclosure (even if, rightly or wrongly, they considered the risk of being caught to be quite small).

Question 5: do you agree that Option 2 is the preferable revised penalty format? If not, how should an objective penalty provision be expressed?

We agree that Option 2 is preferable. We think that defining an objective standard is likely to be impossible, and once subjectivity is introduced into the process it is essential that an independent tribunal is involved. This is key both because the potential amounts of penalties are large, and also because of the potential wider effects on promoters which are regulated by professional bodies of a finding of deliberate or reckless non-compliance with the rules.

We would support a measure which went further than that proposed in the following respect. If the Tribunal found on the facts, using the criminal standard of proof (ie "beyond reasonable doubt"), that a promoter deliberately decided not to disclose a scheme which it believed to be disclosable, we would suggest that it might be appropriate to have a second tier of penalties which were higher still than those proposed. We would also support the creation of a criminal offence of deliberate non-compliance with the disclosure rules if existing offences were felt insufficient.

Where deliberate non-compliance is involved it may also be legitimate to consider the possibility of penalising individuals as well as the legal entities acting as promoters. The new higher penalties will have little deterrent effect if individuals trade through companies with minimal assets against which HMRC can enforce, and are not part of regulated professional bodies so they would be able to resume business through a different entity if their company was bankrupted by a tax penalty.

Question 6: at what level should the increased penalty be set?

See discussion above. It should be high enough to have a deterrent effect taking into account the perceived likelihood of being caught. It might also be set at different levels depending on the flagrancy of the promoter's behaviour (eg not disclosing on advice from a lawyer is not as serious as receiving advice that a scheme must be disclosed and then ignoring it). We think it would be fair to consider penalties computed by reference to fees received for a scheme and/or tax saved (there will in any event commonly be a formulaic link between the two). Explicit criminal sanctions would also be a powerful deterrent.

Question 7: What safeguards could be added to make sure the penalty is not disproportionately high?

Requiring the Tribunal to rule on the penalty is the key. As noted above, it would in our view also be appropriate to legislate for different levels of penalty to arise on different levels of culpability.

Question 8: are there any of the DOTAS provisions that the enhanced penalty should not apply to?

We do not consider that it is appropriate to levy penalties at the enhanced levels for non-compliance with s.313A notices. Firstly, the question of whether a notice has been satisfactorily answered is to some extent subjective, and so the Tribunal would need to be involved to determine this point which could be burdensome for all parties. Secondly, if the s.313A notice stage has been reached, the existence of a scheme (though not its details) is known to HMRC and so the promoter must assume that when it is used the decision not to disclose it is likely to be challenged. The enhanced penalties for the basic failure to disclose should therefore have their deterrent effect in full.

Measure 4: promoters to provide HMRC with periodic information about clients to whom they have issued a scheme reference number

Question 9: do you agree that Option 2 is the preferable option for securing early information about scheme users?

We would be very concerned about this measure for the same reasons as that relating to introducers. We do not think as a general policy matter it is appropriate for any person other than a given taxpayer and HMRC to be held responsible for that taxpayer's affairs, other than in exceptional circumstances. We are concerned about any creeping increase in powers of this kind.

In practice we believe that HMRC should be able to see from the nature of a disclosed scheme whether it is likely to be mass marketable. We do not consider it appropriate to introduce what amounts to a new power to elicit information about a taxpayer from a third party in these circumstances if the motivation is simply to identify whether the scheme is widely used.

If an early warning power was to be introduced we would therefore much prefer Option 1, which places the burden upon the taxpayers themselves. We do not believe that this would be disproportionately burdensome, since a taxpayer could be advised of its responsibilities by the promoter at the time of scheme implementation and the notification to HMRC would be just another matter to be done in the course of implementing the scheme. Although unexpressed in the document, we wonder whether the real concern here is that many taxpayers would fail to comply?

Question 10: would there be any practical difficulties in providing client lists?

We doubt that this would be a significant issue, but as noted above we consider that Option 1 is preferable which would remove the necessity for this.

Question 11: are there any alternative ways of providing HMRC with the same information?

See answer to Question 9. We consider that HMRC already has the powers it needs to enforce rapid disclosure.

Question 12: what would be a reasonable time limit for the provision of initial and periodic lists?

As noted above, we do not consider that a regime which imposes the obligation to identify scheme users on promoters as opposed to users is appropriate.

Measure 5: revisions and extensions to the "hallmarks"

Question 13: can they identify any potential practical problems in complying with any part of the proposed changes?

The question of whether the DOTAS regime should apply to bespoke planning as well as mass marketed schemes is a very live question throughout the discussion of the proposed hallmarks. A material extension to the scope of disclosable schemes, as seems to be proposed in relation to employment schemes and income into capital schemes, will by its nature inevitably potentially catch many individualised arrangements. As noted in the preamble to these comments, this does not seem helpful to any party: from the taxpayer/adviser's point of view, much more time will need to be spent determining whether a given piece of planning is within the rules even where at first blush one would be confident it should be seen as legitimate planning rather than avoidance, and from HMRC's perspective, many disclosures will be received which are unlikely ever to lead to legislative change since they relate to non-readily-repeatable structures.

Generally therefore we would caution against making the definitions too wide if the policy decision is taken that the DOTAS regime should continue to apply to bespoke arrangements.

Question 14: would the new hallmarks and extensions be effective and proportionate?

The minor changes to the hallmarks regarding confidentiality seem to us uncontroversial.

We think the changes to the premium fee hallmark are unworkable, at least in relation to bespoke planning. In our City practices it is relatively unusual to receive instructions in relation to a specific, one-off piece of tax planning. Such planning most commonly arises as an aspect of a much larger commercial transaction, for which the tax piece will not be billed separately. As such it will be very difficult to determine how much of the fee paid is attributable to the tax planning, especially where (as is increasingly the case) we do not bill on a time basis but charge a fixed fee for the job.

We also very much doubt whether smaller enterprises whose business is tax planning would take such one-off instructions as a matter of course. Their business models rely on the mass marketing of schemes – they will invest time working on ideas which may or may not ultimately be concluded to work, and then sell the ones that pass the test to as many clients as possible as quickly as possible.

If a hallmark relating to fees is still considered necessary, we think that it should apply to arrangements where the fee is computed by reference to the anticipated tax saving and/or where the fee is conditional to any degree on the tax saving being delivered. This should be effective to damage the economics of the avoidance industry in the manner intended: relatively few clients are prepared to pay material fees up front for aggressive planning, preferring to wait to be sure the planning has been effective.

As noted above, we think that there is a real danger that the new income to capital hallmark and the widened employment hallmark will be disproportionate and problematic for both taxpayers and HMRC if applied to bespoke schemes as opposed to mass marketed ones.

We agree that the off-market terms hallmark should be deleted.

We think further work is needed on the drafting of the new regulation 12A relating to loss schemes. As drawn the regulation would catch an ordinary surrender of losses using group relief, or an intra-group transfer of a loss making trade within s.343 ICTA 1988: this cannot be correct. Should the target here not be schemes which enable the economic benefit of unrelieved losses to be enjoyed by entities outside the group of which the company with the losses is a member?

We are concerned at the proposals in relation to both standardised tax products and leasing schemes to amend the references to "the main purpose" to "a main purpose". We think this will lead to confusion.

In relation to a standardised tax product, we find it extremely unlikely that the tax saving will be anything other than "the" main purpose – if the scheme is standardised and marketed as such, then surely its only main purpose must be the tax saving?

Whilst we recognise that leasing has historically proved fertile ground for avoidance, it must also be acknowledged that leasing by its very nature usually has tax planning at its forefront. It is one of the few remaining areas of UK tax where the tax treatment diverges dramatically from the accounting treatment. As long as it remains policy to tax leasing in this way, it will inevitably be the case that securing tax benefits is a main purpose of many if not most leasing transactions. The tax treatment is one of the most common reasons for choosing a finance lease rather than a secured loan, and is explicitly sanctioned by statute. We believe widening the test in relation to leasing schemes will therefore be unworkable – HMRC should be looking to catch only those transactions where nothing would have happened at all but for the tax benefit (ie ignoring those cases where the lessee needed finance but chose to lease rather than to borrow), and the "the main purpose" test would seem as good a way as any to achieve this. Applying the "a main purpose" test will arguably catch every leasing transaction and so is not useful.

Question 15: what might the revised and extended hallmarks capture that ought to be excluded?

See above.

Yours faithfully,

David McIntosh
Chair
City of London Law Society

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

Individuals and firms represented on this committee are as follows.

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