By email: ca.consultation@hmrc.gsi.gov.uk

23 October 2014

Dear Sir/Madam

Government consultation: Strengthening the tax avoidance disclosure regimes

Introduction

The British Property Federation (BPF) is the voice of property in the UK, representing businesses owning, managing and investing in property. This includes a broad range of businesses comprising property developers and owners, financial institutions, corporate and local private landlords and those professions that support the industry.

We welcome the opportunity to respond to the government's consultation on strengthening the tax avoidance disclosure regimes.

Executive summary

General

- **We are fully supportive of the government's desire to better understand the nature of tax avoidance schemes as they arise.** However, a careful balance must be struck between ensuring identification of egregious tax avoidance schemes and multiplying the compliance burden on good corporate citizens by expanding the range of disclosable tax planning arrangements.

VADR

- **We do not consider that it would be appropriate to subsume the VAT disclosure regime (VADR) into DOTAS.** VAT operates in a significantly different way to other taxes and constitutes a large proportion of the Government's total tax income. It is in our view entirely right that a separate, tailored disclosure regime should apply.

- **Falling disclosure numbers does not mean that the VADR rules need changing.** Before amending the regime Government should consider the extent to which its perceived shortcomings arise as a result of differences in the types of arrangement that HMRC and taxpayers believe to be disclosable.

DOTAS

- **The proposed financial product hallmark is at present too widely drafted.** By capturing any arrangement where a term in a financial instrument gives rise to a tax advantage it is likely to apply to a swathe of everyday situations where there is no malignant tax avoidance motive. Disclosure requirements should apply only where contrived steps are involved.

- **We are disturbed by the emerging perception that disclosable arrangements automatically constitute tax avoidance, and can be punished as such.** The DOTAS regime increasingly forms

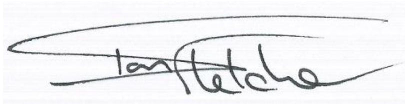
the basis of punitive measures such as issuing accelerated payment notices or excluding a business from government procurement processes. That is not what it was designed to do and is increasing the reputational risk for businesses that use innocent tax planning arrangements.

- **It is therefore crucial that HMRC are able to quickly consider whether arrangements merit SRNs and for arrangements that do not constitute tax avoidance to have SRNs revoked.** HMRC must accept that responsible taxpayers are likely to seek clarity regarding the tax treatment of certain arrangements, including disclosing 'to be on the safe side'. It must therefore have the resources available to process the potentially numerous disclosures of innocent arrangements.

Detailed responses to certain questions raised in chapters 4, 5 and 6 of the consultation paper are included at **Appendix 1**, while **Appendix 2** sets out a number of innocent tax arrangements that could potentially become disclosable under the proposed financial products hallmark.

We remain at your disposal should you have any questions or require further details.

Yours faithfully



Ion Fletcher
Director of Policy (Finance), BPF

Appendix 1: Responses to consultation questions

DOTAS
Q19: To what extent would the preferred option deliver a balance between providing greater certainty for the taxpayer while ensuring that HMRC can give due consideration to the need to issue an APN?
The recent introduction of accelerated payment notices (APNs) and of consideration of a business's tax affairs (including whether it has engaged in disclosable schemes) as a condition of eligibility for government contracts has effectively made the DOTAS regime the basis for punitive action against taxpayers. There also appears to be an increasing perception that the mere fact that an arrangement is disclosable is a strong indicator that avoidance is taking place, even when this is demonstrably not the case. Given the recently increased public profile of corporate tax affairs, businesses are understandably wary about entering into arrangements that might be perceived as avoidance despite the fact that they are entirely contemplated by the law. Moreover, investors are increasingly discerning in this regard. Any indication that a business engages in disclosable or potentially disclosable arrangements could put off potential investors – even if those arrangements have no tax avoidance motive. It is therefore critically important that DOTAS discriminates between those arrangements which truly have an avoidance motive and those which simply seek to take advantage of a particular tax treatment offered by the legislation. We are heartened that HMRC appears in this Chapter to recognise how important it is for there to be a simple process through which innocent arrangements can be identified at an early stage and precluded from potential punitive action (such as APNs). Our preferred approach for achieving this is for the current 30 day window in which HMRC can assign an SRM to be extended to 90 days. It is crucial, though, that HMRC has the resources to meet this deadline, and that the 90 day period should be inclusive of all questions and queries that HMRC may have regarding the arrangements.
Q21: To what extent does the draft hallmark deliver the policy objective of bringing arrangements involving financial products into the view of DOTAS?
Almost all commercial structures (real estate included) will involve 'financial products' as defined in the consultation paper. Where possible and where it is legal, any sensible business would make use of any tax advantages accruing to those financial products; the vast majority of the time not seeking to obtain any unfair or egregious benefit but rather that which is contemplated by the law. However, the consultation paper rightly identifies that financial products are often used by a minority of taxpayers in the context of egregious avoidance and we therefore understand and sympathise with the Government's desire to widen the range of tax arrangements on which it receives advance information. That said, the new financial product hall mark as currently proposed is in our view too widely drafted. In particular, the threshold set in Condition 3 of proposed Regulation 19 potentially means that where a single term in loan documentation or in a company's articles of association can give rise to a tax advantage, that arrangement is disclosable. That is likely to bring into the scope of

DOTAS an enormous number of everyday arrangements which are in no way aggressive or egregious. Appendix 2 sets out some examples of such situations in a real estate investment context.

Conceptually, it does not feel to us that the new financial products hallmark sufficiently distinguishes between tax advantage and tax avoidance. The UK's tax legislation is littered with provisions that enable and encourage taxpayers to access tax advantages. These include tax relief on investments into start-up companies, tax neutrality on transactions between group companies and various roll-over (i.e. deferral) reliefs for investments in shares, loan notes and business assets. Naturally, Parliament does not want to see these reliefs abused and so, in almost all cases, certain conditions must be met in order for the relief to be available. It is hard to believe that Parliament would desire all arrangements that involve these to be considered tax avoidance, or even to have to be disclosed to HMRC.

Accordingly, it should in our view be possible to remove proposed Condition 3 from the draft Regulations without harming HMRC's ability to collect information on tax avoidance schemes. The presence of contrived or abnormal steps should be the key indicator of avoidance in this context, not the mere presence of a tax advantage.

If – notwithstanding our comments above – the Government decides to retain Condition 3, HMRC is likely to witness a deluge of disclosures covering non-aggressive arrangements. This issue will be exacerbated if the Government decides to remove the grandfathering provisions as this will bring many more arrangement within scope. Not only would the deluge of disclosures cause significant (and probably unnecessary) administrative issues for HMRC it would increase costs for businesses if DOTAS advice must be sought out every time a routine transaction is carried out.

As noted above, falling within DOTAS is increasingly being used as a badge of taxpayer misbehaviour and its extension to cover fairly routine transactions could end up hurting the UK's tax competitiveness if businesses shy away from making use of the reliefs available for fear of being branded tax avoiders.

Chapter 6: VAT Disclosure

General comments

We understand the Government's view that a declining number of disclosures made under the VADR is symptomatic of a regime that is not working as it should and that it is therefore due a review. Indeed, we consider it entirely appropriate for thought to be given as to whether the system could be made to work more effectively.

However, before suggesting any particular changes to the VADR, particularly something as drastic as merging it with DOTAS, it is worth exploring in greater detail whether – and if so why – HMRC feels that it is not receiving as much information as it feels necessary regarding VAT arrangements.

It may be that there is nothing wrong with the current rules themselves, but that a wedge has opened up between what HMRC believe should be disclosable under the rules and what taxpayers and their advisors believe is disclosable. There is a perception among our members (and probably among taxpayers more generally) that VADR is intended to apply to egregious arrangements and not to straightforward, everyday transactions. Arrangements which save taxpayers from 'walking into a bear trap' have generally not been viewed as disclosable; especially where the bear trap

arises from the unclear or clumsy operation of the VAT rules. Such an approach is supported by rhetoric from Government at the time VADR was introduced[1], although we appreciate that HMRC's view may have changed in the interim.

In other words, any problem may well lie with the interpretation and application of the rules rather than with the rules themselves. Or perhaps there is a lack of clarity in this area. To the extent that such is the case, better communication between HMRC and taxpayers is what is needed, rather than any changes to the VADR.

Q23: What form of VADR is likely to be most effective in achieving the policy objectives?

We would stress that before deciding to make any further changes to VADR the Government should explore more broadly with taxpayers why it feels that the current system is not delivering policy objectives. It should also work with taxpayers to identify the reasons behind the reduction in VADR disclosures over the years. It is possible that what emerges from those discussions is that there is nothing intrinsically wrong with the rules as currently drafted but that there is a disconnect between what HMRC and taxpayers feel the system is meant to deliver (and therefore how it should operate). There may also have been a genuine and significant reduction in the use of aggressive tax planning arrangements.

Our preferred option of the three identified by HMRC is to maintain the VADR as a user-based regime, as taxpayers and their advisors are familiar with this system. Furthermore, if the consultation we have recommended above concludes that it is only the interpretation of VADR (rather than the rules themselves) that is resulting in policy objectives not being met then there should be no need to change the focus of VADR away from the user. If necessary, the list of arrangements that are automatically disclosable could be extended or refined.

We would strongly recommend against incorporating VADR into DOTAS. VAT is not only a major source of income for the Government, bringing in about £104bn, or 21% of total revenue, it also operates in a completely different way to other taxes. Furthermore, for every £1 of VAT collected by HMRC, several more pounds of VAT 'wash through' the accounts of businesses, and these could also be within scope of any disclosure regime. Given that the quantum of VAT is substantially larger than that of most other taxes, it is entirely appropriate for VAT to have its own tax avoidance disclosure regime. While the consultation paper is correct in saying that there is little difference from an information gathering perspective between VADR and DOTAS, the unique way in which VAT operates justifies its having a tailored disclosure system.

In addition, it is hard to see how applying DOTAS to VAT will of itself bring about an increase in the number of disclosures to HMRC. Disclosures made under DOTAS have also significantly reduced in number since its introduction so it would appear to be an issue that is common to both systems. Merging the two is unlikely to change this.

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[1] At the time VADR was introduced Economic Secretary John Healey, commented that *"there will be clear criteria for listing the schemes. There must be an avoidance scheme involving contrivance or artificiality, which must be abusive, in that it does not comply with the spirit of the law, and it must represent a serious potential risk to the revenue."* In other words, there was a clear sense that in order for an arrangement to be disclosable there had to be a genuine tax avoidance motive (not just tax advantage) and that the arrangement should involve contrivance or artificiality.

Extending DOTAS to VAT would also make disclosable VAT arrangements subject to the kind of punitive measures currently legislatively linked to DOTAS such as APNs. Conceptually this may well be desirable; why should those that obtain a VAT cash flow advantage through avoidance schemes be able to keep it while HMRC challenges it? However, VAT is accounted for much more often and more quickly than other taxes – it's more or less an instantaneous tax – so there is less scope for taxpayers to obtain cash flow advantages.

The unique way in which VAT works also means that applying APNs is unlikely to be administratively straightforward and much thought would need to be given as to the potential implications for both taxpayers and HMRC.

Finally, we have some reservations regarding moving VADR from a user to a promoter based regime. We consider that if the regime were to be *purely* promoter based, it could reduce VAT compliance for taxpayers and focus more closely on those likely to be developing VAT planning arrangements. However, there are likely to be certain instances in which there is no promoter under VADR, which would presumably leave the user responsible for any disclosure just as at present.

Q24: Which form of VADR would best contribute to achieving consistency and fairness for users and promoters of avoidance schemes across all regimes?

Please see our response to Q23 above.

Q25: Which form of VADR would minimise the administrative burden on businesses, other than those who design and promote avoidance and their clients?

As noted above, it is possible that over time the views of HMRC and those of taxpayers and their advisors regarding the kind of arrangements that need to be disclosed under VADR has diverged. There may be in many cases a lack of clarity regarding what HMRC would like to see disclosed and as a result HMRC is receiving less information than it would like.

If that is the case, the Government must think carefully about extending the effective scope of VADR (even if just through amending guidance). Most businesses are generally cautious in their tax affairs which means that if there is any doubt about whether disclosure is required it is likely to be made, 'just to be on the safe side', even if the arrangements are quite harmless.

That would increase the administrative burden on businesses (even under a promoter based system, as relevant information would still have to be provided to the promoter). There is also a real risk that HMRC could see itself inundated with such disclosures and it should ensure that it has the resources in place to deal with them appropriately.

Appendix 2: Examples of non-aggressive tax planning arrangements

This Appendix sets out a number of commercial arrangements which might be captured by the proposed financial products hallmark (at least as currently drafted). We would not consider any of these arrangements to represent tax avoidance and therefore feel it would be inappropriate for them to be disclosable. If they were to be so it is likely that businesses would start submitting large numbers of disclosure notifications to HMRC, increasing the administrative burden for them and for HMRC for little discernible benefit.

1. Debt funded real estate acquisition

A real estate business wants to acquire a shopping centre, to make improvements and then to enjoy increased rental income. At the outset it has to consider whether the acquisition should be funded by equity or by debt. One advantage of debt funding is the availability of a tax deduction for interest payments and this is one of the key reasons that the business decides to debt-fund its development. The UK's generous rules on interest relief have been identified by Government as a key element of its strategy to make the UK's tax system highly competitive: there is no question here that the taxpayer is doing anything other than obtaining a relief exactly in accordance with Government policy.

Testing this scenario against the financial products hallmark:

- There is a financial product – the loan;
- One of the main benefits of including the loan is to obtain a tax deduction for the interest paid;
- Only one further condition needs to be met and this will be satisfied if the loan documentation contains "one term" which is unlikely to have been included, but for the tax advantage. At a very basic level, this could include the rate of interest itself if that rate has been increased as against, e.g., a preference share dividend return to reflect the fact that it is deductible for the paying entity.

The business (which is not engaged in tax avoidance in any sense) would now need to consider disclosing this arrangement under DOTAS.

2. Sale of business in exchange for shares and loan notes

A management team has built-up a successful property business. They receive an offer for the business, but the consideration is a mix of shares and loan notes. The tax rules allow the selling managers to defer (roll-over) their gain until a later disposal if they accept consideration in shares and loan notes rather than cash. This ability to roll-over is a key benefit for the team.

The loan notes include a clause which prevents any redemptions in the first year. This is because a loan note with a short life might be considered to be equivalent to cash (which could result in roll-over being denied).

All three conditions for DOTAS disclosure are met: there is a loan note, a tax advantage (roll-over relief permitted under the tax rules) and a clause which helps the managers access that relief. But, as in the first example, it is hard to conceive that the management team is involved in tax avoidance activity. Indeed, in these circumstances, it would be usual for management to obtain

clearance under section 138 TCGA to that effect.

3. Joining the REIT regime

It is possible that even joining the UK REIT (real estate investment trust) regime could fall within scope of the proposed financial product hallmark. UK REIT status entitles a company or group of companies to a particular tax treatment (namely, no corporation tax on profits or gains of its property rental business) and in order to become a REIT, changes are required to the terms in the company's articles of association in order to notify shareholders of certain limitations that REITs are subject to.

Again, there is a financial product (the shares in a UK REIT), a tax advantage to the company or group converting to REIT status, and a term in the financial product that enables the tax advantage to take effect. Yet there is no harmful tax avoidance motive.

4. Short term loans

Property investment involves bulky, illiquid assets which are generally subject to irregular transactions. Once a commercial decision has been made to acquire a particular property or group of properties, the deal-making process can happen relatively quickly. Indeed, it is not uncommon for a deal to take under four weeks from initial offer to practical completion.

Due to the sheer size of property loans, it can sometimes be difficult for property businesses to put in place a senior loan financing arrangement between initial offer and practical completion. In such instances a property business acquiring a property may approach a bank for a flexible short term bridging loan (which bears higher interest than a senior loan) to cover part or all of the acquisition cost. Alternatively, shareholders or co-investors may provide similar bridging arrangements.

Such loans are always temporary in nature and rarely last longer than a few months; indeed, it would be uneconomical for a borrower to pay the associated high interest rates for a significant period of time.

Interest on these loans is generally considered to be 'short' for income tax purposes and so it is not usually a requirement to withhold tax on interest distributions arising from these loans. In order to ensure that this is the case, the loan agreement will contain specific terms stating the loan is repayable in less than 364 days to ensure that it is deemed 'short' for income tax purposes

On the basis that a term in a financial product involved in this arrangement generates a tax advantage (or at least gives rise to a tax administration or cash flow advantage), it could be argued that this loan agreement would be disclosable under DOTAS. Once more, there is no harmful tax avoidance motive.

5. CGT groups

Property investments are commonly entered into via a joint venture arrangements for purely commercial reasons (e.g. to spread risk, share expertise etc). Where one of the parties is contributing land or property assets to the joint venture it is not uncommon for the joint venture company to form part of the contributor's capital gains tax group (so that the asset can be easily contributed to the joint venture). For this to be possible, the arrangements must meet the conditions of S.170 TCGA 1992.

In practice, this means that one of the joint venture parties must own more than 75% of the

subsidiary's ordinary shares and have at least 50% beneficial entitlement to the subsidiary's profits and assets. The shares issued by the joint venture vehicle to the relevant joint venture party will have specific terms to ensure that the criteria outlined in S.170 TCGA are met. This practice has historically not been considered tax avoidance but again, there is a financial product containing a term which gives rise to a tax advantage. and so it could potentially fall within scope of the new financial product hallmark.

It is worth noting that this particular arrangement is long established and would not be disclosable but for the proposed removal of the grandfathering provisions.