

Turning the spotlight on the Spotlight

Gary Brothers outlines HMRC's approach to settling historic avoidance arrangements and wonders whether there are better ways to go about it

Too much thinking time is seldom a good thing for me! As I sat in my office looking over the glorious Yorkshire countryside, scoping out my article for this magazine, the subject changed almost in front of my eyes. What was a 'thought piece' about Spotlight 68 (the use of pre-paid debit and credit cards) morphed into a much more rambling dissection of just what HMRC are thinking in their, no doubt, well-intentioned efforts to remedy historic arrangements. In my opinion as a seasoned practitioner, they fall short of offering any real incentives to help HMRC in their efforts to equalise those arrangements.

So, let's go and see where my ramblings take us, but a warning for you – Grumpy Old Man alert!

Background

We are all now used to HMRC's 'Spotlights' initiative, or at least we should be, where (as HMRC put it) they describe "tax avoidance schemes currently in the spotlight". At the time of writing there are 71 published Spotlights, with number 71 being released in June of this year.

So, what's the purpose of HMRC 'spotlighting' current tax avoidance schemes? On their website, HMRC tells us what tax avoidance arrangements they are investigating, with a view to recovering duty, interest and, sometimes, penalties.

The 'more seasoned' (does that translate as 'cynical'?) tax disputes professionals would probably opine that, pragmatically, it is also a low-resource way for HMRC to influence thinking about named arrangements and then to attempt to 'nudge' people to HMRC's view that those arrangements don't achieve the intended outcomes. In the process, this aims to achieve two results for HMRC: hopefully encouraging users to cease using those arrangements; and incentivising users to review those arrangements and to settle historic liabilities with HMRC voluntarily and before HMRC commence their own activities.

Spotlight 68

This Spotlight – 'Using prepaid debit cards for profit extraction to reduce profits and disguise income' – was the prompt for this article. Following the issue of this Spotlight on 31 March this year, I was contacted or referred to a number of general practitioner accountants who had clients affected by the arrangements announced within it. Their understandable question of me was simple – "what do we do"?

Unfortunately, the Spotlight itself was fundamentally silent on how any conclusion might be reached, inviting users instead to "just contact us to settle" (my words, not HMRC's!). It certainly didn't answer my own questions on just the exact mechanism that HMRC thought would be appropriate to unravel such arrangements or what, ultimately, the cost of settlement might be to a user – always the keenest question from any client.

So, bearing in mind HMRC's invite to "just contact us to settle", that's exactly what I did. I emailed the stated contact point, and followed up with phone calls, in which I laid out that I was interested in discussing what settlement looked like and might be effected for a good number of users affected by Spotlight 68. Six weeks later (yes, six weeks!), I finally got a conversation with the team dealing with these issues.

Firstly, let's get it on the record in this article: my conversation with the HMRC team dealing with the Spotlight 68 settlements was very amicable and professional. No hint of judgement of any clients, just a very courteous, transactional approach to the method of resolving these issues.

So, my question of HMRC was pretty simple: what does a conclusion look like? To be fair to HMRC, the answer was pretty simple, too.

Settlement liabilities were based on there being no Corporation Tax deduction for payments into the arrangements, with full PAYE tax and NIC chargeable on the payments out, too

HMRC cited the decisions in Wired Orthodontics and Marlborough DP Ltd and that, in essence, the tax avoidance motive to the payments voided them from any 'wholly and exclusively' claim for deduction in the Corporation Tax accounts of the payer or employer. Also, following the money, HMRC viewed it as clear that the arrangements should also be taxed as employment income in hands of the employee. As part of my discussion with HMRC, they were adamant that there was not scope, at all, for deviating from that approach.

So, by process of very quick mental arithmetic – and I'm sure every reader will be doing the same – the effective rate of tax for any settlement is the Corporation Tax rate adjusted to disallow the in-bound payments, so probably 19% plus the PAYE and NICs charges appropriate to the tax profile of the employee. So NICs plus a likely 40% or 45% tax rate.

By any calculation, people wanting to settle these arrangements are probably (health warning – this is a generalisation for this article) looking at an effective rate of tax north of 75% of their payments and, in some cases, perhaps not far off 100%. Add interest and penalties to the mix, and the potential settlement costs are significant.

The right approach?

Is this the right approach? That's the question!

Let me say at the get-go that I am not, in any way, here to be an apologist for the tax avoidance industry. Like very many, if not all, tax disputes professionals I have now spent years helping clients extract themselves from, often, costly tax avoidance arrangements where they end up paying the taxes they thought they were saving and have still paid fees for those arrangements along the way (plus my fees on top for unravelling and settling those arrangements).

But I am a pragmatist if nothing else.

So, on the one hand, HMRC believe there is extensive use of these arrangements and so, surely, it suits their purposes for users to concede the arrangements and to come forward to settle those matters with HMRC quickly and voluntarily.

On the other hand, like many readers with experience in the tax disputes world, we know what makes clients tick and how they think. An unwelcome, sometimes business

critical legacy HMRC liability is seldom nothing but bad news, so there needs to be something to encourage that business to face that issue and to address it with HMRC.

Balancing those two competing agendas, my question of the HMRC Spotlight 68 team, when they detailed their mechanism for conclusion, was simply: why would users actually settle voluntarily, what would induce them to come forward now?

The answer from HMRC was simple and straightforward – clients could obtain a settlement with no penalty charged by HMRC on the basis of the conclusion being a voluntary disclosure. Additionally, the business could avoid the “stressful distraction of a long, drawn-out enquiry” (HMRC’s exact words).

Parking for a moment my obvious reaction to the implied threat of the “stressful distraction of a long, drawn-out enquiry”, I pushed a little further and asked if there was any other aspect HMRC could point to as encouraging people to come forward to conclude these matters? Something HMRC must want.

The response was again straightforward – we think that’s enough in our eyes! HMRC were at pains to explain that they have the client lists from the scheme provider and it was their intention to “get round to them all eventually”, so coming forward now and on a voluntary basis was, in HMRC’s opinion, better than waiting.

Inducement enough?

So HMRC have expressed two ‘good reasons’ as to why clients ought to come forward voluntarily and conclude the matters highlighted in Spotlight 68:

- (1) No penalty; and
- (2) Avoiding a long, drawn-out enquiry.

Let’s look at those.

There is a whole other article about the likelihood of HMRC being able to sustain charges to penalties if they needed to assess such penalties in this avoidance scenario in any event. This is always a hot topic amongst tax dispute professionals, particularly as HMRC, perfectly reasonably, continue to push penalty behaviours at the Tribunal for Judicial clarity. But, in my humble opinion, the risk of penalties being properly due for these settlements is a low to remote risk, meaning HMRC penalty assessments would be ill-advised. If I’m right, then offering a no penalty outcome for coming forward voluntarily is, then, no real inducement.

And what about the dangled carrot of avoiding long drawn-out enquiry? Really, given the Spotlight, there is no real scope for any debate or dispute with HMRC. I cannot see how there will be any deviation by HMRC from what they told me when I spoke to them. So what ‘long, drawn-out enquiry’ can there really be in any event? Settlement and concession rather than resistance and dispute seems the likely route. Possibly some to-ing and fro-ing to get the figures agreed as accurate by both sides, but that strikes me as pretty much everything. So there really shouldn’t be a ‘drawn-out enquiry’ either, so again no real inducement there.

Being the pragmatist I am, my conclusion on those two issues then took me to thinking about what, or how, HMRC could properly encourage people to embrace a, largely at least in their eyes, unwelcome development and liability. Something, at least, that would make people think that sitting tight and waiting was not an altogether sensible approach and that, instead, approaching HMRC openly to conclude matters, with a softer landing area around settling, might be more productive both for clients and for HMRC.

Naïve or optimistic?

I'm prepared for accusations of both (let's be honest, I've been called worse), but is it time for HMRC to re-think its approach?

If I hark back to the halcyon days of the Lichenstein Disclosure Facility (LDF) – unbelievably (and very broadly) offering a 40% composite rate for everything requiring regularisation and a guaranteed no prosecution, then we have already had a classic, HMRC-supported 'bring out your dead' opportunity. With, I think, sensible and attractive (to clients) inducements built into it. No surprise then that raised broadly £1.2bn during its life (yes, I know it was forecast to raise £5bn, but...).

Is it not time for another?

We know that tax avoidance is frowned upon at every level, but is HMRC being tied up in knots trying to settle them all the best use of their resources? I would suggest we only need to look at the ongoing disguised remuneration and Loan Charge cases not concluded and the fact that we now need another Loan Charge review focusing on the steps preventing settlements, to tell us that HMRC's approach to settlements might benefit from a little refining.

Perhaps HMRC's perceived punitive approach (and we all know why – no advantage is allowed to be given to tax avoiders) is the reason that they don't make the headway that perhaps they could or should? The LDF showed us that HMRC can be pragmatic too, creating an incentive to come forward and conclude troublesome matters. So why not one more generally for the tax avoidance area that so troubles HMRC on the one hand, but provides resource and time hurdle after hurdle to a smooth resolution, based on taxpayer reluctance, on the other?

Let's be frank: if taxpayers purposefully hiding illicit, non-taxed cash in offshore tax havens systematically can get a pragmatic, no-nonsense framework to smoothly conclude matters like the LDF presented, why can't those taxpayers who ventured into tax arrangements, often under seemingly sound advice or professional encouragement, get something that encourages their swift, smooth exit, as opposed to the somewhat more judgemental and punitive approach I experienced on the Spotlight 68 matter?

In short, is HMRC's moral compass a little skew-whiff?

If I had the ear of anyone at HMRC, I'd suggest something that looked like:

- A fixed period of resolution window to come forward voluntarily (say two years);
- A guarantee of no prosecution for full and complete disclosures;
- A single composite rate to capture all duties, interest and penalties (maybe 50% or so);
- A proper, last chance 'bring out your dead' exercise;
- Properly publicised as a one-off event (HMRC are certainly so much better at advertising now than they were in LDF days); and
- Presented as a final final final opportunity to resolve – with proper more punitive terms to follow afterwards.

But what would I know? Grumpy Old Man moment concluded...

- Gary Brothers, Principal, Gary Brothers Consulting