EXPLANATORY MEMORANDUM TO

THE TAX AVOIDANCE SCHEMES (PENALTY) (AMENDMENT) REGULATIONS 2010

2010 No. [XXXX]

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These regulations ("the amendment regulations") amend the Tax Avoidance Schemes (Penalty) Regulations 2007 (SI 2007/3104) ("the principal regulations"). The principal regulations increased the maximum penalties for failure to comply with certain disclosure obligations from £600 to £5,000 per day where the tribunal has made a disclosure order.

2.2 The amendment regulations prescribe similar increased maximum amounts in similar circumstances for new penalties introduced in the Finance Act 2010.

3. Matters of special interest to the Select Committee on Statutory Instruments

None.

4. Legislative Context

4.1 Part 7 of Finance Act ("FA") 2004 (sections 306 – 319) provides for the notification, or "disclosure", to the Commissioners of certain tax arrangements and proposals for those arrangements (hereafter referred to as "schemes").

4.2 Sections 308, 309 and 310 require certain persons to disclose information about schemes falling within certain descriptions. The requirement usually falls on the promoter who must explain how the scheme works within 5 days of its being marketed, made available for implementation or implemented.

4.3 Section 108 of FA 2007 amended FA 2004 and introduced new information powers in relation to the disclosure of tax avoidance schemes. These new powers provided for HMRC to enquire into the reasons why a promoter has failed to disclose a scheme and to enforce disclosure where the evidence warrants it. In particular:

- section 306A provides for HMRC to apply to the Special Commissioners (now the tribunal) for an order deeming a scheme to be notifiable where HMRC has taken all reasonable steps to establish the facts and has reasonable grounds to suspect that it is notifiable. The effect of an order under section 306A is that the promoter has a duty to disclose the scheme under section 308.
- section 314A provides for HMRC to apply to the tribunal for an order that a scheme is notifiable. The tribunal can make such an order only if satisfied that the scheme is notifiable under the existing law. The effect of an order under section 314A is that the promoter has a duty to notify the scheme under section 308.

4.4 Section 98C of the Taxes Management Act 1970 ("TMA") provides for penalties for failure to disclose. Section 98C(1)(a) and (b) TMA provided for the tribunal to impose an initial penalty not exceeding £5,000 and for HMRC to impose further daily penalties, not exceeding £600, for each day that the failure continues after the imposition of the initial penalty.

4.5 FA 2007 amended the penalty provisions of section 98C TMA 1970 providing:

- for the Treasury to make regulations increasing the level of daily penalty for failure to disclose a scheme where that failure continues after an order has been made under sections 306A or 314A;
- for HMRC to make regulations prescribing the period after which the increased penalty level is to apply after an order under Section 314A;
- that where an order is made under section 314A, doubt as to notifiability will cease to be a "reasonable excuse" for continued non-compliance after the period prescribed for the application of the increased penalty.

4.6 The Tax Avoidance Schemes (Penalty) Regulations 2007 (SI 2007/3104) increase the daily penalty from an amount not exceeding £600 per day to an amount not exceeding £5,000 per day where a promoter's failure to disclose a scheme continues after the making of an order under section 306A or 314A.

4.7 The Tax Avoidance Schemes (Information) (Amendment) (No.2) Regulations 2007 (SI 2007/3103) prescribe the time after which the increased penalty applies when an order has been made under section 314A. It is 10 days from the date of the order.

4.8 FA 2010 further amends the penalty provisions of section 98C -

- replacing the initial penalty of up to £5,000 with an initial daily penalty of up to £600 in cases of failure to comply with a

disclosure obligation under sections 308, 309 or 310 (but not an ancillary information obligation under other sections in Part 7). Like the current initial penalty, this new initial daily penalty will be determined by the Tribunal;

- providing for the initial penalty to be an amount not exceeding £1 million where the Tribunal, having taken all relevant factors into account, considers the aggregate initial daily penalties inappropriately low;

- providing for the Treasury to make regulations increasing the level of the new initial daily penalty where a failure to notify a scheme continues after the Tribunal has made an order under section 306A or 314A; and

- providing for HMRC to prescribe the period after which increased penalties apply.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Exchequer Secretary, Mr David Gauke, has made the following statement regarding Human Rights:

In my view the provisions of the Tax Avoidance Schemes (Penalty) (Amendment) Regulations 2010 are compatible with the Convention.

7. Policy background

- ***What is being done and why***

7.1 Tackling avoidance is a key element of the Government's tax policy strategy, which is aimed at making it easier for businesses to comply with their tax obligations whilst tackling those who abuse the system.

7.2 The Commissioners' anti-avoidance strategy has four main elements:

- To discourage taxpayers from using schemes. This includes a critical appraisal of all new legislation to reduce the potential for tax avoidance as well as publicising successes in closing down avoidance schemes.

- To identify as early as possible schemes that are being used.

- To challenge avoidance schemes by contesting returns and, where necessary, pursuing the matter through the Courts.

- To produce legislative changes that will close down avoidance schemes where litigation is not appropriate or where the amount of tax at stake is particularly large.

7.3 Part 7 of FA 2004, section 98C of TMA, and instruments made under them are intended to achieve early identification of avoidance schemes.

7.4 Part 7 applies across all of the direct taxes. However, the Government has targeted the disclosure rules at the areas at high risk from avoidance. The arrangements prescribed in secondary legislation schemes are limited to those that concern income tax, corporation tax, capital gains tax and stamp duty land tax.

7.5 These rules were aimed at new and innovative schemes and intended to redress a timing information gap that exists in relation to the prescribed taxes. For example, the filing date for income tax and corporation tax returns 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 used that HMRC receives a return and can open enquiries.

7.6 Disclosure requires certain persons, usually the promoter, to disclose information about schemes falling within certain descriptions. The promoter must explain how the scheme works within 5 days of the scheme being marketed, made available for implementation or implemented.

7.7 Most promoters comply with their obligations to disclose, but a minority do not. FA 2007 introduced new information powers (outlined above) aimed at tackling non-compliant promoters of tax avoidance schemes, including provision for HMRC to apply to the tribunal for orders requiring disclosure, along with related enhancements of the penalty regime.

7.8 FA 2010 contains further enhancements of the penalty regime (again outlined above) targeting egregious non-compliance by promoters.

7.9 These amendment regulations increase the new initial daily penalty, in line with the existing "secondary" daily penalty, from an amount not exceeding £600 per day to an amount not exceeding £5,000 per day where a failure to disclose continues after an order is made under section 306A or 314A.

7.10 Regulations prescribing the period after which the increased penalties will apply will be made if the House approves these amendment regulations.

- ***Consolidation***

7.11 It is not intended to consolidate the regulations at this time.

8. Consultation outcome

The amendments made in FA 2010 follow a consultation exercise in autumn 2009. There was support for higher penalties in cases of deliberate failure to disclose.

9. Guidance

Guidance setting out HMRC's approach to penalties for non-compliance with disclosure obligations has been placed in the library of the House of Commons.

10. Impact

10.1 The impact on business, charities or voluntary bodies is limited to those that engage in tax avoidance schemes.

10.2 The impact on the public sector is nil.

10.3 An Impact Assessment of the effect that this instrument will have on the costs of business and the voluntary sector is available at: http://webarchive.nationalarchives.gov.uk/20091222074811/http://hmrc.gov.uk/budget2010/strength-revise-dotas-ia-5295.pdf.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 The purpose of the legislation is to identify the detail of schemes seeking to avoid tax and to identify those who use such schemes.

11.3 The reasons for not exempting small businesses from obligations or penalties are:

- Revenue protection. Small businesses may promote or use avoidance schemes where the tax at risk is significant and disproportionate to the size of the business;
- Fairness. Avoidance puts compliant businesses, large and small, at a disadvantage and distorts competition.

12. Monitoring & review

Review of the effects of the measure is expected 3 years from implementation on 1 December 2010.

13. Contact

David Easton at HM Revenue and Customs Tel: 020 7147 2418 or email: David.Easton@hmrc.gsi.gov.uk can answer any queries regarding the instrument.