IATJ 4th Assembly, Amsterdam, August 30th & 31st 2013

Tax Avoidance and Evasion

The United Kingdom

1. How does the United Kingdom distinguish between tax avoidance and tax evasion?

Tax evasion is unlawful conduct vis-à-vis tax rules; tax avoidance is lawful conduct but involves "bending the rules of the tax system to gain a tax advantage that parliament never intended" (HMRC, Tackling Tax Avoidance, September 2012).

Tax evasion may involve a mental element on the part of the taxpayer: deliberate conduct, for example, to conceal taxable subject matter or not to declare a taxable event, to conceal information from the Revenue authority or to claim a tax repayment or tax benefit knowing that you are not entitled to it. This is criminal activity to which criminal sanctions (including imprisonment) may apply. As such it can be distinguished from some unintended or non-deliberate failure to comply in some way with tax rules, which may attract a civil financial penalty but not criminal prosecution.

Avoidance is usually contrasted with tax planning. Avoidance "often involves contrived, artificial transactions that serve little or no purpose other than to produce a tax advantage. It involves operating within the letter – but not the spirit – of the tax law" (HMRC, Tackling Tax Avoidance, September 2012). By contrast tax planning involves using tax reliefs for the purpose for which they were intended.

Tax avoidance transactions may not achieve their objective. This may be due to specific or general anti-avoidance rules or because the basic tax law does not have the meaning or effect for which the taxpayer contends. The vast majority of avoidance transactions are conducted on the basis that the taxpayer tells HMRC everything about his transactions and the 'avoidance' works or fails according to whether the taxpayer's or HMRC's interpretation of tax law is found to be correct.

'Failed' tax avoidance is not ordinarily regarded as evasion (whether of a deliberate or an unintended variety) and therefore does not attract any penalty or sanction unless it turns out that there has been some failure by the taxpayer to disclose all relevant information to HMRC (in which case HMRC may seek a civil financial penalty but only rarely will contend that it amounts to a criminal activity).

There is a difficult area – sometimes described as "avoision" – where the success of a tax avoidance transaction may depend to some extent upon matters such as (a) HMRC not being told everything relevant to the transaction, (b) HMRC lacking the evidence to prove a particular matter upon which the success of the tax avoidance depends, or (c) the taxpayer's reasons for entering into the transaction or the purpose of the transaction where the reasons or purposes are represented to HMRC as not being tax motivated. "Avoision" may be especially relevant in the case of 'offshore' transactions where HMRC have difficulty in collecting information and persons outside the UK's jurisdiction may have no (enforceable) obligation to deliver information. It can be characterised as

"avoision" because it is often impossible to know or to prove whether particular conduct has amounted to deliberate concealment or misrepresentation or is entirely innocent.

2. What are the civil and criminal penalties for tax evasion?

Tax evasion may attract criminal penalties including imprisonment, confiscation of the proceeds of crime and unlimited financial penalties.

HMRC, however, rarely prosecutes and in most cases follows its civil investigation of fraud procedures leading to the imposition of civil financial penalties usually based to some extent on the tax found to have been evaded.

Criminal investigation and prosecution is reserved for cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate. Examples include organised criminal gangs attacking the tax system or systematic frauds, where the individual holds a position of trust or responsibility (such as a judge), where an avoidance scheme has relied upon a false or altered document or the misrepresentation of the facts to lend credibility to the scheme, where money laundering is involved and cases of a repeated unlawful conduct.

3. What are some of the abusive tax schemes and how has HMRC and the Courts dealt with such issues?

Two cases (in both of which I appeared as counsel for HMRC) offer a contrast:

(1) **The scheme**: An employer paid annual discretionary bonuses to employees as follows: (a) the employer established an employee benefit trust (EBT) and donated the bonus cash to the EBT; (b) the EBT contributed the cash to a wholly owned company; (c) the company issued a special class of preference share to the EBT; (d) the sole right attaching to the preference shares was the right to a single dividend; (e) the EBT awarded the preference shares to employees; (f) the company declared a dividend to employees to deliver the bonus cash to employees.

    The planned tax benefit: The scheme relied on the fact that (i) the allocation of shares at (e) was tax exempt (the tax charge being deferred until the shares were sold or redeemed, by which time they would be valueless because the whole value was paid out as a dividend), and (ii) dividends are taxed more favourably than ordinary employee cash bonuses.

    Outcome: the scheme did not work because the court decided that it was merely a mechanism for delivering the cash bonus to employees.

(2) **The scheme**: Company A subscribed B shares at a £50m premium followed by these transactions: (a) A stock lent the B shares to C; (b) C repo'd the B shares to D; (c) D sold the B shares to E; (d) B paid a dividend of £50m share premium to E; (e) D paid a manufactured dividend to C and C paid a manufactured dividend to A; (f) the effect of the dividend was to strip the B shares of all value; (g) D was entitled to subscribe further B shares at a nominal value to enable it to close out the repo with C and to enable C to return the stock loan to A.

The tax benefit: D's sale of shares to E was a capital transaction and the gain accruing was offset by capital losses but D could claim an income deduction for the manufactured dividend paid to C. The effect was to convert unallowable capital losses into allowable income losses. The effect was also to provide six month funding to D although the funding was only profitable on a post-tax basis.

The outcome: HMRC argued that the dividend was a capital payment (being the return of the premium subscribed by A and reflecting the stripping of all capital rights attaching to the shares). This argument would have denied D the tax deduction for its manufactured payment to C. However, the court decided that a dividend is always income so that the tax scheme succeeded in its objective.

The mere fact that a transaction is entered into to generate a tax advantage is not a reason for interpreting the legislation to deny the taxpayer a tax benefit, unless the legislation incorporates a tax motive or purpose test. However, all tax legislation must be interpreted 'purposively' having regard to the 'reality' of the taxpayer's transactions (the *Ramsay* principle).

UK tax legislation incorporates a multitude of specific and general anti-avoidance provisions which are to be interpreted in the manner just indicated. Taxpayers and tax professionals may also have to report tax avoidance arrangements under Disclosure of Tax Avoidance Scheme (DoTAS) rules.

Since 17 July 2013 the UK has also had a statutory general anti-abuse rule of "GAAR". This defines abuse in the following terms:

"Tax arrangements are 'abusive' if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including—

(a) Whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,

(b) Whether the means of achieving those results involves one or more contrived or abnormal steps, and

(c) Whether the arrangements are intended to exploit any shortcomings in those provisions."

One reason for the introduction of a statutory GAAR that was given by the author of the report recommending a GAAR was this:

"At the moment, in the absence of any such anti-abuse rule, the task of judges in the Tax Tribunals and the Courts in dealing with abusive schemes is confined to deciding whether such schemes succeed or fail by applying the normal principles of statutory interpretation to the tax provisions concerned. Judges inevitably are faced with the temptation to stretch the interpretation, so far as possible, to achieve a sensible result; and this is widely regarded as producing considerable uncertainty in predicting the outcome of such disputes. In practice this uncertainty spreads from the highly abusive cases into the centre ground of responsible

> tax planning. A GAAR specifically targeted at abusive schemes would help reduce the risk of stretched interpretation and the uncertainty which this entails."

The statutory GAAR, however, does not purport to amend the *Ramsay* principle.

Increasingly the Government and HMRC are adopting 'non-statutory' methods to curb avoidance, e.g. 'naming and shaming' those who are regarded as avoiding tax.

4. How do you deal with individuals who fail to file a tax return?

The UK operates a self-assessment system for most taxes. Failure by a taxpayer to file a tax return for any tax will usually attract automatic penalties of a fixed amount (irrespective of the reason for the failure) that may increase according to the period for which the default continues. Automatic penalties may be dispensed with in limited cases where taxpayers can demonstrate that they have a 'reasonable excuse' for their failure.

If the failure to file the tax return is found to be 'deliberate', rather than e.g. a failure to know of or to understand the need to file a return, the failure may attract larger financial penalties or criminal sanctions depending upon the nature of the conduct leading to the failure.

5. What are the penalties for Corporate tax fraud? Do corporate sham transactions constitute tax fraud?

Corporate tax fraud would amount to tax evasion and would be dealt with as previously outlined – i.e. attracting civil or criminal penalties depending upon the circumstances of the fraud.

As a matter of its general law, the UK has a relatively limited concept of "sham" transactions. If particular transactions are characterised as "sham", then they will frequently (but not necessarily) be associated with fraud. Put differently, if tax fraud is proved then the transactions that are the basis of the fraud involved may be characterised as "sham" transactions.

6. To what extent do you get involved in international transactions involving tax fraud?

The main example of international tax fraud with which the UK tax tribunals can be involved is "Missing Trader Intra-Community" or MTIC fraud involving VAT within the European Union. MTIC cases frequently involve innocent traders (or those who claim to be innocent) who have become unwitting parties in the chain of transactions giving rise to the fraud.

Generally speaking, tax fraud involving criminal sanctions are dealt with in the UK criminal justice system and do not involve the UK tax tribunals. The UK tax tribunals will be involved, however, in appeals concerning the imposition of civil penalties by HMRC for all forms of evasion (including tax fraud) where HMRC has not resorted to criminal prosecution but is pursuing civil penalties (with the lower burden a proof).

The UK tax tribunals also have jurisdiction to deal with cases involving the confiscation of the proceeds of crime.

Judge Malcolm Gammie QC
22nd August 2013