Strengthening the tax avoidance disclosure regimes for indirect taxes

Introduction

1. The BPF represents the UK’s commercial real estate (CRE) sector. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK’s economic success, provide essential infrastructure, and create great places where people can live, work and relax.

2. We welcome the opportunity to comment on the government’s proposals to review the tax avoidance disclosure regime for indirect taxes. Our key points, which all relate to proposed changes to the VADR, are set out below, while Appendix 1 provides more detailed responses to individual consultation questions.

3. We will supplement this response with illustrations of a range of VAT planning arrangements that are often used by real estate market participants to ensure their VAT liability corresponds to economic reality. HMRC will be aware of many of these and we suspect is unlikely to find them contentious. We would therefore not expect many of them to be disclosable under a reformed VADR, although it would be of enormous value to discuss where the disclosure boundary lies.

Key points

4. We understand that HMRC needs to be aware of developments in the tax avoidance landscape and we fully appreciate that in order to do so there must be a mechanism in place that delivers appropriate information regarding the activities of the small minority of taxpayers that abuse the rules. A form of disclosure-based system such as DOTAS/VADR seems reasonable to us, provided that it remains as far as possible an information collection system and that the administrative burden it places upon taxpayers is proportionate.

5. However, DOTAS appears to have evolved beyond simply being a way for HMRC to remain aware of taxpayer behaviour into an indicator that some sort of offensive behaviour is taking place. The introduction of accelerated payment notices (APNs) and the linking of DOTAS to the public procurement process means that the negative reputational implications of making a disclosure or carrying out tax planning that might potentially be disclosable (even if it is uncontentious in law and HMRC would be unlikely to challenge it) can be considerable.

6. In a world where reputation is hugely important, certain real estate investors (particularly those from the Far East) may balk at entering into particular transactions if the way they are structured means they need to be disclosed to HMRC. The negative connotations that disclosure now entails means investors may ignore the fact that disclosure is not technically a sign of abuse and simply refuse to carry on with a transaction. This may be an extreme scenario, but ultimately the UK’s economy suffers as a result of the investment foregone.

7. It is therefore critical that any reformed disclosure regime for VAT does not give rise to disincentives to invest or to unnecessary uncertainty. With that in mind, we make the following recommendations:

7.1. VAT deserves its own disclosure regime. We understand HMRC’s desire to harmonise VADR and DOTAS, but would warn against trying to make them directly comparable. The design of the disclosure
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regime should be sensitive to the peculiarities of each tax; concepts that apply in Corporation Tax should not be foisted upon VAT if they are simply not relevant.

7.2. Disclosure requirements should be aimed at egregious avoidance. If the rules are too broad in scope – and we believe the consultation proposals are too broad – simple, inoffensive planning arrangements may become disclosable. This would not only result in an enormous administrative burden for taxpayers and HMRC as they struggle to cope with the increased volume of disclosures, but may also mean businesses pay more tax than their economic situation would suggest they should. VAT is full of pitfalls for the unwary – taking action to steer clear of them is not tax avoidance and it should not be at risk of being treated as such.

7.3. Moving from a ‘purpose’ to a ‘benefit’ test significantly opens the scope of disclosure. We understand the rationale behind HMRC’s proposals here; purpose can after all be disguised by the unscrupulous (though we would question how effectively this can be done in practice). However, the broad definition of tax advantage means that relatively straightforward acts of tax planning or even scenarios with no element of planning at all will meet the ‘main benefit’ test, taking them one step closer to having to be disclosed. We suggest an updated concept of tax advantage.

7.4. The hallmarks must be a powerful filter. The broad definitions of promoter, tax advantage and main benefit mean that unless the hallmarks are very carefully drafted, all manner of uncontentious planning arrangements (and not even just those) will become disclosable. This is not what we understand the intention of VADR to be and HMRC should start by designing very narrow hallmarks that can subsequently be widened as necessary if they turn out to be too generous.

7.5. HMRC should provide as much clarity as possible regarding what is a scheme. Notice 700/8 currently makes clear that a taxpayer engaging specialist advice to make sure they recover all input tax to which they are entitled is not in itself a scheme. The Notice also lists a series of actions that should not be considered schemes. This is helpful and should continue under a revised VADR, as it provides comfort to taxpayers that everyday tax planning measures are not disclosable.

We look forward to engaging with you further on this matter over the coming weeks and months as you further develop the policy proposals for VADR reform.

Ion Fletcher  
Director of Policy (Finance)  
British Property Federation  
St Albans House  
57-59 Haymarket  
London SW1Y 4QX  
020 7802 0105  
ionfletcher@bpf.org.uk
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Appendix 1 – detailed responses to relevant consultation questions

Q1: Do you agree that reforming VADR in this way would provide a clearer and more timely picture of the nature and extent of avoidance?

8. It is not clear to us whether moving the obligation to disclose VAT avoidance schemes from users to promoters would provide better information to HMRC regarding the tax avoidance landscape. On the one hand, it sounds like a positive step for taxpayers, as they would in theory no longer need to incur the administrative burden of making a disclosure. Promoters may also be expected to be better informed about the VADR regime and perhaps more compliant than taxpayers in general. Information provision to HMRC may therefore improve.

9. On the other, many VAT planning arrangements are not complex enough to need a promoter. It is often enough to receive limited advice from a specialist (either within the taxpayer’s business or an external advisor) in order to arrange affairs in a way that ensures the amount of VAT paid is commensurate with the economic outcome of a particular transaction. Sometimes no advice at all is required - as demonstrated by the fact that in many businesses VAT compliance is handled by the accounts team rather than by a VAT professional.

10. This means that in a large number of cases there will be no promoter and therefore disclosures will continue to be made by users, which does not represent a particularly significant change from the current system and brings into question the benefit that HMRC would obtain as a result.

11. However, we understand from discussions with HMRC (although it is not in the consultation paper) that where a user is a SME there will be no requirement to make a disclosure. In other words, VADR would apply where there is a promoter and to larger businesses where there isn’t. This is positive from the perspective of administrative simplicity for SMEs and on balance we therefore support bringing the incidence of disclosure under VADR into line with that under DOTAS.

Q3: To what extent do you think the DOTAS rules on who is a promoter and circumstances when a scheme user has to disclose an avoidance scheme would be effective in a revised indirect tax disclosure regime?

12. As set out in our response to Q1, because many VAT planning arrangements will not involve a promoter, the obligation to disclose will fall upon the user. This is not materially different from the current system and therefore all else being equal it is not clear that it will result in a big improvement from HMRC’s perspective, although HMRC may gain additional insight into schemes targeted by promoters at small businesses, which would objectively be a sensible development.

13. However, it is likely that the DOTAS rules on who is a promoter could be made to work in a VAT context. Our main concern would be that the accounts or tax teams of companies or groups of companies end up falling within the definition of promoter where they are simply offering advice on how to avoid VAT’s many bear traps. A disclosure requirement might then be triggered, even if the company or group is a SME and would therefore not have to make a disclosure if they were simply a user of an arrangement.

14. Accordingly, there may be merit in extending the SME user exemption in DOTAS to those deemed to be ‘internal’ promoters if a way can be found to protect HMRC against abuse of this exemption.
Q4: To what extent would the DOTAS ‘benefit’ test be a clearer and more objective test for disclosure of indirect tax avoidance schemes?

15. The benefit test is likely to be a clearer and more objective test. However, it will also result in far more arrangements becoming potentially disclosable, particularly if the definition of ‘tax advantage’ does not change.

16. In many cases one of the main results of structuring a transaction in a particular way will be that the amount of VAT to be paid is less than it otherwise would have been. This is not in itself indicative of avoidance, as steps may simply have been taken to ensure that VAT is not being paid over and above what might be expected given the economic reality of the transaction, or because the VAT would have been recoverable by the customer, or merely because it is accounted for in a different period.

17. In other words, one of the main benefits of avoiding a pitfall is avoiding that pitfall (and therefore securing a tax advantage), but that does not mean that the taxpayer is doing anything untoward. While a ‘purpose’ test is less objective than a benefit test, it sets a higher bar for simple acts of VAT planning to be disclosable and therefore more effectively filters out non-contentious arrangements from the requirement to disclose.

18. Unless the definition of tax advantage is reviewed, moving from a main purpose to a main benefit approach means that any commercial decision that happens to have a VAT effect is potentially disclosable, even (given the broad meaning of ‘tax advantage’) one that has an adverse VAT effect. This would leave the hallmarks as the only filter to prevent an unsustainable volume of disclosures from having to be made to HMRC.

Q6: To what extent should a revised indirect tax disclosure regime place reporting obligations on VAT non-taxable persons?

19. While we are not opposed in principle to extending VADR to non-taxable persons, it is not clear to us what kind of behaviour HMRC would receive additional information about by doing so:

19.1. Promoters of schemes to non-taxable persons will have to provide information of such schemes by virtue of other aspects of the proposals.

19.2. If there is no promoter, the business is likely to be an SME and – if the DOTAS SME exemption is extended to VADR – therefore exempt from disclosure requirements.

19.3. There may be some heavily exempt businesses that are not registered while not being SMEs, but we expect these will be rare.

19.4. Finally, there are non-UK businesses, some of which might have substantial UK operations but not be registered because of the operation of reverse charging. We understand the argument for ensuring such businesses fall within VADR, but would question how HMRC could police and enforce the application of VADR among such businesses if they did not choose to comply.

20. We would welcome further discussion with HMRC regarding the kind of taxpayer and behaviour intended to fall within VADR by virtue of extending the regime to non-taxable persons, as there is a risk that rules are introduced that deliver very little benefit to HMRC while adding complexity and uncertainty for taxpayers.
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Q7: How should users of VAT avoidance schemes who are not registered for VAT, and who receive a scheme reference number from the promoter, be required to notify HMRC when they use scheme numbers?

21. As alluded to in our response to Q6, HMRC needs to carefully consider what benefit it is likely to obtain by extending VADR to non-taxable persons and whether that benefit is worth the additional complexity and the need to devise some special means of notification for such persons.

Q8: Should the indirect tax disclosure regime adopt the DOTAS definition of tax advantage for VAT or should it retain the current definition, suitably adapted to cover non-taxable persons?

22. Applying the DOTAS definition would be inappropriate as it fails to take into account the distinct structure and operation of VAT. We therefore favour – as a minimum – retaining the existing VADR definition of tax advantage.

23. However, we believe that even that definition could be improved, since as currently framed it can result in some very strange outcomes.

24. In particular, the ‘return by return’ approach means that a tax advantage arises to a taxpayer if their liability is brought forward, as the VAT due on their next return is less than it would have been. However, this ‘advantage’ arises even if the taxpayer was actually financially disadvantaged in a previous return period.

25. Even if a taxpayer’s liability is delayed, this might only be because a transaction is delayed by one day, and this happens to put it in the next return period. While a short term cash-flow benefit may arise, it is hardly indicative of a genuine reduction in tax as the liability will still need to be paid. Neither can it be said that any real tax benefit arises merely through the operation of a TOGC, yet a tax advantage would be deemed to arise, as less VAT has been paid than would otherwise be the case.

26. Finally, a tax advantage may also arise where a taxpayer incurs additional VAT and recover some of it, even if they are worse off to the extent of the element that they cannot recover.

27. Accordingly, we would suggest that the definition of tax advantage be reconstructed broadly as follows:

(a) The VAT due is less than it otherwise would be.

(b) VAT is due more than [one year] later than it otherwise would be.

(c) The VAT incurred is less than it would otherwise be.

(d) VAT is incurred more than [one year] later than it otherwise would be.

28. In a) and b), references to VAT due do not include VAT that is, or that could reasonably be expected to be, recoverable by the customer, while in c) and d), references to VAT incurred do not include VAT that is, or more than [90%] of which is, recoverable. Amounts in square brackets are suggestions for further consideration.

29. The definition proposed above is simple and in our view more accurately reflects what is a genuine advantage than does the existing definition, resulting in fewer innocent arrangements having to be considered for disclosure. Conditions (a) and (c) would be ‘at any time’ tests, uncoupling the link between tax advantage and a single return period, while timing matters are covered by (b) and (d).
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Q9: Do you believe that penalties for failure to comply with obligations under the indirect tax disclosure scheme should be the same as those applied under DOTAS? If not, please explain your reasons and explain what penalty structure would be more appropriate.

30. It is hard to comment on the appropriateness of a given system of penalties when it is unclear how a reformed VADR would work more generally. Our main concern would be that the application of penalties could become very widespread indeed if the bar for disclosure were very low. If everyday acts of VAT planning (or even of non-planning!) were to become disclosable we can envisage a large number of taxpayers being totally unaware of their requirement to make disclosures or to report scheme reference numbers. It feels wrong for them all to become subject to penalties when all they have done is engaged in behaviour that for the most part HMRC will have absolutely no objection to.

31. Accordingly, the way in which penalties are levied on the non-compliant should be considered only once the broader VADR framework has been decided. HMRC should also consider delaying the introduction of penalties until the new VADR has had time to sink in and taxpayers have had the chance to familiarise themselves with it.

32. Alternatively, HMRC could take a light touch approach to their application in the first year or two of the new regime’s operation. The involvement of the Tribunal in levying penalties is welcome, as long as the Tribunal is empowered by regulation to adopt a proportionate and reasonable approach to levying them.

Q10: Which DOTAS hallmarks do you believe are suitable for an indirect tax disclosure regime? Would these hallmarks require any modification to work effectively for VAT arrangements, and if so how should they be modified?

33. The broad definitions of promoter, tax advantage and main benefit mean that a very large number of (mostly innocuous) VAT planning arrangements may become disclosable if the hallmarks do not effectively filter them out. This could result in an enormous administrative burden for taxpayers and HMRC as the volume of disclosures multiplies in a short space of time.

34. We understand that this is not HMRC’s intention and it is therefore critical that the hallmarks operate to prevent ‘everyday’ VAT planning from becoming disclosable. Indeed, the hallmarks will be more important than under the current system as the move away from a purpose test to a benefit test means that more arrangements will need to be tested against the hallmarks than is currently the case. The existing hallmarks should be revisited in light of this.

35. That said, subject to the comments below, we feel it would be adequate to apply the DOTAS hallmarks to VADR and there may actually be no need for specific VAT hallmarks (indeed, there is a strong case for repealing some of them – see our comments in response to Q11).

36. The confidentiality hallmark should only apply where an arrangement is intended to be kept secret from HMRC for tax purposes. It should not apply where the intention of transacting parties is for the transaction itself to be kept confidential, as can often be the case in real estate investment, which remains a relatively private market. Neither should the hallmark apply where a professional firms’ standard terms of business include confidentiality clauses.

37. The premium fee hallmark should not be triggered simply by virtue of one group company paying another group company for tax advice it has received. Transfer pricing rules will require intra-group payments to be made in such cases and these payments should reflect the nature of the services received. Tax advice may –
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depending upon its nature – be of a relatively high value, however this should not indicate that a premium fee has been paid for a particular piece of advice and the hallmark should not be triggered in such cases.

38. In our view, the **standardised tax products hallmark** should only apply where an entire arrangement or set of steps is standardised. The aim should be to identify mass-market schemes and not simply the use of standardised documentation in – for example – property transactions. It feels very disproportionate for this hallmark to be triggered simply because parties to a transaction make use of standard TOGC clauses in their contract or because the loan documentation relating to the financing of a transaction is based on the LMA’s standard document. A similar case could be made for design and build scenarios, where HMRC have rather encouraged the use of a standardised JCT contract – hardly to be expected if the use of standard documentation is considered objectionable in itself.

39. Standard documents facilitate what are often complex commercial transactions – they save time for all involved and keep costs reasonable. Such documents are simply tools to achieve a particular economic outcome and not tax products in themselves. The hallmark should not be triggered unless there is evidence that there is a tax product exists, such as where the standard documentation comprises all or most of the documentation that will be needed or where it is provided by or on behalf of a promoter.

**Q11: Which of the current VADR hallmarks should be retained in a reformed regime? What further hallmarks or features of schemes should be added?**

40. Clarity is needed regarding the **sharing a tax advantage hallmark**, as it may inadvertently be in point in a number of innocuous scenarios, for instance where a landlord does not charge VAT on rent, thus allowing them to charge a higher rent, but potentially less than the VAT inclusive amount. Similarly, the amount of service charge payable by occupiers may take account of a landlord’s irrecoverable VAT, which effectively represents the sharing of a tax advantage. We would question how effective this hallmark is and whether it can be abolished, particularly if the DOTAS ‘premium fee’ hallmark is introduced.

41. We also question the need for the **loan/equity funding hallmark**. This could potentially arise very frequently in real estate investment as it is common for individual properties to be held by special purpose vehicles (SPVs) set up specifically for that purpose. The use of SPVs and their subsequent funding through a mixture of debt and equity capital is mainly motivated by the protection that lenders obtain when a borrower’s liabilities are legally segregated in different entities and is not an indicator of tax avoidance.

42. Finally, we would recommend abolishing, or at the very least reforming, the **property transactions between connected persons hallmark**. The meaning of ‘relevant grant’ is very wide indeed; if read literally it might cover any land that has ever been cultivated or built upon at any point in history. It would make more sense to confine it to significant recent works; perhaps by linking it to the Capital Goods Scheme.

43. The hallmark should also be confined to cases where one or the other party is ‘not entitled to credit for all of the input tax’ in relation to the property in question, as otherwise it could apply where a landlord has exempt income from other properties or if a tenant has exempt or non-business activities