EXPLANATORY MEMORANDUM TO

THE NATIONAL INSURANCE CONTRIBUTIONS (APPLICATION OF PART 7 OF THE FINANCE ACT 2004) (AMENDMENT) REGULATIONS 2010

2010 No. 2927

1. This 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 Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations ("the NICs amending regulations") amend the National Insurance Contributions (Application of Part 7 of the Finance Act 2004) Regulations 2007 ("the principal regulations"). They correspond to provisions made in Schedule 17 to the Finance Act 2010 in relation to Income Tax and apply related subordinate legislation to National Insurance Contributions ("NICs").

2.2 These amending regulations will come into force on 1 January 2011.

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

None

4. Legislative Context

4.1 The National Insurance Contributions Act 2006 inserted section 132A into the Social Security Administration Act 1992 allowing the Treasury to make regulations mirroring the Disclosure of Tax Avoidance Schemes Regime insofar as it applies to income tax.

Income Tax

4.2 Part 7 of the Finance Act 2004 (sections 306-319) ("Part 7") provides for the notification or "disclosure", to the HMRC of certain tax arrangements and proposals for those arrangements ("schemes").

4.3 Sections 308, 309 and 310 require certain persons to disclose information about schemes falling within certain descriptions. These descriptions are prescribed in The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (SI 2006/1543). The requirement to disclose usually falls on the promoter who must explain how the scheme works within 5 days of its being made available for implementation or implemented.

4.4 A scheme reference number (SRN) system identifies the users of the schemes. When a promoter discloses a scheme, HMRC allocate a SRN and notify it to the promoter; the promoter must pass it to clients who in turn identify themselves as users of the scheme by reporting it back to HMRC, along with certain other information. Users normally report SRNs on their tax returns, but in some cases must report them separately. The information to be provided, the cases in which SRNs are reported in returns or separately, and the time limits for doing so are prescribed in the Tax Avoidance Schemes (Information) Regulations 2004 (SI 2004/1864).

4.5 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 continued after the imposition of the initial penalty.

4.6 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 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 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.

4.7 Section 108 also 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; and

- HMRC to make regulations prescribing the period after which the increased penalty level is to apply after an order under Section 314A.

4.8 The Tax Avoidance Schemes (Penalty) Regulations 2007 (SI 2007/3104) increased 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.

4.9 The Tax Avoidance Schemes (Information) (Amendment) (No.2) Regulations 2007 (SI 2007/3103) prescribed 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.

4.10 Schedule 17 to FA 2010 further amends FA 2004 and section 98C TMA to -

- bring forward the obligation to disclose a scheme to the time a promoter first takes steps to market it;

- require promoters to provide periodic lists of clients who have implemented schemes;

- allow HMRC to require intermediaries in the marketing of schemes to provide information leading to the identification of the promoter;

- replace 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 with an ancillary information obligation under other sections in Part 7);

- provide for the initial penalty to be an amount not exceeding £1 million where the Tribunal considers the aggregate initial daily penalties inappropriately low;

- provide 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 a disclosure order under section 306A or 314A; and

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

4.11 The Tax Avoidance Schemes (Penalty) (Amendment) Regulations 2010 (SI 2010/2743) increase the maximum amount of the initial daily penalty to £5,000 where a promoter's failure to disclose a scheme continues after the making of an order under section 306A or 314A.

4.12 The Tax Avoidance Schemes (Information)(Amendment) Regulations 2010 (SI 2010/[insert]) prescribe the information and timing rules for the new client list and intermediaries provisions mentioned above. They also prescribe the period after which the increased maximum initial daily penalties apply after the Tribunal has issued a disclosure order. It is 10 days.

4.13 The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2010 (SI 2010/2834) amends SI 2005/1543 to improve the targeting of the existing descriptions upon avoidance.

4.14 All the 2010 changes will come into force on 1 January 2011.

National Insurance Contributions

4.15 Most National Insurance avoidance schemes also involve Income Tax but some do not. The scope of the Disclosure regime was therefore extended in 2007 specifically to include National Insurance contributions.

4.16 Section 7 of the National Insurance Act 2006 inserted section 132A Social Security Administration Act 1992 allowing the Treasury by regulations to make provision requiring, or relating to, the disclosure of information in relation to any notifiable contribution arrangements or notifiable contribution proposal for arrangements.

4.17 The only provisions which may be made under section 132A are provisions corresponding to or applying, with or without modification, relevant tax provisions requiring, or relating to, the disclosure of information in relation to income tax avoidance arrangements.

4.18 The National Insurance Contributions (Application of Part 7 of the Finance Act 2004) Regulations 2007 (SI 2007/785) corresponded to or applied the tax provisions as they stood in May 2007. They were amended with effect from 1 November 2008 by the National Insurance Contributions (Application of Part 7 of the Finance Act 2004) (Amendment) Regulations 2008 (SI 2008/2678) in

respect of changes made to the tax regime in 2007 and 2008. They were further amended with effect from 1 April 2009 by the National Insurance Contributions (Application of Part 7 of the Finance Act) (Amendment) Regulations 2009 (SI 2009/208) to take account of the transfer of functions from the Special Commissioners to the Tribunal by the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 (SI 2009/56) and by the National Insurance Contributions (Application of Part 7 of Finance Act 2004) (Amendment) (No 2) Regulations 2009 SI 2009/612 to take into account amendments made by the Tax Avoidance Schemes (Information) (Amendment) Regulations 2009 (SI 2009/611).

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

7.1 The Government is committed to tackling tax avoidance and will continue to take necessary steps to protect the Exchequer and maintain fairness in the tax system.

7.2 The objectives of disclosure are to:

- provide early information to HMRC about new avoidance schemes to allow the risk they pose to be assessed and, where appropriate, to inform legislation to close loopholes;
- identify users of avoidance schemes, informing HMRC's compliance work; and
- reduce the supply of avoidance schemes by altering the economics of avoidance, reducing the returns to promoters and users as schemes are closed down more quickly.

7.3 The rules on disclosure of tax avoidance schemes have made it possible to move quickly to close off avoidance opportunities.

7.4 The enhancements to the tax regime described at paragraphs 4.10 to 4.14 above are necessary to close unintended gaps and to target egregious non-compliance by a minority of promoters, ensuring that the regime keeps pace with the market for avoidance schemes and remains fit for purpose. For the same reasons, these NICs amending regulations are necessary to apply the changes to NICs and to ensure that the tax and NICs rules remain in harmony. This also means that promoters and users of schemes only have to deal with a single set of rules at any one time.

7.5 Accordingly, these regulations amend the principal regulations so as to apply to NICs (with appropriate modifications and exclusions) the provisions made in:

- Schedule 17 of Finance Act 2010;
- The Tax Avoidance Schemes (Penalty) (Amendment) Regulations 2010 (SI 2010/2743);
- The Tax Avoidance Schemes (Information)(Amendment) (No 2) Regulations 2010 (SI 2010/2928);
- The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2010 (SI 2010/2834).

These amending regulations will come into force on 1 January 2011 to synchronise with commencement of the above changes.

Consolidation

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

8. Consultation outcome

The draft legislation consulted upon was focused on the tax changes. The legislation, as enacted, takes account of responses made to that consultation. These NICs changes are a necessary consequence of the tax changes.

9. Guidance

A copy of the guidance issued by HMRC has been placed in the libraries of both Houses of Parliament.

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 A full Impact Assessment has been prepared covering the package of measures including the effect that this instrument will have on the costs of business and the voluntary sector. It 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 reasons for not exempting small businesses from obligations in relation to disclosure 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

A review of the effects of the package of changes is expected 3 years from implementation on 1 January 2011.

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.