EXPLANATORY MEMORANDUM

THE TAX AVOIDANCE SCHEMES (PENALTY) REGULATIONS 2007

2007 No.

1. This [draft] explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs (HMRC) on behalf of the Treasury and is laid before the House of Commons by Command of Her Majesty. It contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 The above regulations come into force on 21 days after making.

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

3.1 None.

4. Legislative Background

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

4.2 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 it being made available for implementation or implemented.

4.3 Section 108 of Finance Act 2007 amended Finance Act 2004 and introduced 5 new information powers in relation to the disclosure of tax avoidance schemes. These new powers provide 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 the order in which these powers can be used:

- Section 313A provides for HMRC to require a promoter, suspected of failing to disclose a scheme, to give reasons explaining why they think they are not required to disclose. The promoter must comply with this requirement within a period to be prescribed, or longer period as directed by HMRC.

- Section 313B provides for HMRC to apply to the Special Commissioners for an order requiring the promoter to provide further supplementary information or documents to explain or support the reasons why the scheme is not notifiable. The promoter must comply with this requirement within a period to be prescribed, or longer period as directed by HMRC.

- Section 306A provides for HMRC to apply to the Special Commissioners for an order designating the scheme as notifiable in circumstances 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, subject to limited exceptions, the promoter has

a duty to disclose the scheme under section 308. Section 306A provides for the prescribed period within which to comply with section 308 to be varied where the duty arises as a consequence of an order under section 306A.

- Section 314A provides for HMRC to apply to the Special Commissioners for an order designating the scheme as notifiable. The Special Commissioners 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, subject to limited exceptions, the promoter has a duty to notify the scheme under Section 308.
- Section 308A provides for HMRC to apply to the Special Commissioners for an order requiring the promoter to provide further information or documents in circumstances where the promoter has purported to comply with the obligation but HMRC believe the information to be incomplete. This requirement is treated as part of the promoter's duty under Section 308(1) or (3).

4.4 Section 98C of the Taxes Management Act 1970 provides for penalties for failure to disclose. Section 98C(1)(a) and (b) TMA 1970 provides for the Special Commissioners 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 Finance Act 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 notify a scheme where that failure continues after an order has been made using the new information powers under sections 306A or 314A;
- For HMRC to make regulations prescribing the period after which the increased penalty level shall apply after an order under Section 314A. These regulations are subject to the "negative" annulment procedure;
- 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 **increase** the current daily amount from a penalty not exceeding £600 per day to an amount not exceeding £5,000 per day where a promoter fails to notify the scheme within prescribed time limits following the issue of the order under Sections 306A or 314A.

4.7 Regulations prescribing the time after which the increased penalty will apply when an order has been made under section 314A will be made if the House approves these regulations. No such rule is required in the case of an order under Section 306A as, in practice, no penalty can be imposed until the period prescribed for compliance with a duty which arises as a consequence of such an order (10 days) has expired.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Secretary, the Rt Hon. Jane Kennedy, has made the following statement under Section 19(1)(a) of the Human Rights Act 1998:

6.2 I am satisfied that the Tax Avoidance Schemes (Penalties) Regulations 2007 are compatible with the Convention rights.

7. Policy background

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.

7.5 Part 7 of Finance Act 2004 and instruments made under it are intended to achieve early identification of avoidance schemes.

7.6 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 or capital gains tax; and
- Stamp Duty Land Tax on non-residential property

7.7 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.

7.8 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 made available for implementation or implemented.

7.9 Most promoters comply with their obligations to disclose, but a minority do not. Finance Act 2007 introduced 5 new information powers (outlined above) aimed at tackling non-compliant promoters of tax avoidance schemes and provides for HMRC to enquire into the reasons why a promoter has failed to disclose a scheme.

7.10 Finance Act 2007 also provides that the time limits for complying with these new information powers are prescribed by regulations, details of which are also outlined above.

7.11 Finance Act 2007 also provides for daily penalties for non-compliance in the Taxes Management Act 1970, to be increased in certain cases where the new powers have been used, in some cases after a period to be prescribed by regulations.

8. Impact

8.1 A full Regulatory Impact Assessment has been prepared for this measure and has been placed on the H M Revenue and Customs website (www.hmrc.gov.uk).

9. Contact

David Easton at HM Revenue and Customs Tel: 0207 147 2418 or e-mail: David.Easton@hmrc.gsi.gov.uk can answer any queries regarding the instrument.

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