

Summary: Intervention & Options

Department /Agency:
HM Revenue & Customs

Title:
Impact Assessment of Strengthening and Revising the Disclosure of Tax Avoidance Schemes (DOTAS) regime

Stage: Implementation

Version: 1.0

Date: 15 March 2010

Related Publications: The consultation "Disclosure of Tax Avoidance Schemes (DOTAS)" published on 9 December 2009 and the Summary of Responses to that consultation.

Available to view or download at:

<http://www.hmrc.gov.uk/consultations/>

Contact for enquiries: Philippa Staples

Telephone: 020 7147 2444

What is the problem under consideration? Why is government intervention necessary?

The Disclosure of Tax Avoidance Schemes (DOTAS) regime was introduced in 2004 and has provided HMRC with early information about tax avoidance schemes, informing 49 Pre Budget Report (PBR)/Budget measures, up to and including PBR 2009, that have closed off over £12 billion in tax avoidance opportunities. It has also informed HMRC's compliance work.

HMRC has identified a number of areas of DOTAS that are either being exploited by a small number of promoters or where it could be improved. The Government proposes to remove these weaknesses in order to further bear down upon tax avoidance.

What are the policy objectives and the intended effects?

The objectives are to:

- (a) improve and speed up the information that HMRC receives about tax avoidance schemes to inform risk assessment and the selection and timing of anti-avoidance legislation;
- (b) improve the identification of users of tax avoidance schemes, so informing HMRC's selection and management of schemes and returns for enquiries; and
- (c) affect the economics of avoidance.

What policy options have been considered? Please justify any preferred option.

1. Do nothing.
2. Revise and extend DOTAS in a package of measures.

Option 2 is the preferred option.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Expected three years from the date that the legislation implementing the package comes into force.

Ministerial Sign-off For Implementation Impact Assessment:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the cost.

Signed by the responsible Minister:



Date: 15 March 2010

Summary: Analysis & Evidence

Policy Option: 2

Description: A package of measures to revise and extend DOTAS

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' One off IT cost to HMRC of providing for client lists. Admin costs for promoters and some taxpayers of training staff and introducing new reporting processes.
	One-off (Transition)	Yrs	
	£ 250,000	1	
	Average Annual Cost (excluding one-off)		
	£ 275,000	5	Total Cost (PV) £ 1.1 million
Other key non-monetised costs by 'main affected groups' Costs to HMRC, promoters and some taxpayers of becoming familiar with the new rules. Potential increased costs in imposing penalties if a higher penalty leads to a greater degree of litigation.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' The benefit is captured on the estimated exchequer effect (see Key Assumptions/Sensitivities/Risks) and it is not reported in this section. It includes enhancing government's ability to introduce timely anti-avoidance legislation and target compliance resources more effectively.
	One-off	Yrs	
	£ n/a	n/a	
	Average Annual Benefit (excluding one-off)		
	£ n/a	n/a	Total Benefit (PV) £ n/a
Other key non-monetised benefits by 'main affected groups' Greater certainty to promoters about what schemes to disclose and when. Reduced HMRC and customer admin costs resulting from a more targeted approach to anti-avoidance legislation and compliance work. Reduced HMRC admin costs resulting from more effective prioritisation of resources.			

Key Assumptions/Sensitivities/Risks Targeting of the new rules at significant avoidance risks will reduce the the risks of onerous, unnecessary and unwanted disclosures. Increased yield from improved detection is estimated to be in the region of £25m for 2010/11 and £50m per year thereafter. We also estimate that the measures will protect revenue in the region of £200m per year.

Price Base Year 2010	Time Period Years 5	Net Benefit Range (NPV) £n/a	NET BENEFIT (NPV Best estimate) £ n/a
-------------------------	------------------------	---	--

What is the geographic coverage of the policy/option?	UK-wide			
On what date will the policy be implemented?	October 2010			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£ n/a			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ n/a			
What is the value of changes in greenhouse gas emissions?	£ n/a			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro n/a	Small n/a	Medium n/a	Large n/a
Are any of these organisations exempt?	No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£ 250,000	Decrease of	£ N/A
Net Impact			£ 250,000

Key: Annual costs and benefits : Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Introduction

This Impact Assessment updates the consultation stage impact assessment accompanying the consultation document *Disclosure of Tax Avoidance Schemes (DOTAS)* published in December 2009.

DOTAS was introduced in Part 7 of the Finance Act (FA) 2004 and came into force on 1 August 2004. It requires early disclosure of information about certain tax schemes in order to:

- provide early information to HMRC about the detail of tax avoidance schemes to allow the risk they pose to be assessed, and where appropriate to inform legislation to close loopholes;
- identify the users of those schemes to inform risk assessment and HMRC's compliance work; and
- reduce the supply of avoidance schemes by altering the economics of avoidance, reducing the returns to promoters and users as schemes are closed down more quickly.

DOTAS has subsequently been revised and extended and it now covers the whole of income tax, corporation tax (CT) and capital gains tax (CGT) (collectively known as "the main regime"). It also covers stamp duty land tax (SDLT) on commercial property ("the SDLT regime"). Regulations extending the SDLT regime to residential property schemes come into force on 1 April 2010.

Regulations (made under the Social Security Administration Act 1992) apply DOTAS, to the extent that it applies to income tax, to schemes that concern National Insurance Contributions (NICs). When the proposed tax changes come into force, those elements that apply to income tax will be extended to NICs at the same time.

There is a separate disclosure regime for VAT, which is not affected by the proposed changes and therefore not included in the scope of this assessment.

How DOTAS works

DOTAS requires certain persons, normally the promoter of the scheme, to provide HMRC with information about schemes falling within certain descriptions. The promoter must explain how the scheme is intended to work and must normally do so within five days of making the scheme available to clients. Promoters are accountants, solicitors, banks and financial institutions and small firms of specialist promoters known as 'tax boutiques'. Offshore schemes not disclosed by the promoter must be disclosed by the user.

The descriptions of schemes required to be disclosed under the main regime are known as "hallmarks". There are currently eight. Five generic hallmarks target new and innovative schemes: three, more objective, hallmarks target known risk areas. The SDLT regime has a separate description.

A scheme reference number (SRN) system enables HMRC to identify the users of schemes. When a scheme is disclosed, HMRC allocates a SRN and notifies it to the promoter. The promoter passes the SRN to their clients who in turn must use it to identify themselves to HMRC, normally by including the SRN on a tax return. The SRN system currently does not apply to SDLT. But regulations extending the SRN system to the SDLT regime will come into force on 1 April 2010.

The SDLT changes described above have been the subject of a separate consultation and the responses to that consultation have been published on HMRC's website at www.hmrc.gov.uk/consultations/index.htm. The SDLT changes have also been the subject of a full impact assessment which has been published on HMRC's website at www.hmrc.gov.uk/better-regulation/ia.htm.

There are information powers enabling HMRC to investigate cases of suspected non-compliance and penalties for failing to disclose a scheme and failing to pass on or report a SRN.

The impact of DOTAS

Tax avoidance schemes are promoted and used by a relatively small number of businesses and individuals. The number of disclosures of avoidance schemes is currently around 100 a year for the main regime and 30 for SDLT.

But the amounts of tax at risk from avoidance and protected by DOTAS are considerable. Since 2004 DOTAS has informed 49 measures announced at Budget or PBR, up to and including PBR 2009, that have together blocked off over £12 billion in avoidance opportunities.

DOTAS provides early information about new and emerging avoidance threats, allowing, where appropriate, Ministers to announce a measure ahead of PBR or Budget stopping the scheme before it can lead to significant tax losses. In some cases such an announcement has been made within days of information being received.

Since DOTAS was introduced HMRC has adopted a project management approach to enquiries into tax returns, using SRNs as the focus.

Weaknesses inhibiting the performance of DOTAS

HMRC has identified five weaknesses that inhibit the performance of DOTAS.

Penalties

Under the current penalty regime the maximum penalty that a promoter faces for deliberate non-compliance is in practice normally no more than £5,000. This is not sufficient to deter a small but active group of promoters who appear to regard a potential penalty of that size as being a cost of the scheme to be defrayed from the (often very considerable) rewards from selling the scheme to clients. There have been five instances where a promoter has paid a penalty of £5,000 without a formal tribunal hearing, long after the scheme should have been disclosed. Such behaviour subverts the policy intention of DOTAS, which is to provide HMRC with early information that could lead to a Government announcement of legislation effectively stopping the scheme before it can lead to a significant tax loss.

'Introducers'

FA 2007 provided HMRC with powers to investigate cases where it suspects that a promoter had failed to disclose a scheme as required. These include powers to require a person so suspected to explain why the scheme is not notifiable by them. HMRC is increasingly encountering persons who 'advertise' the existence of a scheme to potential clients, but they are not themselves a promoter of the scheme and do not know its detail. Rather they introduce potential clients to the promoter. HMRC has no powers to require such persons to identify the promoter and generally they choose not to do so voluntarily.

The event that triggers disclosure of a marketed scheme

The event that currently triggers the disclosure of a marketed scheme is the making by the promoter of the scheme 'available for implementation' by clients. It has become clear that this event is relatively late in the marketing process, later than was envisaged when the rule was drafted. Moreover, HMRC is aware of cases where a promoter has exploited the rule so that the scheme is not available for implementation by clients until just before implementation, despite those clients having been signed up to the scheme much earlier. Consequently, the current rule tends to provide HMRC with insufficient time to put forward legislative counter-action against a scheme, and Ministers to announce it, before a scheme is implemented.

Information about scheme users

The SRN system has proved a reasonably robust means of identifying users of disclosed tax avoidance schemes. However, it has two inherent weaknesses.

Firstly, HMRC normally identifies users only when returns are submitted, which can be many months after the scheme is implemented. The lack of early information about the number and type of scheme users makes it difficult for HMRC to estimate the tax at risk in real time and make informed choices about which schemes to counter by legislation. It also makes it difficult for HMRC to make informed choices about how to allocate and prioritise resources to compliance work on users. Estimating tax at risk and identifying resources required in real time is of increasing importance in the current fiscal climate.

Secondly, limited partnerships apart, it is difficult for HMRC to identify taxpayers who fail to report a SRN. Improvements have been made to the system to reduce error, but there is still a risk that a scheme user may deliberately fail to report a SRN in the hope of avoiding an enquiry.

The hallmarks

The current hallmarks are heavily focussed on new and innovative avoidance schemes (through the generic hallmarks) with only three hallmarks targeting specific risk areas (leasing, income tax losses and pension contributions) with more objective descriptions. However, an increasing number of schemes of concern to HMRC rely upon 'old tax technology' that is not disclosable (e.g. Employee Benefit Trust and similar schemes seeking to avoid tax and NICs on employment income). The number of such schemes may grow in response to changes in the tax system. For example, HMRC is already aware of such schemes that target the 50 per cent income tax rate (e.g. by converting income into capital).

The current hallmarks also largely focus upon marketed tax schemes. Since 2004 there has been a marked reduction in marketed avoidance schemes accompanied by a shift by some promoters and taxpayers towards more bespoke arrangements. In principle, bespoke avoidance schemes are within the scope of the generic hallmarks, but in practice the main tests of confidentiality and premium fee are not readily applicable to bespoke situations.

The options considered

Option 1: Do nothing

Taken together the weaknesses described above result in DOTAS operating to a significant degree below what it is capable of. Moreover, it would be reasonable to expect that these weaknesses would be increasingly exploited as some scheme promoters and users become more familiar with the opportunities they provide. This would result in an unacceptable loss of tax revenues and create unfair advantages for the minority of promoters and taxpayers involved in tax avoidance.

Option 2: Revise and extend DOTAS with a package of measures

This is the preferred option.

Consultation

At the 2009 PBR HMRC published a formal consultation document proposing five measures to address each of the weaknesses identified above:

- **Measure 1:** Enhanced penalties for failure to comply with a disclosure obligation. The measure would create a new daily penalty of £600 maximum, to run from the date the failure to disclose occurred, with the total amount to be set by the tribunal, taking into account the fees earned (for a promoter) or the tax saving sought (others);
- **Measure 2:** An information power to require persons who introduce scheme promoters to clients to identify who the promoter is;
- **Measure 3:** A change to the trigger point for disclosure of marketed schemes to ensure early disclosure of schemes. The new trigger would be that the detailed design of the

scheme is worked up and steps are taken to communicate the scheme's existence to third parties;

- **Measure 4:** A requirement for a promoter to provide HMRC with a periodic list of clients to whom they have issued SRNs; and
- **Measure 5:** Revised and extended hallmarks (the descriptions in regulations of schemes required to be disclosed).

The consultation document exposed draft Finance Bill legislation for comment covering Measures 1 to 4 above. It also exposed for comment draft regulations covering Measure 5. The consultation closed on 19 February. We received 19 written responses and during the consultation process HMRC also met with a number of stakeholders and held an open seminar. The consultation identified a number of issues and concerns about the detail of the legislation and a number of small but significant changes have been made to the draft legislation as a result. A response to the consultation is published alongside this impact assessment at www.hmrc.gov.uk/consultations/index.htm

Implementation

Budget 2010 announced that Finance Bill 2010 will include legislation that would introduce Measures 1 to 4 as described above. It also announced that Descriptions Regulations, not dependent upon the Bill, will revise and extend the DOTAS 'hallmarks' (descriptions of schemes required to be disclosed).

The Bill will contain substantive provisions and powers to make regulations. The substantive powers will come into effect on separate days to be appointed by Order. It is expected that the substantive provisions and the regulations (including the Descriptions Regulations) will come into effect on a common date in autumn 2010. NICs regulations mirroring the tax changes, insofar as they apply to income tax, will come into force at the same time as the tax changes.

This impact assessment considers the 5 measures announced at Budget 2010 as a package, since the effect of the package is greater than the sum of the individual measures. However, whereas Measures 1 to 4 are included in the Finance Bill, Measure 5 will be implemented solely by means of regulations, which will be the subject of further discussions with business. Consequently, this assessment will be updated when regulations implementing Measure 5 (hallmarks) are made and laid.

Impacts on promoters and users – general description

Measure 1: Enhanced penalties for failure to disclose a scheme

The measure itself does not create a new disclosure obligation or change the circumstances in which a person is liable to a penalty (but measures 2 and 4 each create a new information reporting requirement, failure to comply with which would be subject to a penalty)

The measure provides for an increased penalty for failure to comply with existing disclosure obligations. It targets the small proportion and number of persons who fail to comply with a statutory obligation either to disclose a scheme or to provide information in response to a formal notice seeking information concerning that scheme.

Measure 2: A power to require persons who introduce potential clients to a promoter to provide information about the promoter

A person issued with a notice by HMRC would be required to provide the name and address of the person who supplied them with the scheme whose existence they are communicating to third parties.

If the current level of casework remains unchanged, HMRC would expect to issue a maximum of 20 such notices in a year.

Measure 3: A change to the time when a promoter must disclose a marketed scheme to HMRC

Scheme promoters would have to amend their processes to identify schemes requiring to be disclosed earlier in the process than now. They would have to update their internal guidance and train staff.

The revised rule is targeted at actively marketed schemes and is not intended to affect other schemes, which although not fully 'bespoke' are not actively marketed (e.g. the circumstances where a promoter is approached by a client and provides them with a 'packaged solution'). Disclosure of schemes not actively marketed will continue to be triggered, as now, by the earlier of the promoter making a proposal for arrangements available for implementation or becoming aware of the client entering into a transaction forming part of the arrangements.

Measure 4: Promoters to provide HMRC with periodic information about clients to whom they have issued a scheme reference number

Scheme promoters will have to introduce processes for capturing data and generating reports about clients to whom they are required to issue a SRN. The data required will be the name and address of the client, which should be known to the promoter. Promoters would have to transmit those reports to HMRC. It is proposed that this would be done by using the KANA system, which is already used to send disclosure reports (forms AAG1 etc) to HMRC securely online.

Promoters would also have to train staff and to monitor the HMRC website for any SRNs that are withdrawn.

The impact on users would be limited. The promoter would be providing information which scheme users would normally be required to provide to HMRC at a later stage. The enhanced information should result in HMRC targeting its enquiries more effectively, reducing the number of unnecessary enquiries. However, there may be some instances where the list prompts HMRC to contact a client who has not implemented the scheme. Changes to the legislation as a result of the consultation should restrict such instances to a small number.

Measure 5: Revisions and extensions to the "hallmarks" (descriptions of schemes that must be disclosed)

Promoters would have to revise internal guidance and ensure that their staff become familiar with the new descriptions.

There would be an increase, at least initially, in the number of disclosures. Previous revisions and extensions have led to a short term spike in disclosures followed by a fall to a steady state. The current steady state is a relatively small number (around 100 disclosures a year) and the changes, if properly targeted, should not lead to a disproportionate increase in that number. They should also provide greater clarity in borderline cases.

An increase in disclosures would lead to a corresponding increase in the number of SRNs issued by HMRC, to be transmitted onwards by promoters (and reported on the new clients) and reported back by scheme users.

Compliance Costs

Each of the proposed measures would have a different impact on the costs to those providing HMRC with disclosures or other information.

Prior to consultation, HMRC proactively identified the following potential costs:

- revising internal guidance and providing staff training;
- potential infrastructure costs of collecting and transmitting the required additional information; and
- costs to promoters of changing systems to disclose marketed schemes earlier.

During consultation HMRC did not receive any responses providing estimates of the costs. Some respondents expressed concerns that the costs could be disproportionate, in particular if the hallmarks (Measure 5) were too widely drawn. On the basis of the changes that have been made to the draft Finance Bill legislation, and on the assumption that the hallmarks will be narrowly targeted, it is considered that promoters will be able to meet the requirements of the package by adapting existing systems and that the associated costs will not be significant. HMRC will review the compliance cost estimates when the regulations implementing Measure 5 are made and laid and this assessment is updated as described above.

Impact on HMRC

Costs to HMRC include:

- costs of producing guidance and communicating changes to promoters;
- costs of changing IT systems to receive client lists from promoters (estimated at £150,000 in year 1) and of matching client list data to existing systems. The total costs for this work are estimated to be less than £250,000 and have been included in HMRC's spending plans.
- potential increased costs in imposing penalties if a higher penalty leads to a greater degree of litigation

Admin Burden

The admin burden is assessed through the 'Standard Cost Model', an activity-based costing model which identifies what activities a business has to do to comply with HMRC's obligations, and which estimates the cost of these activities, including agent fees and software costs.

Using the Standard Cost model the admin burden has been estimated to be £275,000 per year (2010 prices). This is the combined effect of all quantifiable measures. Measure 1 will have no impact as the admin burden is only quantified for compliant businesses. The figure above is therefore a combination of the remaining four measures. This has been calculated by considering businesses; promoters, introducers, clients and employers.

Policy Benefits

It is envisaged that the proposed changes will lead to a series of benefits to HMRC and promoters that will include:

- greater certainty about which schemes are disclosable and when, thereby reducing the costs associated with dealing with cases where disclosure is uncertain or disputed;
- reduced costs of introducing and responding to anti-avoidance legislation as the proposed measure will inform a more generic approach to legislation; and
- more effective use of HMRC's resources through better information about the tax at risk in relation to schemes and users.

Exchequer Effects

DOTAS is an information device and its main impact is to protect revenue by informing both legislation and compliance work. As reported earlier in this assessment, since 2004 DOTAS has informed legislation that has closed off over £12 billion in avoidance opportunities.

Measures 1 to 4 will introduce further incentives for timely and accurate disclosures. Two broad effects would be expected. Firstly an improvement in the flow of information with a consequent acceleration, for schemes with significant tax risks, of legislation closing the scheme down. For schemes with the most substantial tax risks, the objective would be to make the legislation effective from a date before the scheme is implemented and tax revenue potentially lost. The

second broad effect is that, if the legislation is perceived to be effective, promoters will not market schemes that are high risk of being closed down before they can be implemented.

We have drawn upon the evidence of avoidance schemes recently closed by HMRC through DOTAS to assess the impact of the package and we estimate that it will protect revenue in the region of £200 million per year. This is based on the assumption that the policy will prevent the implementation of at least one scheme per year similar to those recently legislated against by HMRC.

Judging from the current yield contribution of DOTAS we would also expect that the extended hallmarks will lead to an increase in yield from the improved detection and challenge of failed avoidance schemes. As the increased yield is based on the cumulative effect of improved detection activity over the course of a year the benefit for the first year will be affected by the fact that the measure will not come into effect until the third quarter. On this basis the increased yield from improved detection is estimated to be in the region of £25 million for 2010/11 and £50 million per year thereafter.

Specific Impact Tests

Full details of the specific impact tests are listed at:
http://berr.gov.uk/regulation/ria/toolkit/specific_impact_tests.asp.

Competition Assessment

The aim of this measure is to provide increased transparency about the marketing and use of avoidance schemes. Tax avoidance distorts competition by limiting the ability of those who do not engage in avoidance to compete fairly.

Small Firms Impact Test

Businesses of any size can buy and sell avoidance products and the objective of providing a level playing field between scheme promoters and fairness to taxpayers precludes exempting small businesses from this measure. However, HMRC does not expect the measure to have a significant effect upon small business either in absolute terms or proportionately.

Legal Aid

These proposals would not significantly increase legal aid impacts.

Sustainable Development

These proposals are in accordance with the principles of sustainable development. In particular, more effective finance arrangements across taxes promote good governance and a sustainable economy.

Privacy Impact

We have conducted a privacy impact screening for Measure 4, client lists, and have concluded that a privacy impact assessment is not required. The screening has identified a requirement for secure data handling in three areas:

- how the lists will be transmitted from the scheme promoter to HMRC;
- how HMRC associates the correct UTR to the name and address information on the lists; and
- how the combined name, address and UTR information is made available to project managers and project caseworkers.

A project is taking these issues forward. In particular, changes to HMRC's IT systems will be made to ensure that promoters can transmit client lists to HMRC electronically in a secure format.

Other impacts

These proposals will have no significant impact on emissions of greenhouse gases, or other environmental impact.

These proposals will have no significant impact on health and well-being.

These proposals will have no significant disability, gender or race equality impact.

These proposals will not have a significantly different effect in rural areas.

These proposals are compatible with the Human Rights Act.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No