EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (DISCLOSURE OF AVOIDANCE SCHEMES) REGULATIONS 2004

2004 No. 1929

1. This explanatory memorandum has been prepared by the Commissioners of Customs and Excise 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

These Regulations, which come into force on 1st August 2004, prescribe the time within which information concerning VAT avoidance schemes which are notifiable under Schedule 11A of the Value Added Tax Act 1994 must be provided to the Commissioners; they make provision for the form and manner of notification to be specified in a public notice published by the Commissioners; and they prescribe the information to be provided in respect both of schemes which must be notified and also of schemes which are voluntarily notified under Schedule 11A.

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

3.1 The Regulations come into force before the expiry of 21 days from the date of laying. The Economic Secretary to the Treasury has announced that the regime for notification of VAT avoidance schemes would be in place by 1st August 2004. It is important that this regime comes into force as soon as practicable after the coming into force of section 19 of, and Schedule 2 to, the Finance Act 2004 in order to make an early impact on the avoidance element of the VAT gap (see section 6).

3.2 No Regulatory Impact Assessment has been made for this Order. See section 7.

4. Legislative Background

4.1 Section 19 of, and Schedule 2 to, the Finance Act 2004 introduced a new regime for the notification to the Commissioners of VAT avoidance schemes. It did this by introducing a new section 58A to the Value Added Tax Act 1994 giving effect to a new Schedule 11A to the Value Added Tax Act 1994, and making consequential amendments to section 70 (mitigation of penalties), sections 83 and 84(appeals) and section 97 (orders and regulations).

4.2 These Regulations implement Schedule 11A. They are the first exercise of the powers conferred by Schedule 11A for this purpose.

4.3 The relevant Finance Act 2004 provisions come into force on the passing of that Act so far as necessary for enabling the making of orders and regulations by virtue of Schedule 11A and otherwise on a day appointed by the Treasury by statutory

instrument. The Finance Act 2004, section 19(2)(b) and Schedule 2, (Appointed Day) Order 2004 appoints 1st August 2004 for this purpose.

4.4 Schedule 11A requires notification, subject to the conditions set out in that Schedule, of schemes designated by Treasury Order ("designated schemes") and also of schemes ("hallmarked schemes") which include or have associated with them a provision (also designated by Treasury Order) likely to be entered into for the purposes of tax avoidance. The Value Added Tax (Disclosure of Avoidance Schemes) Order 2004 designates these schemes and provisions and allocates a reference number to designated schemes. It will also come into force on 1st August.

4.5 Schedule 11A also provides that the reference number of designated schemes should be notified to the Commissioners and for voluntary notification of hallmarked schemes to be made.

4.6 Where there has been a failure to fulfil the obligation to notify a scheme the Commissioners may assess a penalty; of up to 15% of the tax advantage in respect of designated a scheme and up to £5,000 for a hallmarked scheme.

4.7 Schedule 11A provides for these Regulations to include transitional provisions and savings. These are found at regulation 2(2) and (3). The effect is that there is no time prescribed for notification, and thus no need for notification, if the prescribed accounting period in which the claimed tax advantage arises begins before 1st August 2004.

4.8 Both the Regulations and the Order were exposed in draft on Customs website throughout June. This was a very useful consultation exercise which resulted in several changes to the drafting of both.

5. Extent

This instrument applies to all of the United Kingdom.

6. Policy background

6.1 Tackling tax avoidance is a key element of the Commissioners' VAT Compliance Strategy, which is aimed at making compliance easier for businesses to comply with their VAT whilst tackling those who abuse the system.

6.2 The role of tax avoidance in creating a VAT gap between the VAT receipts the Commissioners could expect to receive given the level of economic activity and the amount they do receive is significant. It is not possible to estimate losses from avoidance activity by constructing effects from individual elements, but the Commissioners' latest estimate is that £2.5 to £3.0bn a year is lost through VAT avoidance.

6.3 Avoidance tends to be concealed within other business activities and therefore is often difficult to identify.

6.4 The Commissioners' anti avoidance strategy has four main elements:

- To discourage traders 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 which are being used.
- To challenge avoidance schemes by raising assessments 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.

6.5 Schedule 11A and instruments made under it are intended to achieve early identification of avoidance schemes.

7. Impact

7.1 A Regulatory Impact Assessment has not been prepared for this instrument. This is the established policy for anti-avoidance measures, such as this, where the impact on business, charities and voluntary bodies which do not engage in tax avoidance is minimal.

7.3 The Commissioners have agreed with the Regulatory Impact Unit of the Cabinet Office that this measure does not call for a Regulatory Impact Assessment for this reason.

7.4 The Commissioners have prepared a Tax Avoidance Impact Assessment which replaces a Regulatory Impact Assessment in respect of these Regulations. It can be found on the internet at www.hmce.gov.uk/forms/budgetnotices/finance-bill-2004.htm and a copy is annexed to this memorandum.

7.5 The impact on the public sector is negligible.

8. Contact

Alan McGuinness at HM Customs and Excise Tel: 020 7865 5252 or e-mail: Alan.McGuinness@hmce.gsi.gov.uk can answer any queries regarding the instrument.

HM CUSTOMS & EXCISE TAX AVOIDANCE IMPACT ASSESSMENT

1. **In *Protecting Indirect Tax Revenues*, published alongside the 2002 Pre-Budget Report, the Government announced its strategy for tackling indirect tax losses through fraud, avoidance and general non-compliance. One part of this strategy is to publish Tax Avoidance Impact Assessments explaining provisions necessary in proposed legislation for the purpose of countering avoidance.**

This is the Tax Avoidance Impact Assessment for the following legislation:

The Value Added Tax (Disclosure of Avoidance Schemes) Order 2004

The Value Added Tax (Disclosure of Avoidance Schemes) Regulations 2004

2. Objective of the legislation.

Clause 19 and Schedule 2 of the Finance Bill 2004, introduce disclosure requirements relating to the use of VAT avoidance schemes. This Order and these Regulations are made under the order and regulation making powers contained in Schedule 2.

The Government's objective is to increase transparency in the tax system. The new rules will provide Customs and Excise with information about tax avoidance schemes, and those using them, much earlier than at present to enable swifter and more effective investigation and, where appropriate, counter action.

3. This legislation, or provisions within this legislation, has been introduced to combat tax avoidance activity.

Tax avoidance thrives on secrecy and concealment. It can be very difficult for revenue authorities to identify tax avoidance schemes, and all those using them, in time to assess the potential threat to tax revenues and take appropriate counteraction. VAT returns do not include information about schemes being used or how they work. Even when an avoidance scheme is identified there often has to be a lengthy enquiry process to establish the facts.

A successful anti-avoidance strategy therefore needs to be supported by appropriate tools to allow the revenue authorities to find, and then challenge or close down, avoidance schemes as quickly as possible. The new measure is designed to provide greater information about the take-up of schemes Customs already know about, and early notice of some new, potentially damaging, schemes.

4. The following measures are therefore included within the legislation to combat the avoidance outlined in Section 3 of this TAIA:

- Certain known avoidance schemes are listed in the Order on a statutory register of abusive schemes. Businesses with an annual turnover of £600,000 or more that continue to use these schemes after 1 August 2004 will have to inform Customs and Excise within the time, and in the form and manner set out in the Regulations.

- Larger businesses with a turnover of £10 million or more will also have to disclose the use of any scheme that meets certain criteria. These criteria are also published in the Order. The businesses concerned will have to inform Customs and Excise within the time, and in the form and manner set out in the Regulations, with prescribed information relating to the scheme

The legislation does not give Customs and Excise additional powers to challenge these schemes and arrangements. Where appropriate, schemes will be investigated and challenged as at present – either through the

Courts or with new legislation where necessary.
5. Any query relating to this Tax Avoidance Impact Assessment should be addressed to: Mrs Andrea Pierce, Floor 4, HM Customs & Excise, 22 Upper Ground, London, SE1 9PJ.
6. Date of Publication: **19 July 2004**