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Dear Sirs

Revenue Law Committee response to the consultation document on strengthening the tax avoidance disclosure regimes

The City of London Law Society ("CLLS") represents approximately 14,000 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 on strengthening the tax avoidance disclosure regimes, and appreciate that the DoTAS regime is a key tool in tackling tax avoidance. However, the DoTAS regime has over the past few years come to serve two quite distinct purposes: one being the timely provision of information about tax planning to HMRC, and the other (more recently) being a label for identifying unacceptable tax avoidance, and attaching consequences to it. These two purposes pull in different directions when the decision has to be made about how widely the scope of DoTAS should be cast. Much of what is proposed in the consultation document focusses on the original purpose, and to ensure effective information gathering the net is to be cast wider.

The financial products hallmark

The focus of the City of London Law Society is predominantly on larger businesses, as it is those which typically form the greater part of the client base of our member firms. As such, in responding to the consultation document we have focussed on the aspect which we believe to be most relevant to our clients: the financial products hallmark.

While the current hallmarks are not perfect, they are workable and in practice cast the net of disclosure such that the impact of DoTAS does not impact business unduly. However, we cannot stress strongly enough our expectation that this new financial product hallmark will impose a significant burden on business.

The hallmark does not to any significant extent filter out acceptable tax planning. The third condition sets a low bar; a financial product that contains any term to achieve a particular tax result (such that it is unlikely that it would not have been entered into were it not for the tax advantage) could meet condition 3. Arguably an even lower bar is that set by the fourth condition; there must be a contrived or abnormal step without which the tax advantage could not be obtained. Putting "contrived" to one side, the word "abnormal" should be given its ordinary meaning, and may go so far as to cover any feature of the arrangements which would not have been used otherwise than to secure a tax relief, deduction or other advantage. A common example might be a loan note with a provision for currency conversion to achieve non-QCB status, or even choosing to finance with debt rather than equity (particularly if that debt includes provisions for, for example, PIK notes). To take tax advice and act upon it will often be enough to satisfy this condition. The fact that ISAs must be explicitly excluded speaks volumes.

This leaves only the second condition, the requirement that one of the main benefits of including the financial product in the arrangements is to secure a tax advantage, to filter out acceptable tax planning. One might think that because the main purpose test has been around for decades, the tax profession understands it and can readily apply it (and presumably the same goes for the main benefit test). All we can say is that the experience of our members is different, they can in practice be very difficult tests to apply except in the most simple of cases.

It is acknowledged that tests of this sort set a "low threshold" in the guidance on the general anti-abuse rule. In that context, it is the job of the double-reasonableness test to filter out tax planning which is not egregious. In the context of DoTAS, it is the job of the hallmarks to filter out tax planning that is acceptable. But given that the only substantive filter contained within the financial products hallmark is the main benefits test, it will be no more effective than the gate-way into DoTAS found at section 306 Finance Act 2004, and will not adequately filter out acceptable tax planning that passes through that gateway.

This is not surprising. Neither a main purposes test nor a main benefits test makes any attempt to distinguish between acceptable tax planning (for example, structuring one's affairs to benefit from a tax incentive as Parliament intended) and tax avoidance which is contrary to the "spirit" or "purpose" of the legislation in question.

Our recommendation would be to introduce a condition to the hallmark which can effectively distinguish between acceptable and unacceptable tax planning (as is the case for banks, that is the exclusion for arrangements that might reasonably be expected to be acceptable under the code of conduct). One option would be to incorporate the double-reasonableness test found within the general anti-abuse rule. As an alternative, the hallmark could incorporate a condition of the type contemplated at paragraph 2.44 of the consultation document for inheritance tax; i.e. that only arrangements which an informed observer could reasonably conclude are a tax avoidance scheme need be disclosed. A broad "white" list would also help.

Impact on business

Chapter 4 of the consultation document to an extent acknowledges that the breadth of disclosure may be a concern. Paragraph 4.8 states that:

> *"... it is possible that some arrangements may need to be disclosed which do not pose particular risks to the Exchequer."*

We believe that this significantly understates the position. Financial products are found in very many if not most commercial transactions, and for the reasons given above it will be inevitable that many of those transactions will include financial products satisfying Conditions 3 or 4 of the financial products hallmark. If the hallmark is introduced as drafted, businesses will therefore be faced with the question of whether their commercial transactions could satisfy the "main benefits" test time and time again. Tax advice will be required and businesses will be concerned about whether they ought to or could conclude that at least one main benefit of the arrangements is to obtain a tax advantage.

They will be faced with a stark choice between:

(1) not disclosing and running the risk of failing to comply with the DoTAS regime;

(2) disclosing and facing all of those disadvantages described below; or

(3) not proceeding with the transaction.

This cannot be a sensible position for businesses to find themselves in on a regular basis.

The dual purposes of DoTAS

At the beginning of this response, we identified the two distinct purposes of DoTAS. If the regime's sole purpose were the provision of information, then casting the net widely (beyond unacceptable tax avoidance) may be justified. Compliance costs would be a cause for concern, but importantly there should be no stigma or detrimental consequences attached to disclosing. This indeed was the position during the early years of the regime. Many disclosures were made on a "protective" basis. They had nothing to hide, and if there was any uncertainty over whether arrangements should be disclosed, then they were. The lack of stigma attaching to disclosure was acknowledged by HMRC. The guidance provided (and still does) that:

> *"[s]imilarly, we do not regard all arrangements that include or meet a hallmark description as practices that are unacceptable to us – whilst we have tried to keep burdens to a minimum, you may have to tell us about schemes that may not be considered to be avoidance."*

The second purpose, using disclosure as a label for identifying unacceptable tax avoidance, is apparent from the Government's policy on procurement and from the new accelerated payments measure. There is also another aspect to this. Many parts of the media can use (and indeed have used) disclosure under DoTAS as a simple and seemingly objective means of identifying businesses which are "tax avoiders". Understandably so; the regime is called "Disclosure of Tax Avoidance Schemes". "Tax Avoidance" is in its title. Today, the consequences of disclosure are a very real

disincentive to disclose. The quality of information provided to HMRC inevitably must suffer.

Much of the vernacular around DoTAS cements the perception that the regime is only relevant to tax avoiders. In the consultation document, "hard working people" are contrasted with "those who devise and promote tax avoidance schemes" and the users of those schemes. There may well be a perception within HMRC that DoTAS is only a concern for those promoting or using tax avoidance schemes. Perhaps this is because the majority of schemes disclosed are deemed to be unacceptable. However, this perception fails to appreciate the shadow which DoTAS casts over responsible businesses and their tax managers. They will need to consider whether all but the simplest tax planning is disclosable. For many of the clients that our members advise, doing business which could require disclosure is now simply not an option.

The financial product hallmark, because it does not attempt to filter out acceptable tax planning and will potentially apply to a very broad range of commercial transactions, will make this problem significantly worse.

Good administration

If the financial product hallmark is to be introduced in its current form, then the problem of tarnishing responsible businesses as tax avoiders must be addressed.

Chapter 4 proposes a solution being an improvement to the process for issuing and withdrawing SRNs; perhaps giving HMRC up to 90 days from disclosure to engage with the promoter before issuing an SRN. This would indeed be a step in the right direction; but in many cases 90 days is simply too long for commercial transactions. If businesses really must wait 90 days, then in many cases the commercial opportunity will be lost.

It would be very helpful for there to be a commitment from HMRC that reasonable endeavours will be taken to conclude whether an SRN will be issued or not within a much shorter time-frame; the shorter the better. The 90 day window can still be used as a long-stop by which an SRN must be issued.

An approach of broader disclosure should be accompanied by a wholesale sea change in the language used in relation to DoTAS. People who disclose should not be called "promoters" or "users" until an SRN is issued (and then only if the transaction nevertheless proceeds notwithstanding the issue of an SRN). Until then, they are taxpayers or tax advisors complying with the requirements for tax transparency. A "notifiable arrangement" is just that. Until an SRN is issued it is not yet a "tax avoidance scheme". The regime is about "disclosure and tax transparency", and its name should reflect that. For a business to say that it has on occasion complied with its obligations for disclosure and tax transparency is an entirely different proposition to saying that it has disclosed or used a tax avoidance scheme. It is very important that responsible businesses are not tarnished as tax avoiders.

If you have any questions in relation to our comments, or would like to discuss any of the points raised, please contact Simon Yates (partner, Travers Smith LLP) on tel. 020 7295 3414, simon.yates@traverssmith.com.

Yours faithfully,

Simon Yates
Chair
The City of London Law Society Revenue Law Committee

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

Individuals and firms represented on this committee are as follows.

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