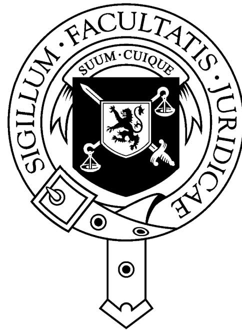

RESPONSE FOR THE FACULTY OF ADVOCATES
to the Consultation
on the Legislative Consent Memorandum
in respect of the

Strengthening Tax Avoidance Sanctions and Deterrents: A discussion document

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I. Introduction and summary

1 This is the response of the Faculty of Advocates ('the Faculty') to HMRC's consultation document 'Strengthening Tax Avoidance Sanctions and Deterrents: A discussion document'. In the time available the Faculty has not been able to respond to all the questions raised therein and has mainly concentrated on the issues of principle which are most likely to affect counsel. We have also commented on the definition of "defeated tax avoidance".

2 In summary, while it may be appropriate for penalties to be imposed on those who enable failed attempts at unacceptable tax avoidance, the Faculty considers that the situations in which such penalties should be possible ought to be significantly narrowed from the proposals in the consultation document. In particular, the Faculty is not aware of any other context in which penalties are imposed on service providers in the absence of any breach of duty towards their clients, or some form of

wrongdoing or neglect. It is submitted that the situations in which penalties may be imposed should be narrowed:

a) so as to be available only in relation to advisers who have contributed positively to the design of the scheme (as opposed to giving advice on whether or not the scheme is effective to achieve the tax outcome sought);

b) so as to apply only to arrangements which are counteracted under the GAAR, are notifiable under DOTAS legislation, or are disclosable VAT arrangements;

c) where the reasons for the failure of the scheme do not include any material defect in implementation;

d) where the facts on which the scheme failed are not materially different from the facts as explained to the adviser on whom it is intended to impose a penalty; and

e) where the advice given by the adviser is such that it constitutes professional negligence towards the adviser's client.

3 Penalties should be linked to fees, and not tax-geared. Fee-linked penalties are adequate deterrents; tax-geared penalties have the potential to be seriously excessive.

4 In addition, the adviser should have the opportunity to appeal against the penalty on the ground that the planning was in fact effective (in other words, that the scheme is not in fact a failure).

5 Imposing a penalty on the adviser in every case in which a dispute about avoidance arrangements is settled by agreement between the taxpayer and HMRC would be excessive. The adviser's right of appeal where a

penalty is imposed must be carefully designed to ensure that it is effective.

II. Context

6 The Faculty suggests that it is important to consider the purpose the proposals are seeking to achieve, and the existing means by which HMRC can achieve those purposes.

7 The Foreword to the Consultation document sets out the problem as being that, ‘a small minority of people in the UK seek to exploit the tax laws in a way parliament never intended’.

8 Therefore, the problem sought to be solved is that taxpayers put in place arrangements that seek to use the applicable tax rules in a manner contrary to the spirit of what Parliament intended, even if, on their face, the rules would apply in the way put forward by the taxpayer. As a generality, the Faculty agrees that this is a problem that HMRC are justified in seeking to eliminate.

9 However, the Faculty submits that any measures to be put in place should not go beyond what is necessary to address that problem. If it is thought necessary to impose penalties on advisers, those penalties must not be capable of being imposed in circumstances wider than those in which that problem arises.

10 Second, the context in which the proposals are being put forward is one in which, in the past few years, HMRC have been granted significant new powers to combat unacceptable tax avoidance, and in which, by using those powers, HMRC have had significant success in reducing that type of

behaviour. Thus, for example, the DOTAS regulations have enabled HMRC to counteract marketed schemes at very short notice; the GAAR has enabled HMRC to reduce the most egregious instances of tax avoidance and has (it is thought) therefore limited attempts at such avoidance; and requirements in relation to promoters of tax avoidance schemes have required promoters to provide, in effect, deterrent information to potential users of avoidance schemes. Thus, according to HMRC's statistics the tax gap arising from avoidance has reduced from 0.7% of total theoretical tax liabilities in 2009/10 to 0.5% in 2013/14 (the latest year for which statistics have been published).[1] Again according to HMRC, the total tax gap from tax avoidance in 2013/14 had been reduced to £2.7 billion.[2] While still a significant sum of money, the gradual reduction indicates that existing measures are already having a significant effect in preventing tax avoidance; and that they may be expected to continue to do so in the future, even in the absence of any new measures. But of course, Finance Acts 2015 and 2016 have introduced further measures to prevent tax avoidance, such as follower notices and accelerated payment notices; provisions on serial tax avoiders; extensions to the DOTAS and POTAS regimes; and provisions to assist HMRC in applying the GAAR more efficiently. It is to be expected that these measures will have the effect of further reducing the tax gap from tax avoidance.

[1] HMRC, *Measuring tax gaps 2015 edition*, p. 19, table 1.5.
[2] *Ibid*., p. 19, table 1.6, where this is further divided between taxes.

11 The proposals must be considered in the context that the problem they seek to combat is one that has diminished in significance in any event, and will continue to do so.

12 The third point of context is that it is important that taxpayers have access to professional advice as regards potential tax avoidance issues.

13 The Consultation document indicates that at least part of the problem is caused by unscrupulous tax advisers who misrepresent the nature of proposed structures and their chances of success to potential clients, thereby misleading those clients into engaging in tax avoidance subsequently found to be ineffective.

14 On that basis, penalties should, in the first place, clearly not be available against advisers who have independently and objectively, advised that in their opinion the arrangements in question achieve the tax outcome sought. It may not, in any event, be the intention of the Consultation document to include such advisers (who would not appear to come within the definition of "promoter" in the DOTAS rules), although we are not sure about that; the examples in paragraph 2.29 leave room for uncertainty. We understand that such honest and objective advisers are not within the scope of the Australian promoter penalty law to which the Consultation document refers at paragraph 2.16.

15 The Consultation document assumes that advisers generally give favourable advice on the prospects of a scheme and such advice encourages taxpayers to engage in unacceptable tax avoidance. This assumption is not correct, at least not in the case of counsel. For example, counsel instructed to advise on a proposed structure may opine

favourably; or may give the view that the structure does not work; or that it has a less than 50% chance of success. It is generally important that taxpayers have access to counsel's advice, whatever it may turn out to be, in particular because it is given independently of promoters and others. The proposed penalties could (if and to the extent that they extend beyond advisers who contribute to the design of schemes) have the effect of precluding counsel from giving such advice. For example, the Professional Code of Conduct of the Faculty of Advocates provides that an advocate, 'should not accept instructions to act in his professional capacity in circumstances where he has a direct personal interest in the outcome'. Individual counsel may therefore take the view that they are bound to refuse instructions to act where there is a possibility of penalties being imposed on counsel where a court or tribunal disagrees with counsel's view (or even simply because the taxpayer chooses to concede rather than litigate on the issue). This would deprive taxpayers of access to independent advice, including advice that would tend to deter them from proceeding with a proposed arrangement.

16 Accordingly, it is submitted that counsel generally, and any other tax advisers who are not responsible for designing a scheme or arrangement, but who merely comment on its effect, should not be within the scope of the penalty regime at all.

17 We also consider that even in the case of counsel and other advisers who are (to any material extent – a *de minimis* contribution to design should be ignored) responsible for the design of a scheme, penalties should be exigible on the failure of the scheme only where the advice given was

seriously flawed. For example, we understand that promoter penalties in Australia apply only where it could not be reasonably argued that, as a matter of law, the scheme worked or achieved its desired benefit. A not dissimilar approach would be to make the imposition of penalties conditional upon the conduct of counsel (or other adviser) in designing a scheme falling so low as to amount to professional negligence, although we recognise that the Australian approach is easier to apply to advisers in respect of whom professional standards are hard to define.

18 In any event, we do not consider it appropriate to impose strict liability to penalties on counsel and other advisers who, acting reasonably, contribute to the design of tax avoidance schemes, even when those schemes are later found to be ineffective. Penalties of this type and proposed scale (with attendant publicity) are not like parking fines which occasion little or no opprobrium from one's peers; they should only be imposed where some lapse in standards has merited them. In the light of the weapons already in HMRC's armoury (see paragraph 10 above), we would respectfully question whether unsuccessful attempts at tax avoidance will, in future, constitute such a social evil as to require a new and draconian penalty which may be imposed without fault.

III. Penalties on tax advisers

19 As set out above, the Consultation document aims at taxpayers who seek to exploit applicable tax laws in a way that Parliament did not intend.

20 The purpose of the proposed penalties is to deter advisers from giving advice tending to encourage taxpayers to engage in arrangements that involve that type of exploitation.

21 In paragraphs 13 *et seq* above, we have already indicated our view that advisers who do no more than provide an independent and objective view on a scheme's prospects for success should not be liable to a penalty if their advice turns out to be wrong. We have also indicated that we are not entirely clear whether the Consultation document intends that such advisers should potentially be liable to the penalties which it proposes. If and to the extent that it is intended to include them, it should be clear that no penalty can be imposed on an adviser who has advised that the prospects of success of a proposed arrangement are less than 50%. Otherwise, the penalty is imposed not because of anything the tax adviser has done, but because of the taxpayer's attitude to risk. (It may be that the current proposal is that penalties should indeed not be imposed in this scenario; if that is the intention, it is suggested it be made explicit in any legislation.)

22 As the proposal is described in the Consultation document, the only conditions that need to be satisfied before a penalty may be imposed (that is, leaving aside issues of reduction) are (i) the person must have 'enabled' a taxpayer to enter tax avoidance arrangements (where 'enabled' is broadly defined), and (ii) the arrangements must have been defeated by HMRC.

23 If the purpose is to prevent exploitation of tax rules, it is suggested that at least one further pre-condition of liability is needed, namely that the

reason the arrangements are defeated is not because of failure(s) in implementation. For example, it may be that a particular arrangement requires an LLP to have been validly constituted; but the arrangements put in place, for some reason, fail to bring the necessary LLP into existence. In those circumstances, the 'defeat' of the arrangements is not because of any improper exploitation of the tax rules, but rather because of the inefficacy of the transactions at general law. Therefore, such a defeat should not give rise to a penalty designed to deter advisers from enabling improper exploitation of tax law.

24 In addition, the Consultation document indicates that penalties should be available where arrangements fail a 'sole or main purpose' test. It would of course be improper for an adviser who knows that, as a matter of fact, the sole or main purpose of a particular arrangement is to avoid tax, to advise that such a test would not be breached (indeed, an adviser who did would be guilty of professional negligence, whether by giving advice contrary to the known facts, or advising as to how to try to 'dress up' circumstances so as to diminish the significance of any tax avoidance motive). But if an adviser has been told only facts that indicate there is no tax avoidance motive, then the failure to meet a 'sole or main purpose' because of facts not disclosed to the adviser should not result in penalties on the adviser. Accordingly, penalties should be available against an adviser only where the facts on the basis of which the scheme was defeated are not materially different from those disclosed to the adviser.

25 Where arrangements fail for technical tax reasons, it is necessary in the first place to ensure that they do so for a reason consisting of breach of an

anti-avoidance provision. Therefore, the availability of penalties should be restricted to circumstances in which a finding of a loss of tax has been arrived at because of a failure (i) under the GAAR, (ii) of arrangements liable to be disclosed under DOTAS, or (iii) of disclosable VAT arrangements.

26 In addition, the Faculty can see a justification for including arrangements that fail to meet a test requiring that the sole or main purpose of arrangements is not the avoidance of tax. However, a failure to meet such a test is likely to be a failure on the facts, rather than a failure of legal analysis. As the intention of the penalties is to impose the risk of failure on the law on tax advisers, the Faculty takes the view on balance that a failure to meet a 'sole or main purpose' test should not enable the imposition of penalties on advisers, at least in the absence of professional negligence.

IV. Amount of penalties

27 The Consultation document asks whether penalties should be tax-geared, linked to fees, or something else.

28 It is submitted that penalties linked to fees are a sufficient deterrent to tax advisers.

29 By contrast, penalties linked to the potential loss of tax have the potential to be seriously excessive. This is particularly so where the tax adviser in question is self-employed (for example, counsel). In certain circumstances, the effect of a penalty would be to bankrupt the adviser. For certain professions (for example, solicitor, accountant, and chartered

tax adviser), this could lead to the loss of a practising certificate. Therefore, tax-geared penalties go significantly beyond what is necessary to achieve the effect sought.

V. What is defeated tax avoidance?

30 The Faculty has reservations about how a penalty could fairly be imposed following a "defeat" of a scheme which consists of the taxpayer and HMRC agreeing that a dispute between them should be settled on the basis that the scheme does not work, as is envisaged in section 4 of the Consultation Document.

31 Taxpayers settle with HMRC for a wide variety of reasons. Those reasons do, of course, usually take account of the prospects of success in any litigation. But they are rarely limited to a consideration of the technical merits of the scheme and nothing else. A host of other factors may influence a taxpayer; for example, attitude to risk, the costs of litigation, personal issues such as ill health and the terms of settlement on offer from HMRC. Again, the taxpayer may have died and his executors (on the instructions of his successors) may simply want to put the matter to bed. Indeed, taxpayers (or their representatives) may give such non-legal factors more weight than relatively favourable advice on the prospects of success from their counsel.

32 Even where the settlement is reached because the taxpayer is advised that his prospects for success in the litigation are poor, that may (as we have already remarked in paragraph 24 above) be because of evidential difficulties in the taxpayer's particular circumstances, not because of

some technical flaw in the scheme. Those difficulties may in no way be attributable to the promoters of the scheme.

33 Again, even where a taxpayer settles with HMRC mainly because his counsel says his case is technically weak, his counsel is not necessarily right.

34 It should also be borne in mind that HMRC itself may seek to agree a compromise in a case, rather than to litigate, if it feels its prospects in the tribunals and courts are less than assured.

35 In all those cases, there is the risk that a penalty would be imposed on the promoters of the scheme as a result of extraneous and irrelevant circumstances.

36 Clearly, imposition of a penalty in those circumstances would be unfair, and it would seem wrong for a penalty to be imposed irrespective of the circumstances in every case where a taxpayer settles with HMRC without litigation. Some filter is required so that only material failures in the legal analysis, or fanciful constructions of the facts, on the part of the promoters, should be penalized at all.

37 In any event, the promoters of the scheme must have a right of appeal against the penalty. But how are they to appeal unless they are in a position to know the full circumstances and exactly why the case was compromised as it was by the taxpayer and HMRC? This is not just a question of reading HMRC's correspondence file about the case, suitably anonymized (if HMRC would volunteer, or could be compelled, to make that available to the promoters). In many cases it would require access (which is very unlikely to be afforded) to all the evidence held by the

taxpayer and to privileged legal advice given to the taxpayer (and, perhaps, also to HMRC).

38 In those circumstances, it seems to the Faculty that an effective right of appeal against a penalty imposed on a promoter because a dispute about the scheme has been compromised between HMRC and a taxpayer will require very careful design. It cannot require knowledge of the taxpayer's own circumstances, or of the advice given to him, all or part of which is likely to be undiscoverable. It would seem that the appeal should only concern itself with the scheme as advised to the taxpayer, rather than as actually implemented by him, unless the scheme required arrangements which no reasonable taxpayer could, in reality, be expected to bring about in the real world.

VI. Answers to questions

39 The Faculty's answers to the questions posed are therefore:

Q2. Counsel, and any tax adviser not responsible to a significant degree for the design of a scheme or arrangements, should be excluded from the scope of the proposed penalties.

Q3. It is necessary to restrict the circumstances in which a penalty can be imposed so that the following are necessary conditions for the imposition of a penalty (in addition to the conditions set out in the Consultation document):

(i) the adviser is guilty of professional negligence towards his / her client, having positively advised that the

arrangements were more than 50% likely to achieve the tax outcome that they have been held not to achieve;

(iii) the reason for the failure is not because of a failure on the facts of the case, but because of a failure on legal interpretation / application, in circumstances where the facts as found by the court or tribunal are not materially different from those told to the tax adviser prior to giving the advice in question; and

(iv) the arrangements in question have been counteracted under the GAAR, were notifiable under the DOTAS regime, or constituted disclosable VAT arrangements.

Q4. A tax-geared penalty is not appropriate.

Q5. Any penalty should be limited to the fee received for the work in question.

Q7. An adviser on whom penalties are imposed should be able to appeal on the basis that the tax outcome held not to have been achieved was in fact the correct outcome.

Q13. The circumstances in which a penalty is imposed because a taxpayer and HMRC have agreed that arrangements do not achieve their purported tax advantages should be carefully circumscribed if unfairness to promoters is to be avoided. Similarly, the basis on which an appeal may be brought against such a penalty requires careful definition.