EXPLANATORY MEMORANDUM TO

THE TAX AVOIDANCE SCHEMES (PRESCRIBED DESCRIPTIONS OF ARRANGEMENTS) REGULATIONS 2006

S.I. 2006 No. 1543

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs on behalf of the Treasury 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. Description

2.1 The above regulations come into force on 1 August 2006.

2.2 The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 prescribe the arrangements in relation to income tax, corporation tax and capital gains tax that certain persons are required to notify to HM Revenue and Customs (HMRC) by virtue of Part 7 Finance Act 2004 (c.12) (Disclosure of Tax Avoidance Schemes).

2.3 The regulations revoke The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2004 (SI 2004/1863).

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

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 Section 306 of the Act provides that the schemes required to be notified are those which:

- fall within any description prescribed by the Treasury;

- enable, or might be expected to enable, any person to obtain a tax advantage in relation to any tax that is so prescribed in relation to arrangements of that description, and

- are such that the main benefit, or one of the main benefits that might be expected to arise from the arrangements is the obtaining of a tax advantage

4.3 "Tax" is defined in section 319 of the Act as income tax, capital gains tax, corporation tax, petroleum revenue tax, inheritance tax, stamp duty land tax, or stamp duty reserve tax.

4.4 The powers to prescribe arrangements have been exercised:

- In relation to income tax, corporation tax and capital gains tax, in The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2004 (SI 2004/1863) coming into force on 1 August 2004. These regulations have been amended by The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements)(Amendment) Regulations 2004 (SI 2004/2429) coming into force on 30 September 2004; and

- In relation to stamp duty land tax in The Stamp Duty Land Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2005 (SI 2005/ 1868), coming into force on 1 August 2005.

4.5 Where there has been a failure to fulfil the obligation to notify the Commissioners may seek to impose a penalty. A person who fails to disclose a scheme etc is liable to an initial penalty of up to a maximum of £5,000. Where after this initial penalty is imposed the failure continues then a further daily penalty of up to a maximum £600 per day will be imposed. Promoters who fail to give a registration number to their client are also liable to a maximum penalty of £5,000.Taxpayers who fail to show scheme registration numbers on returns are liable to an initial penalty of £100 rising to £500 for subsequent failures. In respect of both promoters and taxpayers, initial penalties will be determined by the Special Commissioners and there will be a right of appeal against the imposition of the penalty.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

These Regulations are subject to annulment and do not amend primary legislation. Accordingly, no statement of compatibility with the European Convention on Human Rights is required

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 One of the features of the tax system that provides avoidance schemes breathing space is the existence of information gaps. HMRC generally has powers to open enquiries into tax returns, but not to enquire into schemes in themselves. 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.

7.3 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 the Act and instruments made under it are intended to achieve early identification of avoidance schemes. 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.

7.6 The arrangements prescribed in secondary legislation in relation to income tax, corporation tax and capital gains tax were limited to two areas, employment and financial products. Disclosure was a new concept and there were inevitable uncertainties as to how it would operate in practice. Consequently, the Government decided to limit the scope to the highest risk areas.

7.7 Monitoring of the disclosure regime in relation to income tax, corporation tax and capital gains tax has identified three risks:

- Significant avoidance exists outside these areas. For example, measures were announced in the Pre-Budget report 2005 to combat significant avoidance of corporation tax involving the use of intangible assets. There has also been a series of measures combating avoidance within the leasing regime. Both of these areas are outside the current scope of the disclosure regime;

- There is evidence that the “filters” used within the descriptions of arrangements to target schemes that are potentially avoidance may not capture all of the schemes that the regime was intended to capture; and

- the time limit for disclosing schemes where no promoter is involved (by the filing date of the return to use the scheme, compared to the normal time limit for promoted schemes of within 5 days of the scheme being marketed or implemented) severely affects the objective of the disclosure regime to obtain information in close to real time.

7.8 In order to counter these risks regulations will:

- Extend the disclosure regime to the whole of income tax, corporation tax and capital gains tax;

- Employ a suite of seven descriptions of arrangements (commonly referred to as “hallmarks”) to target new and innovative schemes, standardised tax products and two specific high risk areas: schemes designed to create tax losses for individuals and leasing arrangements; and

- Reduce the time limit for notifying schemes where no promoter is involved to within 30 days of the first transaction implementing the scheme.

7.9 HMRC has held intensive and extensive discussions with tax practitioners, businesses and representative bodies since the extension and modification of the regime was announced in the Chancellor’s Pre-Budget Report on 5 December 2005. Drafts of the regulations were published on the HMRC website on 28 April 2006 alongside a partial Regulatory Impact Assessment and comments were invited by 31 May. Comments were received from a small number of tax practitioners and representative bodies. Those comments have been incorporated into the regulations.

8. Impact

A full Regulatory Impact Assessment has been prepared for this instrument 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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