appg Anti-Corruption & Responsible Tax

THE POLICY INSTITUTE

KING'S College LONDON

Ineffective tax avoidance: targeting the enablers

A policy paper from the All Party Parliamentary Group on Anti-Corruption and Responsible Tax[iii]

1 Foreword by Dame Margaret Hodge MP

In recent months we have faced the worst public health crisis in generations and an unprecedented shutdown to the economy. While the threat of COVID-19 may be lessening, question marks remain over how the Government intends to restore growth and maintain jobs. The challenge is not only to meet present needs but also rise to future aspirations. One thing is clear: to shoulder the fiscal burden of the coronavirus crisis, we must all pay our fair share. Now more than ever it is essential that we crack down on those that do not. It is absolutely the right time for us to be even tougher on aggressive tax avoidance, wherever it occurs.

Much revenue is lost from tax avoidance schemes that simply do not work. It is this tax avoidance of the most egregious kind with which this paper is concerned. We are not trying to start a witch hunt against honest advisers that make a mistake. We're not simply pursuing all those that breach the codes of conduct for a professional regulatory body. We're looking at the very worst end of the tax advice spectrum. The enablers of these failed tax avoidance schemes are breaking the law, plain and simple. It is this criminality that we aim to address.

The users of failed tax avoidance schemes may be pursued over time by HMRC and the courts, but those that devise and promote them rarely see any repercussions. People should only be achieving tax savings where they are confident, on a 'conservative' view of the legislation, that Parliament intended the saving. Yet unscrupulous individuals have long made a pretty penny by

enabling highly dubious tax avoidance schemes. Tax lawyers, accountants, banks, and advisers profit from this lucrative business but they are rarely held to account or penalised.

The way that the law is currently set out means that it is virtually impossible to prosecute these enablers of failed tax avoidance schemes, even when a criminal offence has been committed. Without documentary evidence to demonstrate their dishonesty, they can insist they believed their schemes would work and plead innocence. This paper demonstrates how, with a few simple legislative changes, the law can be strengthened so that the enablers of aggressive tax avoidance can more easily be prosecuted. We are seeking to stimulate a wide debate on the role of advisers in this sphere and we put forward two ideas.

First, we want to make it more practical for HMRC to prosecute enablers that break the law. A new threshold should be introduced for such criminal prosecutions. Instead of the existing test of proving dishonesty, there is an equally stringent threshold for penalising enablers in the civil law regime. This threshold, known as the GAAR 'double reasonableness' test, is not effective for the civil regime but would be more appropriate as a test for criminal prosecutions instead. The bar for criminal prosecution would remain high, but it would become practical and possible to pursue cases. One would expect this change in the law to act as a strong deterrent to those devising and marketing schemes that prove to be unlawful.

Second, we propose lowering the threshold for advisers under the civil law regime and toughening up the financial penalties. As it stands enablers simply lose the fee they earned from their incorrect advice. We propose lowering the threshold so that the civil penalties can be more easily applied and increasing the fines to more than just the fee earned in order to act as a further disincentive.

It is high time that the Government acted to curtail aggressive tax avoidance facilitated by lawyers, banks, accountants and advisers. They must tackle the exploitative enablers that profit while the public purse dwindles. By implementing the simple suggestions in this paper, the Government can demonstrate their determination to bear down on tax avoidance.

2 Introduction

Sometimes when tax avoidance is challenged by HMRC it is found by the courts to be effective and the taxpayer obtains their tax saving. In other cases the avoidance is found to be ineffective, and the tax is payable. In these latter cases, the tax professionals involved will have given incorrect advice as to the effectiveness of the scheme. This is often quite understandable: the application of the law to the facts is often uncertain, and so the mere fact that a tax avoidance scheme is found by the courts to be ineffective does not necessarily mean that the advisers were acting unscrupulously. There are some tax professionals, however, who *knowingly* recommend tax avoidance schemes which are ineffective.[1]

[1] See House Of Commons, Oral Evidence taken before the Public Accounts Committee, Tax Avoidance Schemes, Thursday 6 December 2012, questions 31-36, available at https://publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/uc788-i/uc78801.htm; see also J. Maugham, 'Weak transmission mechansism – and the boys who won't say no', 7 August 2014, available at https://waitingfortax.com/2014/08/07/weak-transmission-mechanisms-and-boys-who-wont-say-no/ and C. Quentin, 'Legal Opinion', in L. Seabrooke and D. Wigan, eds., *Global Wealth Chains*, Oxford: Oxford University Press, 2020 (forthcoming)

The problem of unscrupulous tax advisers promoting schemes they know to be ineffective goes beyond cases where people are conned into adopting them. Perhaps counter-intuitively, it also happens in cases where the client is well aware that the scheme does not work. This is because sophisticated taxpayers know that they can *argue* that these arrangements work. They are effectively daring HMRC to contest a resource-intensive tax appeal that could last years, potentially all the way to the Supreme Court, which it may well lose. In addition, a tax avoider that uses one of these schemes can also place a range of procedural impediments in the way of recovery of the tax: relying on limitation periods, for example, or arguing that the HMRC assessment is procedurally flawed. And this is to assume that HMRC finds out about the arrangement at all. If they do not (and the scale of this problem is unknown) then the avoidance succeeds by default, even though it is legally ineffective, without need for any further action by the tax avoider.

There is a flaw in the laws on abusive tax conduct which means that the unscrupulous advisers get away with it. This is not to say that the promotion of ineffective schemes is necessarily lawful. Indeed, as a matter of principle it is almost certainly a criminal offence to knowingly promote one. But in practice the applicable law does not act as a significant enough deterrent. There are two relevant legal regimes: (i) the common law offence of cheating the public revenue; and (ii) civil penalties for enablers of defeated tax avoidance schemes. It is to the defects in those regimes that this paper turns in the next section.

Before embarking on that discussion, it should be noted that some regulated tax professionals (although not all) are required by their regulatory bodies to act to a certain standard of professional probity with regard to tax avoidance.[2] In addition, the government is currently consulting on the efficacy of that regulatory environment.[3] This paper, however, is about a more focused topic. What is identified in this paper is a specific defect in the existing law applying to extreme cases; a defect which can readily be fixed.

3 The existing legal regimes

3.1 The criminal regime

The principal *criminal* offence that the enablers of tax avoidance could be charged with is the common law offence of cheating the public revenue.[4] In order for the offence to be made out, there has to be a finding to the effect that the defendant's conduct was dishonest. In other words, the defendant's conduct has to have been 'objectively dishonest according to the standards of ordinary decent people'.[5] An adviser promoting a scheme which they know to be ineffective would without doubt meet this standard. This offence is therefore potentially being committed every time an ineffective scheme is promoted. Such conduct is unlikely to be prosecuted, however.

This is because it is not generally possible to prove that the adviser really *knew* that the arrangements were ineffective. There is generally said to be a range of opinions as to the

[2] See for example the code of conduct promulgated by the Association of Tax Technicians and the Chartered Institute of Taxation, available here https://www.tax.org.uk/sites/default/files/180525-PCRT-FINAL-CIOT-2.pdf
[3] https://www.gov.uk/government/consultations/call-for-evidence-raising-standards-in-the-tax-advice-market
[4] Strictly speaking this is simply the common law offence of cheating, which has been abolished except insofar as concerns the public revenue: s.32(1)(a) Theft Act 1968
[5] *Ivey (Appellant) v Genting Casinos (UK) Ltd t/a Crockfords (Respondent)* [2017] UKSC 67

effectiveness of any given tax avoidance scheme amongst professional tax advisers. A defendant can therefore claim that they genuinely believed that the scheme could be effective.

HMRC does prosecute some cases of avoidance as criminal offences, but these are cases where the dishonesty is to be found on the face of the documentary evidence. For example, an avoidance case where 'reliance is placed on a false or altered document or such reliance or material facts are misrepresented to enhance the credibility of a scheme'.[6] In these cases which do get prosecuted, there is something visibly dishonest on the face of the documents – some crucial fact which has not been disclosed, for example. To be clear, this is not the kind of case with which this paper is concerned. This paper is about cases where everything is above board and seemingly lawful, except for the fact that the legal arguments relied on to give rise to the tax saving are not credible. It is not that this latter kind of case is less serious or harmful than the kind which gets prosecuted. The reason that these cases do not get prosecuted is because (in contrast to those cases where the dishonesty exists on the face of the documents) it is impossible to prove the crime has been committed. The legal arguments supporting the scheme may be utterly implausible, but the adviser can nonetheless simply claim that they believed them to be correct. The dishonesty is there in these cases, just as it is in the cases with false or altered documents, but it exists solely in the adviser's mind.

In summary, an adviser recommending a scheme which they know to be ineffective is completely safe from prosecution, even though they are committing a criminal tax fraud, provided that the documents are in order and full disclosure is made as and when required.

3.2 The civil regime

There also exists a regime of *civil* penalties for enablers of defeated tax avoidance schemes. This regime is, by contrast, suitable for catching the kind of case with which this paper is concerned. The regime is to be found in Finance (No 2) Act 2017, and broadly speaking what it does is impose penalties on the promoters and enablers of tax avoidance schemes which are found to fail. There are, however, elements of the regime that constrain its effectiveness. In particular:

(i) The financial penalty imposed by the civil regime is limited to the fee that the enabler or adviser received for the promotion of the scheme.[7] There is therefore no financial downside for tax advisers potentially engaging this regime except the risk of (effectively) going unpaid for their time spent promoting or enabling the scheme. This downside is an inadequate deterrent to the kinds of activity with which this paper is concerned. The tax industry is extremely lucrative and so the fee that tax advisers stand to earn (i.e. in the event that the avoidance goes unchallenged), is a huge potential upside. The potential downside of mere wasted time is in comparison disproportionately small.

(ii) In order for the civil regime to apply, any avoidance scheme must not only fall within the definition of 'tax arrangements' contained in the legislation; they also need to be 'abusive'. 'Abusive' here has (in essence) the same meaning as it has in the General Anti-Abuse Rule ('GAAR') i.e. it is the so-called 'double reasonableness test'. According to this test the arrangements are abusive if, and only if, they 'cannot reasonably be

[6] https://www.gov.uk/government/publications/criminal-investigation/hmrc-criminal-investigation-policy; for an (extremely rare) example of such a prosecution of a tax professional, see *R v Charlton and others* [1996] STC 1418

[7] Para 15 Sch 16 FA (No2) 2017

regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances'.[8]

This hurdle is notoriously high. It is not just that the arrangements need to be unreasonable; they need to be so unreasonable that it would be unreasonable to think that they were reasonable. This test was designed to attack only 'egregious' avoidance. It is operated by HMRC in obligatory consultation with an advisory panel of tax professionals put in place pursuant to the GAAR legislation. The panel is designed to provide HMRC with an industry view as to whether the tax planning in question is tax planning which is so (in the industry parlance) 'aggressive' that the tax planners themselves think it is beyond the pale.[9] In effect, the double reasonableness test imposes the need for a *criminal* standard of proof on the *civil* regime of enablers penalties. If the conditions of the double reasonableness test are met, that effectively means it is *beyond reasonable doubt* that no tax adviser could reasonably recommend the scheme.

There is no good reason for the enablers penalty regime to be constrained in this way. It has the consequence that the regime does not generally apply to ineffective tax avoidance, even in circumstances where it was apparent from the outset that the avoidance was more likely than not to fail. The tax industry likes to insist that a range of views is possible on any given avoidance scheme. That is indeed the case, but there is no benefit to society in views being taken at the more bullish end of the scale. Indeed, there is a strong policy argument for discouraging advisers from taking a bullish view on a scheme where a conservative view would tend to advise against it. **People should only be achieving tax savings where advisers would be confident, *on a conservative view of the legislation*, that Parliament intended the saving**. Otherwise the effect is that tax savings accrue unfairly to those with more bullish advisers. And there is currently no upper limit to how bullish an adviser can be because of the defect in the criminal law noted above.

3.3 Areas of potential improvement in the two existing regimes

So here we have three notable defects in these two regimes i.e. (1) the evidential problem faced in prosecuting the criminal offence in most avoidance cases, (2) the high (i.e. criminal law level) hurdle of the GAAR test in the context of the civil penalty regime, and (3) the fact that the civil penalty is relatively trivial.

The argument that this paper puts forward is that these defects are best understood in the context of each other. There exists in these regimes all the necessary elements of a meaningful approach to the problem of advisers promoting and enabling ineffective schemes, but those elements are not currently correctly combined to form an appropriately structured approach. The very high hurdle that exists in the case of the civil regime would be more appropriate as an alternative route to establishing dishonesty in the criminal regime. In addition, the civil regime would be more effective with a lower threshold and tougher penalties. The final section of this paper sets out these conclusions in the form of two proposed policy interventions.

---

[8] Para 3(2) Sch 16 FA (No2) 2017

[9] Sch 43 FA 2013; for the thinking behind this aspect of the regime see the GAAR final report available at https://webarchive.nationalarchives.gov.uk/20130402163458/http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf

4 The proposed policy interventions

4.1 Make the GAAR test an alternative route to establishing dishonesty for criminal prosecutions in tax avoidance cases

A scheme which meets the GAAR test is (broadly speaking) one where it would not be reasonable to consider that the scheme was a reasonable one. The scheme would therefore be one where an adviser could not credibly claim to have held an honest belief that the scheme achieved the intended saving. These are therefore circumstances where, in principle, criminal law should be engaged: the promotion of the scheme can safely be treated as dishonest to a criminal standard of proof. These are nonetheless circumstances where, as discussed above, finding evidence of that dishonesty is going to be all but impossible. **This paper therefore proposes that, in circumstances where the GAAR test is met, there should be no need for HMRC to separately prove the existence of dishonesty in order to make out the offence of cheating (or, as the case may be, conspiring to cheat) the public revenue.** A simple 'one-liner' legislative intervention into the common law offence of cheating the public revenue should be sufficient to achieve this improvement to the law in this area. It should be noted that this would not mean that a scheme failing the GAAR is necessarily a criminal act. The remaining elements of the criminal offence would have to be made out. This intervention would simply mean that, the 'double reasonableness' conditions having been met, the prosecution would not have to separately show dishonesty.

4.2 In the regime of civil penalties for enablers of defeated tax avoidance schemes, replace the GAAR test with a 'more-likely-than-not-to-fail' test

While it is true that a range of opinions may exists among tax professionals as to the effectiveness of a tax avoidance scheme, savings should only be achieved in circumstances where advisers can be confident that the saving was intended by Parliament. There is no benefit to society in some people getting tax advantages that others with less aggressive advisers are not getting. This just serves as an incentive to advisers to be more aggressive. That being the case, there is no reason for the threshold for the application of the regime of civil penalties for enablers to be as high as it currently is. To discourage enablers, the civil regime should extend to any case where the better view of the applicable legislation was that the scheme would not succeed. **A supplementary proposal is therefore that the scope of the regime of civil penalties for enablers of defeated tax avoidance schemes be expanded. Rather than applying only where the GAAR test is satisfied, this regime should apply in any case of defeated tax avoidance where the scheme was, at implementation, more likely than not to fail.** It would be up to HMRC to decide whether this threshold is met, subject in the ordinary way to appeal to the tax tribunal. This improvement to the law could be implemented by amending the relevant parts of the enablers regime. **Furthermore, the financial penalties for the enablers of ineffective tax avoidance should be toughened up so that any fine is more than the fee earned.**

---

[i] This is not an official publication of the House of Commons or the House of Lords. It has not been approved by either House or its committees. All-Party Parliamentary Groups are informal groups of Members of both Houses with a common interest in particular issues. The views expressed in this report are those of the group.

[ii] This paper was researched by The Policy Institute and funded by The Joffe Trust & CIPFA.