

Association of Accounting Technicians response to HMRC's consultation paper “Tax avoidance involving profit fragmentation”

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to this consultation paper published on 10 April 2018.
- 1.2. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of taxes.

2. Executive summary

- 2.1. **AAT supports government legislation to counter tax avoidance schemes.** However, it is important that genuine commercial arrangements remain unaffected by the proposed legislation.
- 2.2. **AAT recommends that HMRC provides clear guidance in plain language when these proposals are introduced.** This will mean individuals and businesses that have no intention of using profit fragmentation to aggressively avoid tax can readily confirm this is the case.
- 2.3. **Proposing to allow the taxpayer a period of 30 days to make submissions against the HMRC preliminary notice is not acceptable.** This should instead be brought into line with the 90 day period to give written notices of representation to HMRC under S222 FA 2014.

3. AAT response to the consultation "Tax avoidance involving profit fragmentation"

Question 1: The government would welcome any evidence and information about these and similar arrangements to assist it in designing legislation that is properly targeted and does not bear inappropriately on businesses that pay all the taxes due in the UK.

- 3.1. Anecdotal evidence has been widely reported in the public domain¹. The tax avoidance schemes, set out in Chapter 2 of the consultation document in the "alienated, receipts" example - paid offshore for fictitious consultancy services and excess expenses - are both of the type where a challenge under Transfer Pricing would be appropriate.
- 3.2. However, changes would be required to the current transfer pricing legislation, for example Part 4, Taxation (International and Other Provisions) Act 2010 (TIOPA) excludes small and medium sized enterprises. It is questionable whether the 'distant relation' would qualify as a connected person for the purposes of TIOPA.
- 3.3. As regards HMRC's concerns in the gathering of large amounts of information detailed at 2.16 of the consultation document, the Information and Inspection Powers under Schedule 36 Finance act 2008 are widely drafted in as far as they apply where "the information or document is reasonably required for the purpose of checking the taxpayer's tax position". There are heavy penalties for non-compliance or delay.

Question 2: The government would welcome comments on whether any additional conditions are required to ensure that the approach set out above is effective and robust.

- 3.4. The proposed additional legislative provisions set out in proposal 1 (targeted legislation) would be sufficient to fill the gaps identified in paragraph 3.2 above.

¹ BBC, Paradise Papers, 6 November 2017:
<http://www.bbc.co.uk/news/uk-41886608>

Question 3: Will the proposed conditions allow most businesses to decide quickly and simply whether or not they are caught by the legislation?

- 3.5. If adopted the proposed conditions will enable most businesses to decide quickly and simply whether they are caught by the legislation. However, AAT recommends that HMRC provides clear guidance in plain language so that individuals and businesses that have no intention of using profit fragmentation to aggressively avoid tax can readily confirm that this is the case.

Question 4: Will this test of a lower rate of tax be effective?

- 3.6. The proposed 80% trigger rate should be an effective measure to initiate a challenge to the “significantly less tax” test.

Question 5: Are there any alternatives which should be considered?

- 3.7. AAT considers that the 80% measure is a reasonable legislative trigger and that no alternatives need be considered.

Question 6: The government would welcome views on any genuine activities carried on in low tax territories which might require special consideration.

- 3.8. These cases are capable of being identified in HMRC’s risk reviews and so special consideration should not be necessary.

Question 7: Any comments on this excessive profits test would be welcome

- 3.9. The ‘excess profits test’ involves HMRC reviewing all of the facts concerning suspect arrangements to identify sums transferred to the connected entity in the overseas low tax territory, which are in reality profits for services actually carried on in the UK, but where the ultimate benefit is to members of the trader’s family. This test is eminently suitable to identify avoidance schemes involving fragmentation where there is difficulty in linking the avoided UK profits directly to the taxpayer but will benefit his or her wider family.
- 3.10. Given that the purpose of the proposed legislation is to counter abuse by using offshore entities to avoid UK tax, it is reasonable for HMRC to recognise genuine activities by offshore entities which are not abusive.

Question 8: Is the use of “power to enjoy” as a test the best way of addressing these schemes?

- 3.11. The use of “power to enjoy” as a test is the best way of addressing schemes where the taxpayer may not directly receive an amount of money but where they benefit from it in another, indirect way.
- 3.12. The concept of taxing benefits such as paying off loans for family members or placing money in a trust is common in current UK benefits legislation and it is reasonable for this to apply to the “power to enjoy” concept to the proposed anti-avoidance legislation.

Question 9: Will the “power to enjoy” rules catch all likely targets?

- 3.13. The wording of the “power to enjoy” rules is sufficiently wide to catch profit fragmentation where the UK person may not directly receive an amount of money but where they benefit from it in another indirect way.

Question 10: Will they risk bringing in arrangements where no tax avoidance is involved?

- 3.14. Yes, there is a risk of bringing in arrangements where no tax avoidance is involved if the legislation is not tightly drafted and/or properly operated as in the recent situation regarding Accelerated Payment Notices².
- 3.15. AAT recommends taxpayers be given protection by the inclusion of an explanation of its purpose early within the proposed legislation, whereby a Tribunal can adjudicate if HMRC unfairly targets a taxpayer in a situation where no tax evasion or aggressive tax avoidance is involved.

² AccountingWeb, HMRC issued 6,000 APNs in error, 3 May 2018:
<https://www.accountingweb.co.uk/tax/hmrc-policy/hmrc-issued-6000-apns-in-error>

Question 11: The government would welcome comments as to whether this connection test is appropriate

- 3.16. Given that the government wishes to ensure that arrangements which would not occur in an arm's length situation do not avoid the proposed legislation it is reasonable that a test applies which catches arrangements where parties, though not connected, act together for benefit.
- 3.17. Similar tests are already applied in UK taxation legislation³ - to connect persons acting as partners and in situations where a person with whom they act may secure control or exercise control over a company.

Question 12: Will this connection rule bring in any arrangements where avoidance is not involved?

- 3.18. Where legislation is too widely drafted it is always possible that the wording will encompass arrangements where avoidance is not involved. It is to protect against such situations that AAT suggest the protective measures outlined above.

Question 13: Do you have any other comments on this proposed rule?

- 3.19. The general purpose of the proposed rule makes sense where persons are acting together in arrangements which would not occur in an arm's length situation and where the persons are not formally connected.

Question 14: What potential double taxation should be taken into account in the legislation?

- 3.20. Double taxation relief has been legislated for under bi-lateral double tax treaties over many years and it is important that long established agreements are not unilaterally affected.
- 3.21. Nevertheless, the proposed legislation should not be emasculated where the operation of double taxation might simply defer the tax avoidance charge to some unknown point in time.
- 3.22. The provisions of S100 Finance Act 2015 (Credit for UK or Foreign Tax on the same profits) relating to Diverted Profit Tax (DVT) might be considered. This gives 'Just and reasonable' credit but within the time limit of the review period.

Question 15: Any comments on interaction with other anti-avoidance legislation would be welcome.

- 3.23. As mentioned above, consideration should be given to the potential comparison with DVT at S100 FA 2015. Paragraph 4.21 in the consultation document notes that HMRC is aware that existing anti-avoidance legislation would generally take priority over the proposed legislation.
- 3.24. The proposed legislation should specifically exclude a penalty charge where a penalty arises in other anti-avoidance legislation.

Question 16: The government would welcome comments on the features which should be included in the notification requirements.

- 3.25. It is reasonable for there to be legislative provision for notification requirements where this is not covered by current Disclosure of Tax Avoidance Schemes (DOTAS) rules⁴ (as updated by later Finance Acts).
- 3.26. AAT recommends that this is in the form of an additional Hallmark to cover UK profits which are moved to offshore structures in low tax jurisdictions to entities which have little or no substance.

Question 17: The government would welcome comments on these proposals for payment of tax for users of these arrangements.

- 3.27. Where notification would be required under the new hallmark as recommended above, the Accelerated Payment Notice rules of Part 4 of FA 2014 would apply.

³ S839 ICTA 1988

⁴ Part 7 of Finance Act 2004

- 3.28. With regards to the proposal to allow the taxpayer a period of 30 days to make submissions against the proposed HMRC preliminary notice this would appear out of line with the longer period of 90 days to give written notices of representation to HMRC under S222 FA 2014.
- 3.29. Such notices are more involved than an appeal. AAT therefore recommends that the period to make submissions under the proposed legislation should also be 90 days.

Question 18: Are there any conditions in particular which might impose onerous reporting burdens on companies not involved in avoidance?

- 3.30. Where the proposed additional hallmark is clearly drafted and the proposed time for representations is extended to 90 days, such companies should be in the same position as any taxpayer who should consider their position as to whether they are required to report under DOTAS.

Question 19: Views would be welcome on whether there are alternative approaches to preventing the avoidance without affecting genuine commercial arrangements.

- 3.31. Given that legislation is required to counter profit fragmentation, it is important that genuine commercial arrangements remain unaffected by the proposed legislation.
- 3.32. The following safeguards should apply for genuine commercial arrangements to:
- 3.32.1. any DOTAS reporting hallmark
 - 3.32.2. self-assessment of the proposed legislation
 - 3.32.3. HMRC should display impartiality in risk assessment in considering the “excessive profits” test
 - 3.32.4. Tribunals should have authority to rule on whether arrangements are made primarily for commercial reasons

Question 20: Are there any other considerations that the government should take into account when considering the design of this legislation

- 3.33. Consideration should be given to minimising the volume of legislation.
- 3.34. This might be done by a new part or chapter in TIOPA where the exclusions listed in paragraph 3.2 are closed.
- 3.35. The government should also consider the OECD Base Erosion and Profit Shifting (BEPS) reports that cover tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions.

4. About AAT

- 4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are more than 4,250 licensed accountants who provide accountancy and taxation services to over 400,000 British businesses.
- 4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any queries, require any further information or would like to discuss any of the above points in more detail, please contact Aleem Islan, AAT Technical Consultation Manager, at:

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