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Duty-bound by tax planning pitfalls

A great deal has been written and spoken about tax avoidance in recent years. Much of it has been ill-informed, tendentious or just plain wrong.

Very little of it has made it any easier for a taxpayer or an adviser to know where the limits lie. Add to that the fact that the limits of what is acceptable may vary according to the political and judicial climate of the day and the subjective view of the taxpayer – 'I engage in tax planning: you avoid tax' – and the problems become almost insuperable.

The heart of the problem is that there is no clear definition of tax avoidance. It has been described by Revenue & Customs as "bending the rules of the tax system to gain a tax advantage that parliament never intended".

Others have put it more bluntly as "failing to pay the right amount of tax". But each formulation inevitably poses a question: in the first case, "what did parliament intend?" in the second, what exactly is the "right amount of tax"? Defenders of aggressive avoidance schemes would counter that the answer to both questions is the same: the right amount of tax, and what parliament intended to be paid, can be nothing other than the amount of tax that is provided for by the strict letter of the law.

Parliament must, after all, be assumed to be capable of saying precisely what it means: therefore, if tax is not eligible under the law it is not payable. "Tax avoidance" does not, on that analysis, come into it: it is not possible to "avoid" tax, but only to establish what the law demands in a given set of circumstances and either pay it (which is the legal requirement) or not (which is unlawful evasion, not avoidance). Hence the plaintive cry of the alleged tax avoider – "I have paid the full amount of tax due".

Perhaps surprisingly, the courts have, in general, some sympathy for that view. As one judge, Lord (Leonard) Hoffmann, colourfully put it, if a scheme does not work the reason is "simply that upon the true construction of the statute, the transaction which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes".

In a sense, therefore, tax avoidance does not really exist. Rather, for advisers it is simply a question of advising a client on the tax consequences of the actions and transactions he has undertaken, or may be planning to undertake, some of which may be fully commercial and some of which may (or may not) have been undertaken because of the hoped-for tax benefits. It is simply a question of advising whether those hoped-for tax benefits are likely to be achieved.

Sadly, in a world where HMRC accords an increasingly high priority and proportion of its resources to the countering of real or imagined avoidance, advisers must tread ever more carefully in giving advice in all cases which involve an apparent reduction of tax liability, perhaps even in cases of comparatively modest and benign planning.

At the furthest extremes of aggressive tax planning, the planning may be stopped in its tracks by the General Anti-Abuse Rule (GAAR). The adviser must ask himself whether the planning, even if it otherwise plainly works, should be considered “abusive” – that is, whether the planning cannot reasonably be regarded as a reasonable course of action.

That is a high hurdle to clear – it is an anti-abuse rule, not a mere anti-avoidance rule; but it is also a rather curious test, implying as it does that no reasonable person could possibly hold the view that it is reasonable to utilise absolutely any and every means of reducing a tax liability, however arcane and artificial, provided it is within the law. Given that this is precisely the view that some QCs have expressed the difficulty of applying the test will be apparent. But applied it must be. And failure to apply it where relevant may bring swingeing penalties.

Next is the question of whether the planning is within the scope of the Disclosure of Tax Avoidance Schemes (Dotas) rules. There is not enough space here to go into the detailed rules: suffice it to say that its net is cast far wider than marketed tax avoidance schemes, though most widely marketed schemes will be caught; and that if planning should have been notified to HMRC under Dotas and is not, unpleasant and expensive consequences may ensue for all concerned.

Dotas also brings into play the potential for HMRC to issue an “Advance Payment Notice” (APN). These so-called “guilty until proven innocent” notices reverse the normal tax collection procedures by requiring tax to be paid, pending final resolution of the matter before the courts, on the assumption that the scheme will fail. So where a client has entered into a Dotas-type scheme, or proposes to do so, on the basis that it will, at worst, allow him to defer his tax liability, the adviser will need quickly to disabuse him of that notion.

Whether or not planning is within GAAR or Dotas, HMRC’s efforts in countering tax planning of all kinds are increasingly bearing fruit in the courts. Sometimes HMRC succeeds on the technicalities of the interpretation of the law: but sometimes on the implementation of the arrangements. It is bad enough when failure of a scheme leads to a claim by HMRC for payment of back tax together with interest, as it inevitably will. But in some cases HMRC is also seeking penalties, which in theory may range up to 100 per cent of the tax at stake, albeit that they are generally at much lower levels.

How come? Surely a taxpayer who enters into some planning arrangement on the advice of an apparently competent adviser, perhaps even a QC, that it works, and who files his tax return on that basis, cannot possibly be guilty of an offence? While that is true as a generality, we are starting to see HMRC examining more closely exactly what questions a scheme user asked and what steps the user took to understand the scheme and its workings. Taking everything at face value and signing scheme documents without question may expose a taxpayer to penalties if the implementation of the scheme falls short.

When advising on tax planning, advisers must bear in mind that if and when planning fails, disappointed clients are likely to look around for someone to blame. And they will usually be looking not in the mirror, however justified that may be, but at their adviser.

Even in the brave new world of HMRC's assault on "aggressive" tax avoidance some planning will succeed, despite HMRC's objections. But accurately predicting what planning will be found by the courts to work requires a reliable crystal ball. Until these are widely available, the best an adviser can do is to give clear documented advice as to the risks that HMRC's view of the planning may not accord with the adviser's and of the need to ensure that the transactions undertaken are exactly and precisely those on which advice has been sought. Short cuts may be costly.

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Key Points

- There is no universally agreed definition of tax avoidance.
- Planning may be stopped in its tracks by the General Anti-Abuse Rule.
- HMRC's efforts in countering tax planning of all kinds are increasingly bearing fruit in the courts.

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