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Attention: Julie Elsey.
HM Revenue and Customs, Counter Avoidance Group, 3C/04,
100 Parliament Street,
London SW1A 2BQ

By email to aag.consultation@hmrc.gsi.gov.uk

27th February 2014

Dear Sir

Revenue Law Committee response to the "Tackling marketed tax avoidance" Consultation Document (of 24 February 2014)

The City of London Law Society ("CLLS") represents approximately 15,000 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.

We welcome the opportunity to comment on the consultation document of 24 January 2014 entitled "Tackling marketed tax avoidance" and on the accompanying draft legislation. We will be restricting our comments to the proposals for accelerated tax payments in follower and other cases.

CONSEQUENCES OF FAILING TO TAKE ACCOUNT OF RELEVANT JUDICIAL RULINGS

Inappropriately wide definition of "tax arrangements"

In relation to HMRC's power to give a failure notice, condition B is that a return, claim or appeal is made on the basis that a "tax advantage" results from "tax arrangements" (draft Sch 1 para 1(3)). Arrangements are "tax arrangements", broadly, if obtaining a tax advantage is the main purpose, or one of the main purposes, of the arrangements. This

would apply to making an investment through an ISA, because an ISA is more advantageous from a tax perspective than the obvious comparator transaction (making the same investment outside an ISA) and obtaining the ISA's tax advantages will generally be at least one of the investor's main purposes in making the investment (*IRC v Trustees of the Sema Group Pension Scheme* [2003] STC 95). In our view, a definition of tax arrangements which is wide enough to apply to taking out an ISA is wholly inappropriate for an onerous, and potentially draconian, measure which (under threat of penalties) requires a taxpayer to pay tax which is not yet proved to be due but which HMRC considers is due by reference to a judicial ruling on similar facts.

It is imperative that this accelerated tax payments measure is confined to egregious tax avoidance (of the kind targeted by the GAAR) and does not, therefore, apply to any kind of acceptable tax planning. As the Exchequer Secretary says at the beginning of the foreword to the consultation document: "Aggressive tax avoidance is unacceptable". We would have no objection to this measure if it was confined to aggressive tax avoidance. It is not. Para 5.36 of the Summary of Responses (published on 24 January 2014 alongside the consultation document) says that the definition of "tax arrangements" will ensure that the measure is "properly targeted". It does not.

Of course, we are not saying that HMRC would ever open an enquiry, or seek a judicial ruling, in relation to a taxpayer making a normal investment in an ISA. We are merely saying that a test of tax arrangements which is capable of applying to an ISA (even in theory) is too wide for a measure requiring tax to be paid in advance of its being proved to be due.

The reason why HMRC would never open an enquiry, or seek a judicial ruling, in relation to a taxpayer making a normal investment in an ISA is that taking out an ISA is consistent with the statutory purpose of the ISA legislation. Parliament intends people to take advantage of the ISA tax reliefs so as to encourage savings. In our view, consistency (or, rather, inconsistency) with statutory purpose would be a suitable benchmark for testing the existence of tax arrangements in relation to the accelerated tax payments measure. We also believe that obtaining a tax advantage should be the main (not one of the main) purposes of the arrangements. We, therefore, suggest that the final words of draft Sch 1 para 2(4) (definition of "tax arrangements") should read:

> "... the obtaining of a tax advantage in a manner inconsistent with the principles on which the relevant tax provisions are based and their policy objectives was the main purpose of the arrangements".

Limited right of appeal against failure notices

If a taxpayer receives a failure notice that he or she believes is a flawed failure notice on the grounds (i) that the relevant reduction of tax or other tax relief in his or her tax return or under appeal does not arise from "tax arrangements", or (ii) that the final judicial ruling identified in the failure notice is not applicable to the relevant reduction of tax or other tax relief in his or her tax return or under appeal, the taxpayer does not appear to have any right to appeal to the tribunal against the failure notice on the grounds that it is invalid. This absence of a right of appeal seems to us to be a denial of a basic human right and is presumably intended to deter appeals (and, therefore, justice) in cases which HMRC regard as tax avoidance but which, as we argue above, may not involve any element of tax avoidance at all. Indeed, we would regard the absence of a right of appeal as a denial of a basic human right even if the definition of "tax arrangements" was narrowed in the way we suggest above.

If a taxpayer (i) receives a failure notice that he or she believes is flawed on one or other of the two grounds mentioned above, (ii) refuses to accept the judicial ruling or take the

necessary corrective action (whether or not following a request for reconsideration by HMRC), (iii) reluctantly pays the accelerated tax payment specified in the failure notice (as required by draft Sch 1 para 20(2)) on or before the due date (draft Sch 1 para 20(4)) (eg 31 January following the year of assessment), (iv) pursues an appeal in the tribunal in respect of the alleged tax arrangements, and (v) is successful in that appeal, we assume that the taxpayer will be repaid the accelerated tax payment with interest. This would seem to follow from the fact that the accelerated tax payment is treated as a payment of tax on account (draft Sch 1 para 20(3)). However, we think that the right to be repaid with interest the tax wrongfully charged should be made clearer, even if only in the Explanatory Notes.

We think it is wholly unacceptable that the above taxpayer should be denied the right to apply to the tribunal for postponement of the accelerated tax payment (draft TMA 1970 s.55(8B)-(8D)). This absence of a right to apply for postponement of the accelerated tax payment seems to us to be intended to deter appeals (and, therefore, justice) in cases which HMRC regard as tax avoidance but which, as we argue above, may not involve any element of tax avoidance at all. However, if the taxpayer had a right to appeal to the tribunal against a failure notice on the grounds that it was invalid and the definition of "tax arrangements" was narrowed in the way we suggest above (so that the measure only applies to egregious tax avoidance), we would agree that it was acceptable to deny a right to apply for postponement of the accelerated tax payment.

Repayment of penalties in case of successful appeal by taxpayer

If a taxpayer (i) receives a failure notice that he or she believes is flawed on one or other of the two grounds mentioned above, and (ii) refuses to accept the judicial ruling or take the necessary corrective action (whether or not following a request for reconsideration by HMRC), the taxpayer will be liable to stringent, tax-geared penalties (draft Sch 1 para 8(2)). Furthermore, if, based on that belief, the taxpayer declines (or is unable) to pay the accelerated tax payment specified in the failure notice, he or she will be liable to further stringent, tax-geared penalties (draft Sch 1 para 21).

If, again based on that belief, the taxpayer pursues an appeal in the tribunal in relation to the alleged tax advantage and is successful in that appeal, the taxpayer should be repaid the above penalties with interest. However, we cannot find anything in the consultation document or any provision in the draft legislation (or its explanatory notes) confirming that the taxpayer is entitled to a repayment of these penalties with interest in the case of a successful appeal against the underlying tax liability. If we are right, we would regard that as not just unacceptable but bordering on the unconstitutional. It would reinforce our concern that the entire regime smacks of an attempt to deter appeals (and, therefore, justice) in cases which HMRC regard as tax avoidance but which, as we argue above, may not involve any element of tax avoidance at all. Even if tax avoidance is involved, if the taxpayer wins the appeal, he or she should not incur any penalties and any which have been paid should be repaid with interest.

It is true that there is a right of appeal against the penalties introduced by this measure but, in a case where the taxpayer pursues an appeal in the tribunal in relation to the alleged tax advantage and is successful in that appeal, the penalties should be repaid automatically with interest without it being necessary to bring an appeal.

Calculation of the penalties

To the extent that the tax advantage specified in the failure notice consists of an unutilised tax loss, the value of the tax advantage for penalty purposes is 10% of the loss (draft Sch 1 para 11(2)(b)). We can see that, as the loss is unutilised, the penalty cannot

(yet) be tax-geared, but a penalty equal to a percentage of the loss seems to be wholly arbitrary and potentially punitive.

To the extent that the tax advantage specified in the failure notice consists of a tax deferral, the value of the tax advantage for penalty purposes is 25% of the deferred tax for each year of the deferral or, if less, 100% of the deferred tax (draft Sch 1 para 12). A penalty for a mere deferral of tax which, after 4 years, is equal to 100% of the deferred tax seems to be wholly arbitrary and potentially expropriatory.

PROPOSED EXTENSIONS OF THE ACCELERATED TAX PAYMENTS MEASURE

Extension of the accelerated tax payments measure to DOTAS schemes

We do not support the proposal that the accelerated tax payments measure should be extended to participants in tax arrangements which are notifiable under DOTAS. The scope of tax arrangements which are notifiable under DOTAS is as wide as that of tax arrangements under the basic accelerated tax payments measure, except that, in addition, one of various prescribed hallmarks must be present. These hallmarks do not confine DOTAS to aggressive tax avoidance.

We would accept the link to DOTAS if the link was conditional on the main purpose of the arrangements being the obtaining of a tax advantage in a manner inconsistent with the principles on which the relevant tax provisions are based and their policy objectives.

Extension of the accelerated tax payments measure to GAAR schemes

Para 4.17 says that the GAAR "aims to counteract the most abusive tax avoidance schemes". Whether it is in fact confined to abusive tax avoidance remains to be seen. We will not know the answer to that question until some cases reach the courts. Nevertheless, assuming that it is correct that the GAAR is confined to abusive tax avoidance, we would accept that linking the accelerated tax payments measure to the GAAR would be appropriate. However, in our view, the link should be conditional on:

- the taxpayer entering into tax arrangements to which the GAAR potentially applies (disregarding the possibility that some other challenge may be available to HMRC);
- HMRC referring that taxpayer and his or her tax arrangements to the Advisory Panel; and
- the Advisory Panel giving a unanimous opinion that the entering into or carrying out of the tax arrangements by the taxpayer is not a reasonable course of action.

Yours faithfully,

Bradley Phillips
Chair
The City of London Law Society Revenue Law Committee

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

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