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National Insurance Contributions Bill

Bill No 80 of 2014-15

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The *National Insurance Contributions Bill 2014-15* would allow for both categories of National Insurance contributions (NICs) which are payable by the self-employed – Class 2 and Class 4 – to be collected through self assessment from April 2016. The Bill would also extend existing tax rules regarding 'accelerated payments' and 'high-risk' tax promoters to NICs, and introduce a Targeted Anti-Avoidance Rule to prevent the avoidance of NICs by 'intermediaires'. The Bill is scheduled to receive Second Reading on 8 September 2014.

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Summary

The *National Insurance Contributions Bill 2014-15* has four elements:

- **Simplifying NICs paid by the self-employed**: the Bill would move the collection of Class 2 NICs into self assessment, for the 2015/16 tax year onwards. This would mean that this category of NICs paid by the self-employed could be collected alongside Class 4 NICs and income tax from April 2016.

- **Extending new rules for follower notices & accelerated payments to NICs**: under Part 4 of the *Finance Act 2014*, HMRC may issue 'follower notices' when in dispute with a taxpayer over the tax benefit delivered by an avoidance scheme. Where HMRC take the view that the scheme is the same as one that has been reversed in the courts, it may notify the taxpayer and require that they make a pre-payment of the amounts of tax at stake. These monies would be held by HMRC until the taxpayer's final liability has been determined. HMRC may also require an 'accelerated payment' where the taxpayer has used an avoidance scheme reported under the Disclosure of Tax Avoidance Schemes (DOTAS) regime, or a scheme that falls foul of the General Anti-Abuse Rule (GAAR). The Bill would extend HMRC powers to issue follower notices and demand accelerated payments in similar circumstances for NICs.

- **Extending new rules for 'high-risk' promoters to NICs**: under Part 5 of the *Finance Act 2014*, HMRC may place conditions on the conduct of individual accountancy businesses and other promoters of tax avoidance schemes. Where a promoter breaches the terms of this conduct notice, HMRC has new powers to obtain information and impose penalties. The Bill would extend this regime to NICs.

- **Introducing a Targeted Anti-Avoidance Rule for intermediaries**: in 2014 the Government introduced new rules to tackle tax avoidance by 'intermediaries' – employment businesses or agencies who liaise between workers and client companies using their services. This avoidance activity had consisted in exploiting the way tax and NI rules apply to intermediaries based offshore, and in facilitating false self-employment. Legislation with regard to income tax was included in the *Finance Act 2014*; equivalent provisions with regard to NICs were made in secondary legislation. The *Finance Act 2014* also included a Targeted Anti-Avoidance Rule (TAAR) - legislation to ensure that further false self-employment schemes that sought to circumvent these new rules could be struck down in court. The Bill would provide for a similar TAAR for NICs.

The Bill was published on 17 July, and is scheduled for Second Reading on 8 September 2014.

Clauses 1 to 5 of the Bill, with **Schedules 1 & 2**, cover the four measures set out above. The Bill has three other clauses. **Clause 6** makes provision for HMRC's administrative expenses in relation to the Bill's provisions. **Clauses 7 & 8** define abbreviations, establish the title of this legislation, and determine its extent. The Bill extends to England and Wales, Scotland and Northern Ireland.

The Bill, with its explanatory notes, which give a clause by clause description of the Bill, are published on the Bill's page on the Parliament site, which also gives details of its Parliamentary progress to date. Background material on the Bill is collated on Gov.uk.

1 Introduction: the structure of NICs

National Insurance benefits are funded by a system of compulsory contributions on earnings, paid by employees, employers and the self-employed. Most of the income from these contributions – NICs, for short – goes into the National Insurance Fund, kept separate from revenue raised by national taxes. The Fund is used exclusively to pay for contributory benefits, including the State Pension, contributions-based Jobseeker's Allowance, and bereavement benefits. The Fund operates on a 'pay as you go' basis: broadly speaking, this year's contributions pay for this year's benefits. One portion of NICs receipts does not go into the Fund, but goes directly into the National Health Service. The National Insurance Scheme was first introduced in 1911 but assumed its present design in 1975.[1]

NICs are divided into six classes:

- **Class 1** contributions, which are paid by both employees and employers on the employee's earnings. The employee's share is known as the primary contribution, the employer's as the secondary contribution.

  Employees are liable for primary Class 1 NICs on earnings above the 'Lower Earnings Limit' (LEL), set currently at £111 a week. A zero rate of NICs is charged on earnings above the LEL up to the 'Primary Threshold' (PT), set at £153 a week. The main rate of NICs, which is 12%, is charged on earnings above this threshold up to the 'Upper Earnings Limit' (UEL), set at £805 per week. An additional rate of NICs set at 2% is charged on earnings above the UEL.

  Employers are liable to pay secondary Class 1 NICs at 13.8% on all employee earnings above the Secondary Threshold (ST), which is also set at £153 a week. No upper limit applies to employer NICs.

  At present employees contracted out of the state second pension (S2P) pay a reduced rate of NICs.[2]

- **Class 1A** contributions are payable annually by employers on most taxable benefits in kind. They are payable by employers only. Class 1A contributions are payable at a rate of 13.8%.

- **Class 1B** contributions are payable annually by employers on items which are dealt with under a PAYE Settlement Agreement (PSA) for income tax – usually minor or irregular expenses and benefits. Class 1B contributions are payable at a rate of 13.8% on the value of the items included in the PSA and on the total tax payable by the employer under the PSA.

- **Class 2** contributions are paid by the self-employed at a flat rate of £2.75 per week. A self-employed person can apply to be exempted from liability if their annual profits are under a set threshold - the Small Earnings Exemption (SEE). At present this is set at £5,885. Individuals must apply to HMRC for this exemption if they anticipate that their annual profits will not exceed the threshold. In turn HMRC issues a certificate exempting that person from paying Class 2 NICs. This can be backdated for a maximum of 13

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1 The development of National Insurance over the second half of the 20th century is discussed in, Social Security Committee, *The Contributory Principle*, 7 June 2000, HC 56 1999-2000; in particular, see, *Memorandum submitted by the Department for Social Security*, December 1999.

2 This rebate applies for individuals paying into a salary-related scheme only (see, *Contracting out of the State Second Pension*, Library standard note SN4822, 23 March 2011). With the introduction of the single-tier State Pension, scheduled for April 2016, the additional State pension will close and, by extension, the option to contract out of it (see, *Single-tier State Pension*, Library standard note SN6525, 24 March 2014).

weeks from the point of application or to the start of the tax year (whichever is the shorter).

- **Class 3** contributions are paid on a voluntary basis, at a flat rate of £13.90 per week, by people who fall outside the scope of Class 1 and Class 2 contributions.[3]

- **Class 4** contributions are paid annually by the self-employed on profits that are immediately derived from a trade, profession or vocation and which are chargeable to income tax. Class 4 NICs are payable at a rate of 9% on profits between £7,956 and £41,865 and 2% on profits above £41,865.

For 2014/15 the rates of NICs are unchanged from the year before. The Primary and Secondary Thresholds are increased in line with inflation. The Upper Earnings Limit is increased by £8 to £805, so that it remains aligned with the higher rate threshold – the point at which individuals become liable to pay income tax at the higher 40% rate.[4]

The rates of NICs for employees and employers for 2014/15 are set out below:

Earnings[a] £ per week	**Employee (primary) NIC rate (per cent)[b]**	**Earnings £ per week**	**Employer (secondary) NIC rate (per cent)[c]**
Below £111 (LEL)	0%	Below £111 (LEL)	0%
£111 to £153 (PT)	0%	£111 to £153 (ST)	0%
£153 to £805 (UEL)	12%	Above £153	13.8%
Above £805	2%		

[a] *The limits are defined as LEL - lower earnings limit; PT - primary threshold; ST - secondary threshold; and UEL - upper earnings limit.*
[b] *The contracted-out rebate for primary contributions in 2014/15 is 1.4 per cent of earnings between the LEL and the upper accrual point (UAP) of £770 for contracted-out salary-related schemes (COSRS).*
[c] *The contracted-out rebate for secondary contributions is 3.4 per cent of earnings between the LEL and UAP for COSRS.*

A person's entitlement to contributory benefits is dependent on both their record of paying NICs over time, and the Class of NICs they have paid.[5] While payment of Class 1 NICs provides access to the full range of contributory benefits, self-employed persons paying Class 2 NICs have not been entitled to claim certain benefits: principally the additional State Pension and contribution-based Jobseeker's Allowance.

Payment of Class 4 NICs does not count towards entitlement to any contributory benefits. The current earnings-related percentage system for NICs was introduced in stages from 1975. This reform included the introduction of Class 4 NICs, which were intended to spread the cost of benefits available to the self-employed in a more equitable way and so reduce the burden on the self-employed with low earnings.[6] Even taking into account their reduced

3 From October 2015 a new Class 3A is to be introduced, to enable people reaching State Pension age before 6 April 2016 to increase their entitlement to the additional State Pension. For details see, Library standard note SN6525 pp27-28 & DWP, *Class 3A Voluntary National Insurance - policy detail*, December 2013.

4 The basis for indexation is the Consumer Price Index (CPI) for the LEL and the PT, and the Retail Price Index (RPI) for the ST. Changes to these thresholds were made by Order (SI 2014/569).

5 A summary of these rules is given in, *National Insurance and benefits*, on HMRC's site.

6 As noted in a survey of the UK tax system published by HM Treasury some years ago: *Tax Benefit Reference Manual*, Commons Library Deposited paper 2009-1987, July 2009 para 5.35.

benefit eligibility, it is the case the self-employed contribute significantly less to the National Insurance system than employees.[7]

Historically liability to pay NICs has been based on whether a person is 'gainfully employed'.[8] At present, for contribution purposes an employed earner is a person who is gainfully employed in the United Kingdom under a contract of service, or a person who holds an office with earnings that are taxed as general earnings. A self-employed person is any other person who is gainfully employed. This catch-all definition means that someone will continue to be liable to pay Class 2 NICs during temporary breaks in their work (say, between contracts or on holidays).[9] In addition individuals may meet the tests of both employment and self-employment at the same time: for example, those with self-employment income from occasional activities, such as writing or tutoring. A maximum annual NI liability is set for people in this position, determined by reference to their individual profits and the amount of Class 1 and Class 2 NICs paid.[10]

NICs is the UK's second biggest tax after income tax, in terms of the amounts of money it raises for the Exchequer. In 2013/14 NICs raised £108 billion, which compares with receipts of £157 billion for income tax, £105 billion for VAT and £41 billion for corporation tax.[11] It is projected that in 2014/15, NICs will raise just over £106 billion, of which £85 billion will go into the NI Fund and £21 billion will go to the NHS.[12]

Primary and secondary Class 1 contributions make up most Exchequer receipts from NICs. It is projected that for 2014/15, they will raise £42.6 billion, and £60.7 billion, respectively. By contrast Class 2 & Class 4 contributions paid by the self-employed are anticipated to raise around £1.8 billion over this year.[13]

Further background on the National Insurance system is given in two Library standard notes:

- *National Insurance contributions : an introduction*, SN4517, 10 June 2014
- *National Insurance Fund : 1975 to 2014*, SN797, 20 May 2014

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[7] For more details see, *Self-employed people and contribution-based Jobseeker's Allowance*, Library standard note SN547, 16 July 2014.

[8] HMRC, *Simplifying the National Insurance Processes for the Self-Employed – consultation document*, July 2013; in particular, "Annex A: the current system".

[9] Individuals who are ordinarily self-employed may be exempted from paying Class 2 NICs in some circumstances: for example, if they are in receipt of certain benefits (such as maternity allowance) or if they are in prison.

[10] *Simplifying the National Insurance Processes for the Self-Employed*, July 2013 p47

[11] HM Revenue & Customs, *National Statistics: HMRC receipts*, July 2014

[12] Government Actuary's Department, *Report on draft of the social security benefits up-rating Order 2014*, January 2014 pp26-7. On the performance of the Fund, and projections for its balance, see, Government Actuary's Department, *Quinquennial Review of the National Insurance Fund*, July 2014.

[13] *Report on draft of the social security benefits up-rating Order 2014*, January 2014 p27. Figures are net of contracted-out rebates.

2 Simplifying NICs paid by the self-employed

2.1 Background

In October 2007 HM Treasury published a report on possible reforms to NICs, focusing on the proposal that NICs should operate more like tax, by being moved onto an annual basis and being collected cumulatively. It concluded that potential savings for employers would be lower than might have been expected, there would be mixed outcomes for lower-paid individuals, and alignment would come at a high Exchequer cost.[14] Although the Labour Government ruled out substantive reforms to National Insurance at this time, it announced that HMRC would look at ways to reduce the administrative burden of both taxes, including the arrangements for the self-employed to pay both Class 2 and Class 4 NICs.[15]

Following consultation, from April 2011 the dates on which payment of Class 2 NICs is due were aligned with the dates for tax under self assessment (ie, 31 January & 31 July each year).[16] However, payments of Class 2 NICs & Class 4 NICs continue to be made separately. In the first case, individuals may either pay Class 2 NICs by Direct Debit through a nominated bank account, or as a result of HMRC issuing a payment request. When paying by Direct Debit, individuals may choose to pay twice a year, in January and July, or monthly, paid four months in arrears. Alternatively HMRC will issue two payment requests each year. By contrast self-employed persons pay Class 4 NICs with income tax on the completion of their self assessment (SA) tax return:

> After the end of the tax year, the individual will receive a notice to file an SA Return which is generally issued in April. The individual will have until the 31st January in the following calendar year to pay the SA liability that is due. This amount will include the income tax and Class 4 NICs that are due. For example for the 2013-14 tax year, an individual will receive a notice to file in April 2014. If filing on-line the SA Return and the SA final payment are due by the 31st January 2015. If the individual's SA liability is more than £1,000 they will also make an interim payment towards the next year's SA liability (2014-15 tax year), with a second interim payment due by the 31st July 2015. The SA Return for the 2014-15 tax year and final balancing paying is due by the following 31st January 2016.[17]

In its first Budget in June 2010 the Coalition Government announced that it would set up an independent body to review the tax system and make recommendations for its simplification.[18] The following month the Exchequer Secretary, David Gauke, announced the establishment of the Office of Tax Simplification. The OTS was commissioned to undertake two reviews in its first year, looking at the existing structure of tax reliefs, and at small business taxation and the specific question of finding a simpler alternative to IR35.[19]

Just prior to the 2011 Budget the OTS published an interim report on small business taxation, in which it argued that combining income tax and NICs would remove a series of

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[14] HM Treasury, *Income tax and national insurance alignment: an evidence-based assessment*, October 2007

[15] *op.cit.* p52

[16] under SI 2011/797. See also, HMRC, *Impact assessment: improved collection of NICs from the self-employed*, February 2011.

[17] *Simplifying the National Insurance Processes for the Self-Employed*, July 2013 p17

[18] *Budget 2010*, HC 61, June 2010 para 1.64

[19] IR35 refers to anti-avoidance legislation introduced in 2000 to counter the exploitation of one-person companies, channelling income from clients through a company to be taxed on this remuneration as dividends rather than earnings, avoiding NICs. The rules have long been criticised by small businesses. For details see, *Personal service companies: introduction of the IR35 rules*, Library standard note SN914, 20 May 2011.

anomalies in the tax system which distorted taxpayers' behaviour, and would result in significant administrative simplification.[20]

The report acknowledged that there were serious obstacles to full integration, but set out a number of steps that could be taken to align the two taxes, such as combining Class 2 and Class 4 contributions. Barring this, the OTS noted that reforming the way Class 2 NICs were assessed and collected would alleviate the problems for many self-employed persons, who found that at the end of the tax year, they were obliged to apply for a refund of overpaid NI:

> From 6 April 2011, payment of Class 2 NICs will be collected on 31 July and 31 January in the year of liability. From that date quarterly billing will be superseded by biannual or monthly direct debit payments, but this is not being collected through the self assessment system.
>
> Problems can arise after the tax year end. HMRC has to calculate and refund any NICs paid by an individual which is in excess of the annual maximum NICs for the tax year. A self-employed person who has employment income will be liable to national insurance Classes 1, 2 and 4 and may pay more than the effective annual maximum. Such individuals can apply in advance to defer paying their Class 2 and Class 4 NICs until after total income for a tax year is known. The deferment process is paper based and has several stages.
>
> Further, where business profits are below a 'small earnings' threshold, the individual may apply for a 'small earnings exception' ("SEE") from paying Class 2 NICs (Class 4 NICs would not be due) but cannot apply for deferment. This separate form and process, with different time limits, is confusing and frustrating for those whose earnings fluctuate above and below the threshold.[21]

HMRC estimate that there are around 4.4 million self-employed persons liable to pay tax and NICs. Of these around 300,000 persons hold an SEE certificate at any given time. About 800,000 have low profits and pay Class 2 NICs but out of this group around 500,000 also have earnings from employment. As HMRC note, "this may mean that they are already covered for contributory benefits and could apply for SEE without any detriment to their benefit position."[22]

The OTS suggested that bringing Class 2 within SA would bring administrative benefits, though it might pose problems for individuals when claiming certain contributory benefits:

> Given that all self-employed individuals must complete self assessment tax returns, the OTS recommends that the calculation of Class 2 and 4 NICs could become part of the self assessment process …
>
> A potential problem in changing the mechanism through which Class 2 NICs are collected is that any liability would become due 9 months after the end of the tax year (though some could come in earlier via payments on account). This could affect an individual who becomes entitled to benefits from the National Insurance Fund. For example, if the individual's entitlement to benefits arose on 1 January 2011, the Department for Work & Pensions ("DWP") would calculate the entitlement based on contributions to 5 April 2010. As the 2009/10 liability would not be payable until 31 January 2011 the individual may not receive his full entitlement.

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20 Office of Tax Simplification, *Small business tax review*, March 2011. The wider questions of merging income tax and NICs are discussed in Library standard note SN4517, 10 June 2014 (see section 4).

21 *op.cit.* para 4.12-14

22 *Simplifying the National Insurance Processes for the Self-Employed*, July 2013 para 2.7

> We think the DWP, HMRC and HMT could find a workaround for such individuals.[23]

In 2012 the OTS completed a series of reports on small business taxation.[24] In a paper on tax administration, it noted that "understanding and paying class 2 NICs is not an issue which gives much difficulty [for businesses] but we still believe that, although not a priority, there could be simplification and cost reductions for HMRC and small businesses in looking at combining the collection process as part of the SA return."[25]

At the time of the 2013 Budget the Government announced that it would consider the case for this change.[26] In July of that year HMRC published a consultation document, which looked at the difficulties for businesses applying for an SEE certificate, and for deferring payment of Class 2 NICs. In the first case, individuals often found that they had to have repeated communication with HMRC because the SEE process is based on *anticipated* profit levels; the paper gives the following example:

> John anticipates profits above the SEE limit and pays Class 2 NICs throughout the year. At the end of the tax year John finds that he has made profits below the SEE limit and decides to apply to HMRC for a refund of the Class 2 NICs he has paid. He has to provide evidence of his profits. John applies for a refund within the time-limits, HMRC approves his application and John gets a refund of the Class 2 NICs that he has paid.
>
> Jake on the other hand expected low profits and applied to HMRC for a SEE. HMRC approves Jake's SEE application and issues Jake with a SEE certificate. Jake doesn't pay any Class 2 NICs. At the end of the tax year Jake finds that he has made profits above the SEE limit. Because Jake had a SEE in place he is not required to pay any Class 2 NICs for the past periods. However Jake is required to inform HMRC who will cancel his SEE certificate going forward and Jake commences Class 2 NICs payments.[27]

The complexity of the system was illustrated by a flow chart of the range of steps individuals could take in paying Class 2 NICs – reproduced overleaf:[28]

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23 *Small business tax review*, March 2011 para 4.15-17

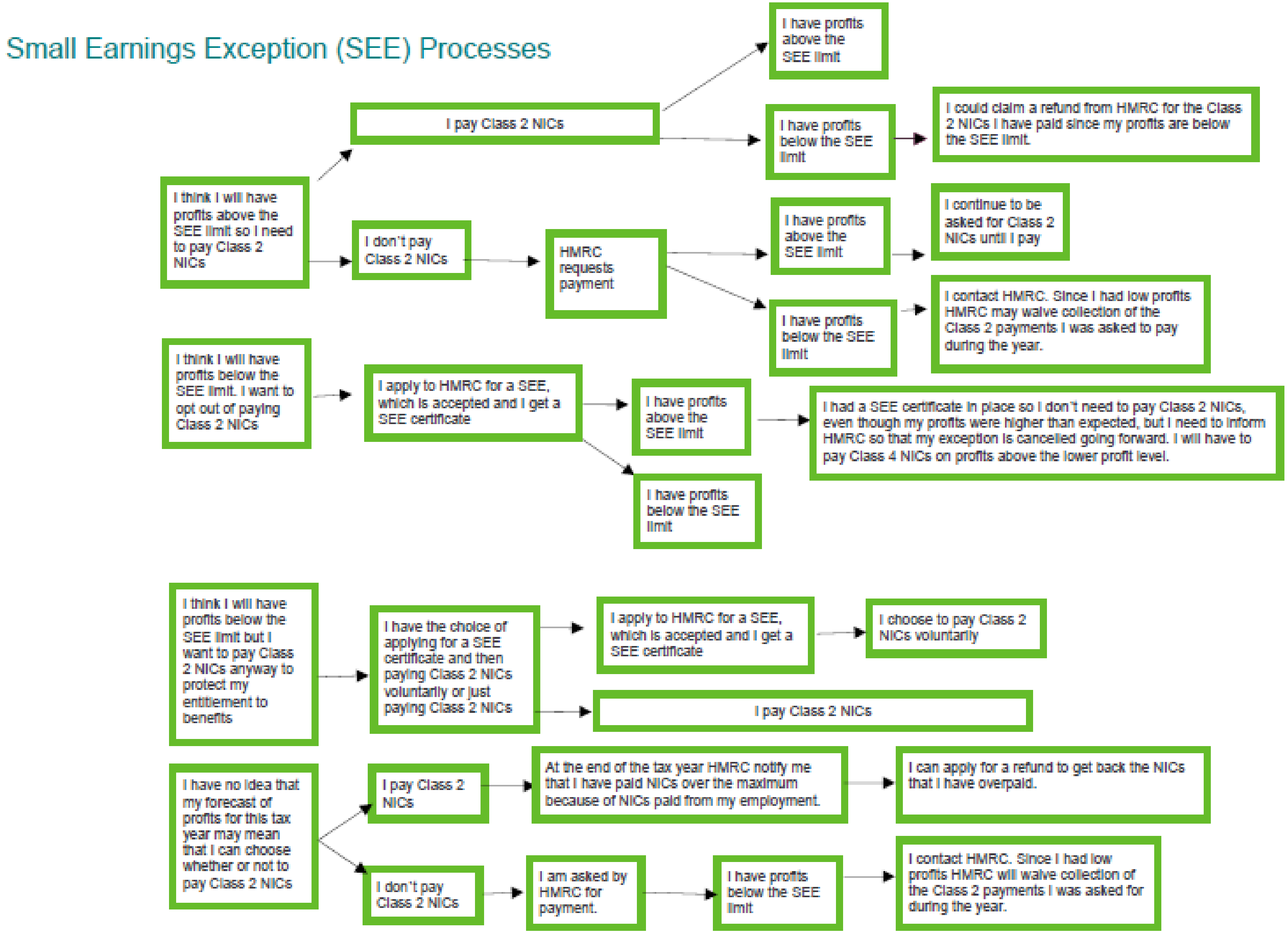
24 The OTS' work on small businesses is collated on Gov.uk.

25 *Small business tax review*, March 2011 para 7.36-7. A survey commissioned by the OTS & HMRC found that approximately 50% of small businesses whose views were canvassed reported that they found paying PAYE and NI easy. For details see, HMRC, *Understanding small businesses' experience of the tax system – research report 159*, February 2012.

26 *Budget 2013*, HC 1033, March 2013 para 2.42

27 *Simplifying the National Insurance Processes for the Self-Employed*, July 2013 p12. Details of the consultation are collated on Gov.uk

28 *op.cit.* p13


Small Earnings Exception (SEE) Processes
I have profits above the SEE limit
I pay Class 2 NICs
I have profits below the SEE limit
I could claim a refund from HMRC for the Class 2 NICs I have paid since my profits are below the SEE limit.
I think I will have profits above the SEE limit so I need to pay Class 2 NICs
I don't pay Class 2 NICs
HMRC requests payment
I have profits above the SEE limit
I continue to be asked for Class 2 NICs until I pay
I contact HMRC. Since I had low profits HMRC may waive collection of the Class 2 payments I was asked to pay during the year.
I have profits below the SEE limit
I think I will have profits below the SEE limit. I want to opt out of paying Class 2 NICs
I apply to HMRC for a SEE, which is accepted and I get a SEE certificate
I have profits above the SEE limit
I had a SEE certificate in place so I don't need to pay Class 2 NICs, even though my profits were higher than expected, but I need to inform HMRC so that my exception is cancelled going forward. I will have to pay Class 4 NICs on profits above the lower profit level.
I have profits below the SEE limit
I think I will have profits below the SEE limit but I want to pay Class 2 NICs anyway to protect my entitlement to benefits
I have the choice of applying for a SEE certificate and then paying Class 2 NICs voluntarily or just paying Class 2 NICs
I apply to HMRC for a SEE, which is accepted and I get a SEE certificate
I choose to pay Class 2 NICs voluntarily
I pay Class 2 NICs
I have no idea that my forecast of profits for this tax year may mean that I can choose whether or not to pay Class 2 NICs
I pay Class 2 NICs
At the end of the tax year HMRC notify me that I have paid NICs over the maximum because of NICs paid from my employment.
I can apply for a refund to get back the NICs that I have overpaid.
I don't pay Class 2 NICs
I am asked by HMRC for payment.
I have profits below the SEE limit
I contact HMRC. Since I had low profits HMRC will waive collection of the Class 2 payments I was asked for during the year.

The paper went on to summarise the process whereby individuals can apply for deferring payment of Class 2 NICs until the end of the tax year:

> There is a maximum amount of NICs an individual is liable to pay across Class 1, Class 2 and Class 4 NICs. Individuals who think they might exceed this maximum can choose to defer payment of NICs until the end of the year. The individual can request deferring Class 2 payment from HMRC via a paper application form. However individuals who expect to have profits below the SEE limit are requested not to apply for Class 2 deferment and instead apply to HMRC for a SEE certificate …
>
> Deferment of NICs can only be made for one year at a time. If an individual expects to exceed the annual maximum in subsequent years, then they currently need to apply to HMRC and renew their deferral to pay Class 2 NICs each year. Where deferment has previously been granted, HMRC automatically issues a renewal application to the individual.[29]

Taken together, these processes "drive significant administrative burdens on small business … Class 2 account for less than 0.3% of the £102bn NICs collected by HMRC in 2012/13 and yet accounted for around 40% of NI related telephone calls to HMRC and associated processing work."[30]

As an alternative, a person's liability to Class 2 NICs would be calculated as part of the process for completing their tax return, and this liability would be added to their liability for income tax and Class 4 NICs:

> When an individual completes their SA Return, they will be asked for a start date and an end date of their self-employment (if these are not completed the system will assume that the individual has been self-employed for the full tax year). They could also be asked on the return whether they want to apply for the small earnings exception if their profits are below the SEE limit. The SA system could calculate the amount of Class 2 NICs due based on the number of weeks the individual has been self-employed.
>
> The Class 2 NICs liability will be added to the individual's total SA liability and will be due by the SA final payment deadline. Once the SA Return is filed, payments against the final liability could be made at any time from the point of filing the SA Return to the 31st January following the end of the relevant tax year … When the individual makes their SA payment, the Class 2 element would still be accounted for separately to enable HMRC to update the individual's contribution record to show that Class 2 NICs has been paid for the relevant tax year.
>
> If an individual reports profits below the SEE limit, they could opt-out of paying Class 2 NICs. This could be prompted through the SA calculation process … As occurs today the individual would need to be alerted to the potential impact on benefit entitlement if they opt out … Additionally because the Class 2 NICs liability will be calculated after the end of the tax year when the self-employed person files their SA Return, the timing means that the total amount of any Class 1 contributions made during that year will be known. This could offer the opportunity to explore how the annual maximum calculation could form part of the SA calculation allowing the Class 2 deferment process to be removed.[31]

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29 *op.cit.* p14

30 *op.cit.* p15

31 *op.cit.* pp18-19

HMRC's consultation paper noted that separate arrangements would apply to the minority of self-employed persons who do not complete a return under SA.[32] It went on to discuss how, in certain circumstances, changing the timing of Class 2 payments could affect claims for contributory benefits: first, Employment and Support Allowance (ESA):

> ESA requires the individual to have paid sufficient NICs contributions in the two complete tax years preceding the benefit year in which the claim is made. The benefit year runs from the first Sunday in January in any calendar year to the Saturday immediately preceding the first Sunday in January of the following calendar year. If Class 2 NICs were collected through SA after the end of the tax year, the deadline for making the SA payment would be the 31st January after the end of the tax year - a few weeks after the relevant benefit year has started …
>
> Under the new process, anyone who made a claim for ESA may not have paid the NICs due to meet the current qualifying conditions. In reality we expect relatively small numbers of self-employed individuals would seek to make a claim for ESA in the few weeks between the first Sunday in January and the 31st January … As the Class 2 NICs element would be shown separately on the SA statement, the individual making a claim in the weeks between the first Sunday in January (the start of the new benefit year) and 31st January (the SA final payment deadline) could file their SA return and pay the Class 2 NICs ahead of their SA payment deadline date to meet the qualifying conditions for ESA.

Second, Maternity Allowance (MA):

> Out of a self-employed population of approximately 4.4m, around 25,000 self-employed women claim MA each year. Entitlement to MA is not assessed on self-employment and Class 2 NICs paid in a particular benefit year; instead it is assessed over a test period of 66 weeks up to and including the week before the week the baby is due … Collecting Class 2 NICs after the end of the tax year could impact some of the 25,000 women who are reliant on Class 2 NICs paid within that current tax year; for example a woman who needs to claim MA in December 2016 and under current tests is reliant on Class 2 NICs in respect of periods in the current tax year from April 2016 to December 2016. Since the SA Return will not be submitted until after the end of the tax year (from April 2017), under the general proposal Class 2 NICs would not have been paid for this period at the time of the MA claim …
>
> The Government … will be considering how best to ensure the changes have no adverse impact for the small group who might otherwise be affected.

Third, the State Pension:

> NICs paid up to the end of the tax year before a person reaches state pension age count towards their state pension. The majority of people will have gained the full number of qualifying years, or the maximum number of qualifying years that they have been able to obtain, before they reach state pension age. However, the impact of collecting Class 2 NICs through SA may mean that some interim awards of state pension may need to be calculated pending payment of the final Class 2 NICs payment or HMRC will need to maintain an exceptions process to enable this minority group to pay Class 2 NICs in year.

And finally, Universal Credit:

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32 Individuals who meet the test for being ordinarily self-employed in the UK may be working abroad temporarily or living abroad, and, as a result, if they are not liable to pay UK income tax and Class 4 NICs, would not complete a self assessment return.

> Universal Credit is a monthly household benefit. Around 650,000 self-employed households are expected to receive Universal Credit … The majority of individuals tend to file their return and pay their SA final payment in January. Therefore moving to collect Class 2 NICs through the SA return is likely to result in most people paying the entire Class 2 NICs liability in one month …
>
> In Universal Credit, a proportion of self-employed claimants will have a Minimum Income Floor[33] applied to their award. As Universal Credit is assessed on monthly earnings, a larger single annual deduction of Class 2 NICs could push a self-employed claimant's earnings below their Minimum Income Floor for that month, which would reduce their Universal Credit award for that month ... Under the proposal to collect Class 2 NICs through SA, this could be mitigated as individuals could still choose to spread their tax and NICs payments over several months if they filed their SA return soon after the end of the tax year.[34]

The consultation also asked for views as to whether the Government should consider more substantive reforms: namely, abolishing the SEE process and removing the liability to pay Class 2 NICs for those on profits below the SEE limit; and, fully aligning the scope of Class 2 and Class 4 NICs.[35]

In December 2013 HMRC published a summary of the responses received. Overall there had been "strong support for reforming self-employed NICs", with many accountants in favour of bringing Class 2 within SA, "as it would provide certainty to their clients that all their tax and NICs affairs can be handled by their agent." There was also a "lot of support to maintain the flexibility to make regular payments throughout the year", to allow those on low or fluctuating profits to spread the cost of Class 2 NICs.[36]

Generally respondents had agreed that removing the need for the deferment process "had the potential of bringing significant benefits", and "removing the need to forecast profits" for SEE certification "would bring greater certainty … and could act as a clearer reminder of the availability and consequences of an opt out facility." Respondents had suggested "filing an SA return before 31 December would be one way to negate" the potential difficulties over claiming contributory benefits highlighted in the consultation document. Finally, on the wider proposals for reform, many respondents had supported abolishing SEE - though some raised concerns about protecting entitlement to benefit – and approved of aligning the scope of Class 2 and Class 4.[37]

In the 2014 Budget the Government confirmed it would bring forward legislation to allow Class 2 NICs to be collected through SA from April 2016, but made no mention of any wider changes on the structure of NICs for the self-employed.[38]

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33 The Minimum Income Floor is an assumed level of earnings which is used to calculate some self-employed claimants' Universal Credit awards when they report actual earnings below the level of their Minimum Income Floor.

34 *Simplifying the National Insurance Processes for the Self-Employed*, July 2013 pp22-25

35 Individuals operating property or investment businesses can find their earnings fall under the statutory scope of Class 2 but not Class 4 NICs (for more detail see Annex B to the consultation document).

36 HMRC, *Simplifying the National Insurance Processes for the Self-Employed – summary of responses*, December 2013 p5

37 *op.cit.* p7, p8, pp10-11

38 *Budget 2014*, HC 1104, March 2014 para 2.212; HM Treasury, *Overview of tax legislation and rates*, March 2014 para 2.15

2.2 The Bill

It is a Parliamentary convention that the annual Finance Bill contains provisions relating to the imposition and alteration of taxes to raise money for financing central government *as a whole*. Finance Bills cannot include any provision to impose a charge for a *specified* expenditure purpose.[39] As noted above, all receipts from NICs must either go into the NI Fund to pay for contributory benefits, or go direct to the NHS, so primary legislation relating to National Insurance is not included in the Finance Bill; either the Government of the day will introduce a separate Bill or provisions will be included in a Bill covering a range of social security matters.

The Government's legislative priorities for the 2014-15 Session were set out in the Queen's Speech on 4 June 2014. The Speech confirmed that in respect of National Insurance contributions (NICs), legislation would be "brought forward to tackle tax avoidance and to simplify their collection from the self-employed." The *National Insurance Contributions Bill 2014-15* was published on 17 July, and is scheduled for Second Reading on 8 September.[40]

Clause 1 introduces **Schedule 1** to the Bill. **Schedule 1** amends the principal legislation underpinning the assessment and collection of NICs – the *Social Security Contributions and Benefits Act (SSCBA) 1992* – and the equivalent legislation for National Insurance in Northern Ireland. The schedule would make two principal changes:

1. liability for Class 2 NICs would arise at the end of the tax year, and not weekly as at present; and,

2. individuals would be liable to pay Class 2 NICs for a given year if their annual profits were equal to, or in excess of, a small profits threshold. Initially this threshold would be set at £5,885 for 2015/16. Individuals with profits under this threshold would be apply to pay Class 2 NICs for the year, should they choose to.

This change is expected to have a negligible impact on Exchequer revenues. HMRC estimate collecting Class 2 NICs this way should cut the administrative burden on businesses by around £19m a year, benefiting about 5 million self-employed persons.[41]

Under s1(2)(c) of *SSCBA 1992*, Class 2 NICs are payable by self-employed persons "weekly", at a fixed rate, as determined by s11 of the Act. Under s11, any self-employed earner is liable to pay Class 2 NICs, unless they are under 16 years of age, or have reached state pension age. Regulations may provide for individuals to be excepted from liability if their earnings are less than £5,885 a year.[42]

Para 2 to **Schedule 1** would remove the term "weekly" from s1(2)(c) of the Act; **para 3** would replace s11, so that liability to Class 2 NICs would arise where someone had 'relevant profits' of, or above, a set threshold. For these purposes, 'relevant profits' is aligned with the figure to be used in determining someone's liability to Class 4 NICs. Similarly Class 2 contributions would be payable in the same manner as Class 4. Individuals with profits under the new threshold would be entitled to pay the same rate of Class 2 NICs, if they wished.[43] This may apply either to those with very low profits, or those who are classified as self-employed but

[39] Further details on the procedure governing Finance Bills are given in, *The Budget and the annual Finance Bill*, Library standard note SN813, 5 December 2013.

[40] HC Deb 17 July 2014 c1023

[41] HMRC, *Class 2 NICs – Tax Information & Impact Note*, 17 July 2014

[42] In turn provision for a self-employed earner to obtain an SEE certificate is made by reg 44 of the *Social Security (Contributions) Regulations* SI 2011/1004.

[43] The Explanatory Notes to the Bill give a worked example of how paying voluntary Class 2 NICs would change: see Bill 80-EN, July 2014 p9.

whose earnings are not covered by the scope of Class 4 NICs.[44] **Para 3** to **Schedule 1** introduces a new section – s11A – to the 1992 Act, to provide for the collection of Class 2 NICs. Of note, s11A(2) would allow for most self-employed earners to make *in-year* payments of an annual Class 2 liability, so that those on low profits could avoid a large end of year tax bill.[45]

The remainder of **Schedule 1** makes a series of consequential amendments to the 1992 Act and other National Insurance legislation, as well as making equivalent amendments to the legislation underpinning National Insurance in Northern Ireland. Of note, **paras 6 & 7** would amend the 1992 Act to prevent this reform having an adverse impact on any claim for Maternity Allowance:

> Self-employed women wishing to claim MA may be impacted by the change given the contemporaneous nature of the qualifying condition that currently determines the weekly rate of MA payments to the payments of Class 2 contributions. Women who have not had the opportunity to file an SA return and pay Class 2 NICs will be able to pay Class 2 contributions early in order to secure MA entitlement at the standard weekly rate. This payment option will apply whether or not the woman ultimately becomes liable to pay Class 2. Self-employed women who choose not to make an early payment of Class 2 will receive the lower rate of MA, unless they have an SA record which demonstrates that they have made the requisite number of Class 2 contributions.
>
> Women who are neither employed nor self-employed but who participate in the business of their spouse or civil partner can receive the lower rate of MA for 14 weeks if their spouse or civil partner has paid Class 2 NICs for 26 weeks, voluntarily or as evidenced by their SA return. Those spouses or civil partners who have not had the opportunity to file an SA return and pay Class 2 NICs will also be able to pay Class 2 contributions early.[46]

Clause 2 would allow the Treasury to make consequential, incidental or supplementary changes in relation to the provisions of **Schedule 1**, by secondary legislation. Regulations made under this part of the Bill would be subject to the negative procedure.[47]

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[44] As noted, the liability to pay Class 2 NICs has a broader scope, as it includes individuals conducting a business, trade, profession or vocation. Class 4 NICs covers those conducting a trade, profession or vocation, who are chargeable to tax under the trading income rules. For more details see Annex B to, *Simplifying the National Insurance Processes for the Self-Employed*, July 2013.

[45] Section 59A of the *Taxes Management Act 1970* requires taxpayers under self assessment to settle their tax liability by making two payments on account. These provisions would not extend to those paying Class 2 NICs whose profits fell under the small profits threshold. See also, Bill 80-EN, July 2014 p36 (Annex A, para 24).

[46] Bill 80-EN, July 2014 pp36-7

[47] That is, generally not subject to a vote in Parliament. For further details see, *Statutory Instruments*, Library standard note SN6509, 18 December 2012.

3 Tax avoidance: follower notices & accelerated payments

3.1 Background

Tackling tax avoidance: an introduction

UK tax law is specifically targeted rather than purposive: in tackling the exploitation of loopholes in the law, governments have legislated against individual avoidance schemes as and when these have come to light. Often the response to this legislation has been the creation of new schemes to subvert the law, which in turn has seen further legislative action – an 'arms race' between the revenue authorities and Parliamentary counsel on one side, and on the other, taxpayers aided and abetted by the legal profession. Over the past twenty years many commentators have proposed a General Anti-Avoidance Rule as an alternative: legislation to allow the courts to overturn an avoidance scheme if it had little or no commercial purpose. They have argued that this would provide certainty for both sides as to the tax consequences of any transaction, encourage taxpayers and legal counsel to redirect their energies to more productive activities, and allow the authorities to simplify the law without fear of it being systematically undermined.

In 2004 the Labour Government considered the case for General Anti-Avoidance Rule, but proposed a new 'disclosure regime' as an alternative.[48] The Disclosure of Tax Avoidance Schemes (DOTAS) regime requires the promoter of certain types of scheme to disclose information about it to HMRC. Taxpayers who use such a scheme are also required to report the scheme reference number on their tax return. HMRC summarise the policy objectives of DOTAS as:

- to provide early information to HMRC about tax avoidance schemes to allow the risk they pose to be assessed, and to inform legislation to close loopholes;
- to identify the users of those schemes to inform HMRC's compliance work; and
- to 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.[49]

Since its being introduced, DOTAS has been expanded to include more taxes and more types of scheme.[50]

In its first Budget in June 2010 the Coalition Government confirmed that it would re-consider general anti-avoidance legislation.[51] Following the work of a study group led by Graham Aaronson QC, in December 2012 the Government announced that it would introduce a 'General Anti Abuse Rule' (GAAR), to be targeted at 'abusive arrangements' *only*.[52] In his report Mr Aaronson identified a fundamental problem with a catch-all GAAR that would counter any scheme if one of its purposes was to deliver tax advantages: there were many cases in the UK tax code where the intention of *the legislation* was to provide a tax saving for certain types of transactions (such as a business deciding to invest in research and development). He argued that a GAAR should leave the 'centre ground of responsible tax

48 HC Deb 17 March 2004 c329. For further background on the introduction of DOTAS see, *Tax avoidance : a General Anti-Avoidance Rule – background history*, Library standard note SN2956, 6 March 2014 pp13-23.

49 HMRC, *Lifting the Lid on Tax Avoidance Schemes*, July 2012 p31

50 Details are collated on HMRC's site. For an overview of these changes see, National Audit Office, *Tax avoidance: tackling marketed avoidance schemes*, HC 730, 21 November 2012. Recently HMRC published proposals for strengthening DOTAS: *Strengthening the Tax Avoidance Disclosure Regimes*, 31 July 2014.

51 *Budget 2011* HC 61 June 2010 para 2.114

52 *Autumn Statement*, Cm 8480 December 2012 para 1.178

planning' undisturbed, while preventing the minority of schemes that were highly contrived or abusive. The new GAAR came into force on 17 July 2013.[53]

Detailed guidance is on HMRC's site; one short extract is given below, which sets out the safeguards which exist for taxpayers, and, in particular, the 'double reasonableness' test for determining when tax arrangements may be found to be abusive, and thus contravening the GAAR:

> B12.1 : To ensure that, in effect, the taxpayer is given the benefit of any reasonable doubt when determining whether arrangements are abusive, a number of safeguards are built into the GAAR rules. These include:
>
> - Requiring HMRC to establish that the arrangements are abusive (so that it is not up to the taxpayer to show that the arrangements are non-abusive).
> - Applying a 'double reasonableness' test. This requires HMRC to show that the arrangements "cannot reasonably be regarded as a reasonable course of action". This recognises that there are some arrangements which some people would regard as a reasonable course of action while others would not. The 'double reasonableness' test sets a high threshold by asking whether it would be reasonable to hold the view that the arrangement was a reasonable course of action. The arrangement falls to be treated as abusive only if it would not be reasonable to hold such a view.
> - Allowing the court or tribunal to take into account any relevant material as to the purpose of the legislation that it is suggested the taxpayer has abused, or as to the sort of transactions which had become established practice at the time when the arrangements were entered into.
> - Requiring HMRC to obtain the opinion of an independent advisory panel as to whether an arrangement constituted a reasonable course of action, before they can proceed to apply the GAAR.
>
> B12.2 : … These safeguards (and particularly the 'double reasonableness' test) would prevent the GAAR operating in relation to arrangements entered into for the purpose of avoiding an inappropriate tax charge that would otherwise have been triggered by a more straightforward transaction. Tax charges of this sort (sometimes referred to as 'bear traps') can be encountered from time to time. For example where a taxpayer has to take what appear to be contrived steps in order to ensure that they are not taxed on more than the economic gain, such an arrangement would not generally be regarded as abusive.[54]

Consultation on tackling 'high risk' promoters: July 2013

In summer 2013 the Government published a consultation paper, *Raising the stakes on tax avoidance*. In this, HMRC focused on the difficulties in dealing effectively with 'high-risk' promoters, a relatively small number of individuals and firms who "would commonly encourage tax advisers' clients to enter into avoidance schemes, attempt to impose conditions of confidentiality on clients and disrupt the relationship between the tax adviser and their client." The paper noted that in general the types of scheme being sold

[53] The decision to introduce the new GAAR is discussed at length in, *Tax avoidance: a General Anti-Abuse Rule*, Library standard note SN6265, 5 August 2014.

[54] HMRC, *GAAR Guidance (Parts A-C)*, 15 April 2013 pp 10-11. Parts D & E to this guidance give specific examples, and set out the procedure for applying the GAAR. Interested readers are also referred to the discussion of the GAAR in the report of the Lords Economic Affairs Committee, when this legislation was published in draft (*The draft Finance Bill 2013*, 13 March 2013, HL Paper 139 2012-13).

"overwhelmingly do not work and have very little chance of succeeding at the outset." Given this, "a key question to consider is why they continue to be used by taxpayers, usually at the cost of a significant fee."[55] The paper noted that when schemes had been marketed to a significant number of taxpayers, HMRC incurred considerable costs in challenging each taxpayer who had used it:

> Buyers of a tax avoidance scheme will submit their returns to HMRC on the assumption that the scheme reduces their tax liability. Where a tax avoidance scheme is mass-marketed, as they often are, HMRC is presented with a large number of returns all based on the same assumption that the scheme will have reduced the person's tax liability in a particular way. Where HMRC holds that the scheme does not work, it follows that it will argue that any returns based on that scheme are incorrect.
>
> When faced with a large number of very similar cases, it is sometimes most efficient for HMRC to investigate 'representative cases', taking them to litigation if necessary. However, when HMRC wins a representative case in the courts, other taxpayers who have used the same or very similar schemes sometimes see little incentive to settle their cases with HMRC.
>
> When HMRC pursues litigation in a number of very similar cases the Tribunal rules allow for the cases to be heard together in certain circumstances, but this only applies to cases which have been notified to the Tribunal. To get to this stage HMRC has to investigate these cases to litigation standard and close them. Not only does this use up the Tribunal's resources, but it also places a strain on HMRC's compliance resources, wastes HMRC's time and delays the collection of the right tax.[56]

In December 2013 the Government confirmed that it would pursue two options to deal more effectively with users of 'failed schemes'. These were to:

- introduce new requirements for users of failed avoidance schemes to oblige them to settle the dispute where the avoidance scheme they are using has been defeated in another party's litigation through the Courts, with penalties attached for non-compliance
- increase obligations and sanctions for high-risk promoters of tax avoidance schemes, by introducing objective criteria for identifying and publishing the names of high-risk promoters, seeking more information from them and applying penalties where there is failure to comply. Their clients will also be required to identify themselves to HMRC.[57]

The second of these options – a regulatory regime for 'high-risk' promoters – is discussed in the next section of this paper.

With regard to the first option, the Government also announced that in these 'follower cases', where someone had used a scheme that had, in other litigation, been overturned in the courts, HMRC would be empowered to issue a demand for an 'accelerated payment' of the monies at stake. This would "provide HMRC will an additional tool to address a legacy stock of … avoidance cases [and] … remove the cash advantage of sitting and waiting during an avoidance dispute, and bring in £700 million over the forecast period." Furthermore, these

[55] *Raising the stakes on tax avoidance: consultation document*, 12 August 2013. See also, HMRC, *Tempted by tax avoidance? A warning for people thinking about avoidance schemes*, August 2013.
[56] *Raising the stakes on tax avoidance*, 12 August 2013 para 5.1-2
[57] *Autumn Statement*, Cm 8747, December 2013 p74

powers to obtain payments of tax 'upfront' could be extended to other categories of avoidance scheme.[58]

Writing in the *Tax Journal*, one commentator explained how accelerated payments could undermine the benefits of avoidance schemes:

> One of the enticements to taking part in a tax-avoidance scheme is the cashflow benefit that such schemes bring. Even if the scheme is found ultimately to fail, a taxpayer undertaking a scheme can (and could until recently even for PAYE and NIC) generally secure the benefit of holding the tax whilst the dispute is determined. With 'marketed' schemes the deal was even better, as generally only one taxpayer is litigated – and it is open to so-called 'follower' taxpayers to argue that their fact patterns are different – and therefore they have to sit and wait until HMRC gets around to them. HMRC is now acting to end this particular party.[59]

In January 2014 HMRC published a consultation paper on accelerated payments, which gave some details of the scale of the Exchequer risk posed by this phenomenon: "the existence of around 65,000 open cases involving marketed tax avoidance schemes illustrates how the current position can lead to a build-up of avoidance schemes that HMRC needs to tackle through investigation and litigation, which can take several years to complete. Over 85 per cent of these cases date back to 2009-10 or earlier … reflecting a market for avoidance products which was very active in earlier years."[60] The document went on to give an overview of how, once HMRC had identified 'follower cases', it would require those taxpayers to amend their tax return, and pay over the disputed amount of tax:

> [Under the Government's proposals, HMRC would] issue … a notice to taxpayers involved in avoidance schemes where there has been a final judicial decision in another taxpayer's case on the same or similar arrangements. The notice requires the taxpayer to amend their tax return (if the return is still under enquiry) or agree to settle the dispute (where a closure notice or tax assessment or determination has been made and is under appeal).
>
> At the heart of this notice is the proposition that the likelihood of the taxpayer's scheme succeeding is remote, given that a tribunal or court has made a decision on the same or similar arrangements. In HMRC's experience, it is extremely rare for a taxpayer to even proceed to their own litigation in the face of such a decision, but while the vast majority do eventually concede they prolong the dispute for as long as they are able, often agreeing to settle only as the date of litigation approaches. In the Government's view, the delivery of a related judicial decision fundamentally changes the presumption of where the tax should sit during this period.[61]

The sum itself would be estimated by HMRC, though subject to revision if the actual amount due was larger, or, if the taxpayer successfully pursued an appeal that, in their own case, their use of the scheme was legal:

> Taxpayers receiving a 'follower notice' are required to tell HMRC the amount of the tax advantage being sought. However, this figure may not be available until the taxpayer agrees to resolve the dispute in response to the notice – and will not be provided by the taxpayer at all in cases where the taxpayer chooses not to resolve the dispute.

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58 Cm 8747, December 2013 p74

59 James Bullock, "Views on the Autumn Statement: enforcement and compliance issues", *Tax Journal*, 6 December 2013

60 *Tackling marketed tax avoidance – consultation document*, 24 January 2014 para 1.1, paras 2.6-8. Interested parties were given only given a month to response to this follow-up document – ie, by 24 February.

61 *op.cit.* paras 3.7-8

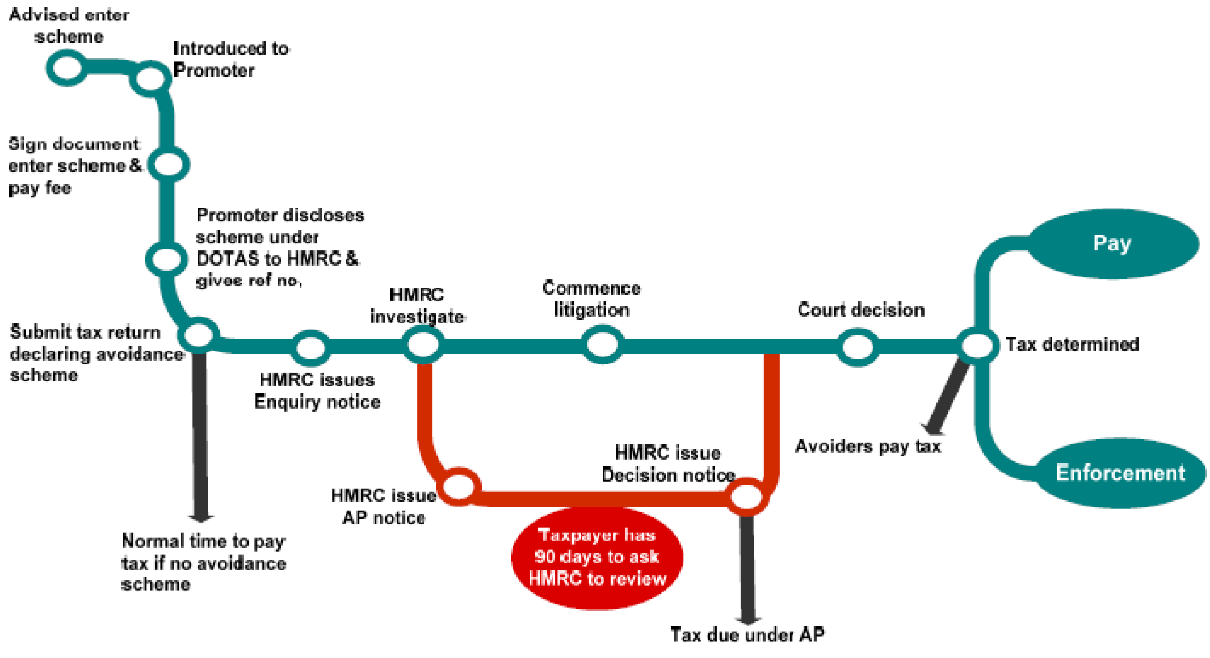
It is proposed, therefore, that HMRC will issue a Payment Notice to the best of their judgement. In the majority of cases HMRC would expect to have a reasonable indication of the amount in dispute as the matter will have been under enquiry, or HMRC will have issued an assessment or determination.

The amount of tax to be paid under the Payment Notice is the amount of additional tax that would otherwise have been paid if the arrangements had not been entered into. This is meant to be a simple recalculation of the additional tax due on the return (or similar document) having removed the effects of the avoidance scheme, less any relevant amounts already paid. It is not a calculation whereby the taxpayer can say that in the absence of these arrangements another structure would have been employed instead.

The amount to be paid will be the amount remaining after any part of the tax in dispute that is already subject to a withheld repayment.

It is important to note that this will simply be a form of payment on account and not a payment that determines the amount of the final liability. If the amount paid is less than the final amount due, the taxpayer will still be liable to pay any remaining balance when the dispute is finally resolved. Equally, if the taxpayer continues to pursue their claim and is successful then they will get their money back with interest.[62]

The graphic below illustrates the 'typical taxpayer journey', where someone has purchased an avoidance scheme, submitted their assessment, and then had that assessment investigated by HMRC:



The [U-shaped lower line] shows how accelerated payments will fit in with the existing customer journey and require payment sooner in the process. The journey can halt at any point when the taxpayer decides to drop their claim and settle, or where HMRC decides that the scheme works and repays the tax.[63]

[62] *op.cit.* paras 3.15-9
[63] *Tackling marketed tax avoidance - Summary of Responses*, 27 March 2014 p34

The most contentious aspect of this reform proved to be the decision to extend accelerated payments to *two other* categories of taxpayer: those in dispute with HMRC because they have used a scheme notified under DOTAS, or those using a scheme which HMRC were seeking to frustrate, using the new GAAR.[64] The consultation document noted that although this would have an impact on a "significant proportion of avoidance schemes", but that HMRC would plan to keep the criteria "under review to determine whether any further broadening may be appropriate."[65] Many commentators argued that it would be retrospective and unreasonable for taxpayers who had already notified HMRC of their use of a scheme under DOTAS to be asked for this type of payment.[66]

Budget 2014

Despite these concerns, in his Budget speech on 19 March the Chancellor confirmed the introduction of accelerated payments, which would "bring forward £4 billion of tax receipts and it will fundamentally reduce the incentive to engage in tax avoidance in the future."[67]

It is estimated that applying accelerated payments to follower cases will raise around £300m in both 2015/16 and 2016/17, with the annual yield falling to £100m by 2018/19. Extending the scheme to DOTAS and GAAR schemes is projected to raise *considerably* more: almost £4bn between 2014/15 and 2018/19, peaking at £1.3bn in 2016/17.[68]

At the time HMRC indicated that the new rules would take effect from the date of the Finance Bill's Royal Assent: specifically, they would cover "all cases where there is an open enquiry or open appeal on or after [this date]."[69] HMRC also gave some details of the cohort of taxpayers which would be affected:

> It is estimated that accelerated payment notices relating to existing avoidance cases currently under dispute will be issued to approximately 33,000 individual taxpayers concerning £5.1 billion of tax under dispute under this measure and the Autumn Statement 2013 measure applying accelerated payments to follower cases.
>
> Estimates of the distributional impacts of these measures are affected by the use of avoidance schemes that deflate the income reported on self-assessment returns.
>
> Having noted this caveat, analysis shows that the population of individuals affected:
>
> - have a mean gross income of £262,000, compared to £29,000 for the wider income tax paying population;
>
> - around 85 per cent of individuals have multiple sources of income, with employment income (including self-employment) the predominant income source for 54 per cent and non-employment, non-pension income the predominant income source for 42 per cent of the individuals affected respectively, compared to 78 per cent and 5 per cent for the wider income tax paying population respectively.[70]

64 For example, "Wealthy investors protest against new UK tax rules", *Financial Times*, 9 March 2014
65 *op.cit.* para 4.3
66 For example, CIOT press notice, *Tax avoidance schemes: 'Emergency measures' tolerable for dealing with courts backlog, but wider application goes too far*, 4 March 2014.
67 HC Deb 19 March 2014 c785. See also, *Budget 2014*, HC 1104, March 2014 para 2.188
68 *Budget 2014*, HC 1104, March 2014 pp57-8 (Table 2.2 – item r; Table 2.1 – item 52). See also, HM Treasury, *Budget 2014: policy costings*, March 2014 p37.
69 HMRC, *Accelerated payments of tax for avoidance schemes* & *Avoidance schemes: relevant judicial ruling - notice to settle dispute*, 19 March 2014. In the case of 'follower cases' there will also have to be a relevant qualifying judgement. The date of Royal Assent proved to be 17 July 2014.
70 HM Treasury/HMRC, *Overview of tax legislation and rates*, 19 March 2014 ppA94-5

At this time HMRC published a summary of responses it had had to the consultation; many respondents had “acknowledged the underlying policy issue”, but went on to argue “that there was no problem to address” – a position based “on three contentions”:

- All taxpayers are entitled to have their dispute considered and resolved without being forced to pay over the tax in the meantime, irrespective of the nature of the dispute, and that in effect the taxpayer would be treated as being in the wrong until they were able to prove their case;
- Any delays are caused by HMRC’s “slow and tardy response” and not by taxpayers, advisers and scheme promoters; and
- HMRC already has adequate powers to force progress in these types of dispute and this gave more power and discretion than was necessary.[71]

In this summary document the Government set out its reasons for not accepting these contentions – first, on the cause of these delays and the suggestion that the proposals invoke a new principle:

> There is ample evidence that those who enter into these schemes do so in the expectation that they will, as a minimum, keep hold of the tax for many years, exploiting the current structure of the enquiry, appeals and postponement legislation. The Government is not prepared to let this continue. HMRC can under current law deny repayments claimed while a dispute is in progress. It is also the case that many taxpayers pay their tax upfront under PAYE, or through deduction of tax at source from interest. These proposals therefore introduce no new principle – instead they extend the current circumstances where the Exchequer holds the disputed tax.[72]

Second, on the argument that HMRC had adequate powers to deal with this problem:

> HMRC currently has powers in section 28C of Taxes Management Act (TMA) 1970 to issue a determination of tax where there has been no return submitted – but that cannot be applied to these avoidance cases, where returns will have been submitted, claiming the tax advantage from the avoidance scheme.
>
> Section 9C of TMA permits HMRC to amend a taxpayer’s self-assessment where tax is at risk. This power is applicable in circumstances where HMRC believes that the subsequent settlement of the liability may be in jeopardy (for example, the taxpayer may leave the UK). This is not applicable to the generality of avoidance cases.
>
> Where there is an appeal, the taxpayer may make a postponement application under section 55 of TMA. If HMRC disagrees with the postponement, the matter must be resolved by the tribunal. Therefore, opposing postponement applications in many thousands of cases under the current rule would impose a substantial burden on the resources of the Tribunal Service. Furthermore this route can only be used where there is an appeal and not where an enquiry is still open.
>
> In the vast majority of cases there is an open enquiry rather than an appeal. HMRC has been criticised for delaying the issue of closure notices. However, as a number of recent published tribunal and court decisions show, these cases involve complex and contrived arrangements that take a significant length of time to resolve. HMRC cannot issue a closure notice prematurely as that would risk the wrong amount of tax arising from the return.

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71 *Tackling marketed tax avoidance - Summary of Responses*, 27 March 2014 para 2.14

72 *op.cit.* para 2.15-6

> Some responses pointed to HMRC's ability under section 28ZA of TMA to refer matters to the tribunal during an open enquiry. However, this would make little impact on the overall problem in that it would to a large extent require consideration of the substantive tax point at issue.[73]

Third, on the contention that the proposals would be retrospective:

> [The proposals] do not change the underlying tax liability. Where an accelerated payment is made and the taxpayer subsequently wins their dispute the tax will be repaid with interest – no different to the situation where, currently, a repayment is denied whilst the dispute is resolved. Application of the proposals to existing disputes will ensure that all taxpayers in an avoidance dispute after Royal Assent will be in the same position, irrespective of when their dispute began.[74]

The Government confirmed that some revisions would be made to the legislation as initially drafted,[75] and that it would publish detailed guidance and a list of existing DOTAS schemes to be subject to accelerated payment by the time the Finance Bill received Royal Assent.[76] However, the response document *rejected* the case, made by many respondents, that taxpayers should be able to formally appeal HMRC's decision to issue a demand for an accelerated payment:

> Provision of a formal appeal right would in practice involve arguing the substantive issue of the dispute itself, which would do nothing to change the current position.
>
> HMRC is committed to applying clear and strong governance to the use of this measure and only "designated" officers will be authorised to calculate the tax due for the payment notice. It is also the case that taxpayers will have 90 days in which to dispute the amount calculated with a view to getting the correct figure agreed.
>
> The accelerated payment does not determine the final liability. Whilst the amount will be calculated as accurately as possible, taxpayers will still have full appeal rights against the eventual closure notice or any assessment or determination that may be issued … The Government does not believe that a specific provision for 'financial extremity' is necessary. HMRC will use its full range of existing tools in pursuing the collection of tax, including appropriately structured payment arrangements, to assist taxpayers in paying the required amounts.[77]

Finance Bill 2014

Provisions in the *Finance Bill 2014* to establish follower notices and accerated payments were debated and approved at the Committee stage of the Bill on 17 June, with just a small number of minor, technical amendments tabled by the Government.[78]

Speaking for the Opposition Shabana Mahmood raised concerns over the relatively short time frame set for the consultation on these measures, but went on to say that, in the light of

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73 *op.cit.* para 2.18-22

74 *op.cit.* para 2.25

75 First, when a late payment penalty is charged on an accelerated payment and, subsequently, that accelerated payment is found to have been too high, the excess penalty plus interest is to be paid back, when the overpayment is repaid (*op.cit.* para 3.41-2). Second, where HMRC seeks to apply accelerated penalties to a scheme it seeks to challenge using the GAAR, the GAAR Advisory Panel will have to agree this is appropriate (*op.cit.* para 4.25-6)

76 *op.cit.* para 5.1-3. This material was published on HMRC's site, and on Gov.uk.

77 *op.cit.* para 3.31-34

78 PBC (Finance Bill), *Thirteenth Sitting* & *Fourteenth Sitting*, 17 June 2014 cc 467-510. For details see, HMT, *Amendments 32 to 38 to Clauses 212 & 222 and Schedule 28 (Accelerated payments)*, 6 June 2014.

the sheer number of outstanding cases, "Opposition Members … support the principle of follower notices as a practical measure that should—hopefully—decrease the amount of time it takes to settle those matters and ensure that the currently uncollected tax is collected quickly."[79] Ms Mahmood noted two concerns about follower notices that had been raised: the fact that HMRC could rely on decisions made by a tribunal, as well as the court, in issuing a follower notice and that taxpayers could not appeal HMRC's decision to take this action. She also asked if HMRC would have sufficient resources to administer the system.

In response the Exchequer Secretary, David Gauke, acknowledged that the time allotted for consultation had been shorter than normal, "because we were keen to ensure that we could progress this matter on a Budget timetable and make it part of the Finance Bill. HMRC made every effort to ensure that anyone who wanted to make a comment was able to, and it continued to accept responses and meet with concerned parties after the consultation formally closed."[80] On the use of tribunal decisions, and the absence of a formal right of appeal, Mr Gauke said:

> HMRC wins an overwhelming majority of avoidance cases at tribunal, and most taxpayers who lose accept the tribunal's decision and do not take their case further. Therefore, in most cases the first-tier tribunal settles the matter. However, if a case is appealed further, follower notices cannot be issued until the litigation is finally settled in HMRC's favour. Excluding first-tier cases would remove an important source of judicial decisions and might lead to taxpayers deliberately avoiding an appeal against and adverse judgment, so it could not be used to generate follower notices …
>
> Creating a right of appeal against a notice would simply clog up the process and not deliver a saving. Taxpayers will be able to require HMRC to reconsider any notice that they receive. There will be a full right of appeal against any penalty issued and against any amendment made to the taxpayer's return if the taxpayer does not amend it himself. HMRC will be ensuring strict governance over the issue of notices, which will have to be authorised by senior leaders.[81]

As Mr Gauke noted, HMRC would be empowered to charge penalties for failure to response to a follower notice:

> Clause 201 applies a penalty if a taxpayer is served with a follower notice, but does not take corrective action within the specified period. The penalty is charged on the amount of tax advantage denied: the extra tax that becomes due, or the reduction in tax repayable, when the scheme is counteracted … [Under] clause 202 … the penalty … is set at 50% of the denied tax advantage. That is in line with the scale of penalties for inaccurate returns, which range from 30% to 100%, depending on behaviour. To encourage taxpayers to co-operate with HMRC to resolve their case, clause 203 allows the penalty due to be reduced to as little as 10% to reflect any co-operation.[82]

That said, taxpayers would be entitled to appeal against a penalty charged in these circumstances. Under clause 207, if a tribunal thinks that the basis of a follower notice is wrong, any penalty would be cancelled or reduced. Although this clause was agreed, unamended, by Committee, the Government tabled amendments at the Finance Bill's Report

[79] PBC (Finance Bill), *Thirteenth Sitting*, 17 June 2014 c469
[80] PBC (Finance Bill), *Thirteenth Sitting*, 17 June 2014 c483
[81] *op.cit.* c484
[82] *op.cit.* cc477-8

Stage, to make clear the grounds on which a taxpayer may appeal against a penalty: ie, that the follower notice should not have been issued to him in the first place or that it was reasonable for him to continue his dispute rather than settle with HMRC on receipt of a follower notice. The amendments also provide that only a designated officer of HMRC will be allowed to issue a follower notice.[83]

In his comments in Committee, the Minister also addressed the question of whether HMRC had sufficient resources to administer the new scheme:

> In November 2013, HMRC created a new counter-avoidance directorate to bring together all marketed avoidance work in one place. The directorate is mainly made up of departmental resources that were already working in the marketed avoidance area rather than additional resource, but about 100 of its 850 people will be funded from new money announced by the Chancellor at the Budget to deliver accelerated payments. We do not believe there will be a detrimental impact on HMRC's other operations.[84]

The Committee went on to consider accelerated payment notices, and the Minister was asked about the possibility that taxpayers might be made bankrupt. Mr Gauke said, "HMRC has time to pay arrangements for those who are constructively engaged with it and who are looking to pay off their tax debts in a constructive way but are constrained by cash flow matters. That is a perfectly reasonable approach." While the Minister did not propose any substantive changes to the proposals, he noted that he had "asked HMRC to ensure that there is active consultation on the published guidance, to ensure that the important issues raised are dealt with in that process."[85] Mr Gauke was asked about the extension of accelerated payments to DOTAS cases, and whether this penalised those taxpayers who had been cautious to make sure they were fully compliant with the law, and used DOTAS in good faith. In reply, the Minister made two observations:

> Disclosure under DOTAS does not necessarily mean that someone will be affected by the accelerated payments regime. HMRC will look at the particular scheme and assess whether it is effective. There may well be circumstances in which HMRC will look at a particular scheme and say, "A DOTAS disclosure has been made, but as far as we can see this scheme is entirely consistent with the law. It is effective and there is no tax under dispute, so no accelerated payment will need to be made." If there is no tax under dispute, there is no accelerated payment.
>
> The other point that is worth bearing in mind is that the trend for DOTAS disclosures is a significant fall, and all the evidence suggests that that trend has been driven not by concerns about accelerated payments, because it was in place before that policy was announced, but due to the fact that not as much aggressive tax avoidance is being undertaken as a few years ago.[86]

On the question of retrospection, the Minister noted the nature of payments made this way:

> We are clear that the legislation is not retrospective. It does not change anybody's tax liability, but it changes who holds the tax during an avoidance dispute ... [The

[83] HM Treasury, *Government amendment 1-3: Right to appeal follower penalty (Clause 207)*, 24 June 2014. This is discussed in a little more detail below.

[84] PBC, *Thirteenth Sitting*, 17 June 2014 c485. The Chancellor mentioned this rise in funding in his Budget speech: HC Deb 19 March 2014 c785.

[85] *op.cit.* c487, c488

[86] *op.cit.* c490

> accelerated payment] will be treated as a payment on account of the final liability, which means that interest will stop running on the amount paid from the date that the taxpayer pays it over. This is emphatically not any form of determination of the final tax liability, which will still be subject to all existing appeal rights. If the taxpayer is ultimately successful, they will get a repayment, with interest, just like the vast majority who have to reclaim any tax they think they are owed.[87]

Several Members contributed to the debate.[88] In his response the Minister addressed their concerns: first, whether there was an inconsistency between the Government wishing to change taxpayers' behaviour when the new scheme would apply to actions taxpayers had taken in the past:

> The point was made that, if this is about changing behaviour, it should only apply to arrangements people enter into after the measures come into effect. The point I would make in response is that new rules are intended to achieve two things: they change behaviour away from avoidance but have the additional objective of accelerating the resolution of the large number of existing cases and the receipt of the revenue tied up in them. We want all taxpayers in this type of dispute to be in the same predicament so that there is no reason to apply the rules differently depending on when the particular arrangements began.[89]

Second, what impact the new regime would have on the system for taxpayer appeals:

> On some of the practical issues involving the impact on HMRC and the tribunal … the measures are expected to prompt a range of legal challenges, including judicial review proceedings, an increase in closure applications to the tribunal and disputed enforcement activity. Flexible legal resource options are being considered to meet the expected demands of the work. That legal resource will be increased and adapted depending on the scale and scope of any challenges … HMRC is in discussion with the Ministry of Justice to plan for the introduction of these measures and to deal with the likely consequences.[90]

Third, the financial burden of payments on taxpayers:

> In cases of genuine hardship, HMRC will consider alternative payment arrangements, as it does with any debt. The priority in cases of genuine hardship will be to get people on to a payment track so that the debt is paid as quickly as possible … Where individuals do not immediately have the cash, it may be appropriate in some instances to back up a payment arrangement with a security against assets. In cases where, for instance, individuals have taken deliberate action to put their assets out of reach of HMRC … so that they cannot pay the tax, bankruptcy action may well be appropriate, but the particular action will always depend on the precise facts and circumstances of the taxpayer.[91]

The Minister went on to announce the Government would review DOTAS over the summer: "DOTAS has been in place for 10 years and has been revised at various times. We believe

87 *op.cit.* cc491-2. The Minister also gave a summary of the Government amendments to these provisions: c493.

88 Teresa Pearce took issue with the Minister's view on retrospection (*op.cit.* c494), while Charlie Elphicke argued that retrospection was about the creation of uncertainty for the taxpayer (*op.cit.* c496). Speaking for the Opposition Shabana Mahmood argued that the Minister's case was persuasive (*op.cit.* cc502-3).

89 *op.cit.* c507

90 *op.cit.* c508

91 *op.cit.* cc507-8

that now is the right time to look at its hallmarks to see whether they still work properly or whether they need updating. We also want to look at how compliance can be updated."[92]

As mentioned, the Government tabled amendments to these provisions, specifically in regard to the grounds for making an appeal against follower notice penalties. These were debated and agreed without further changes at the Report Stage of the Bill on 2 July.[93] On this occasion the Exchequer Secretary clarified one point he had made in Committee, about the potential scope of accelerated payments to previous tax years:

> In Committee, I was asked whether the accelerated payments regime would "reach back to disputed tax liabilities relating to periods prior to the introduction of the DOTAS reporting?"—[*Official Report, Finance Public Bill Committee,* 17 June 2014; c. 507.]
>
> I said that it would not. I want to clarify that an accelerated payment notice may not be issued to a taxpayer with a pre-DOTAS tax dispute where DOTAS—disclosure of tax avoidance schemes—is the only criterion available. Even though a scheme may have come into DOTAS after its introduction, anyone using it before DOTAS will not be subject to accelerated payment on DOTAS alone. However, accelerated payment based on a follower notice can apply to pre-DOTAS cases because the notice does not depend on the DOTAS disclosure.[94]

These provisions now form Part 4 (ss 199-233) of the *Finance Act 2014*.

3.2 The Bill

Clause 3 introduces **Schedule 3**, which would extend the tax provisions for follower notices & accelerated payments to NICs. The provisions would come into effect two months after Royal Assent. They would apply to all cases where there is an open NICs dispute or appeal on or after this date. Where changes have been made to the tax rules regarding follower notices & accelerated payments, **clause 4** would allow the Treasury to make consequential changes to NI legislation by Order. Secondary legislation made under this provision would be subject to the affirmative procedure if this legislation amended or repealed primary legislation (**clause 4(4)**).[95]

The extension of HMRC's powers to issue follower notices to NIC disputes is projected to have a negligible impact on Exchequer revenues,[96] while extending accelerated payments to NICs disputes is estimated to raise £165m in 2015/16, falling to £45m by 2018/19.[97] The Government has underlined that it has always been its intention to extend each scheme to NICs "at the earliest opportunity."

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92 *op.cit.* c509. The Committee proceeded to agree to this section of the Bill without a division. As noted above, HMRC's consultation on DOTAS was launched on 31 July.

93 HC Deb 2 July 2014 cc961-1017

94 HC Deb 2 July 2014 cc965-6

95 That is, subject to votes in the Commons and the Lords. For further details see, *Statutory Instruments*, Library standard note SN6509, 18 December 2012.

96 HMRC, *Amendment of return to take account of relevant judicial ruling: Follower Notices – tax information & impact note*, 17 July 2014. It is estimated that overall charging penalties in follower cases will raise £75m in 2015/16, and £30m a year thereafter: *Budget 2014*, HC 1104, March 2014 p59 (Table 2.2 – item bf).

97 HMRC, *Accelerated payments of NIC associated with schemes subject to a Follower Notice or covered by the DOTAS rules or counteracted under the GAAR*, 17 July 2014.

4 Tax avoidance: high-risk promoters of avoidance schemes

4.1 Background

During 2013 the Government consulted on two measures to tackle the marketing of tax avoidance schemes: the introduction of 'follower notices' for taxpayers using schemes similar to those that had been struck down in the courts, discussed in the previous section of this paper, and, placing new obligations and sanctions on 'high-risk' promoters. The consultation paper discussed how these businesses posed increased risks to tax revenues:

> There are some advisers who promote tax avoidance schemes and are not or do not want to be transparent with HMRC – these advisers are potentially high-risk promoters. Instead they commonly display other behaviours that are detrimental to the fairness of the tax system such as:
>
> - designing, marketing or implementing products that on analysis have negligible probability of working
> - relying on non-co-operation with HMRC to achieve a tax advantage for their clients
> - selling products that rely on concealment and mis-description of elements to succeed.
>
> Promoters of these schemes pose a high risk to the Exchequer through tax lost and are a burden on HMRC which has to re-direct resources to tackle these promoters and their products.[98]

The Government discussed two approaches to identifying this cohort of businesses: either having a number of tests in statute, so that a promoters who met one or more of these would be immediately classified as 'high risk', or, retaining a degree of discretion by HMRC, allowing the department to use legislative criteria on a case-by-case basis. Of the two, it favoured the second approach, as it would be "tailored to the particular facts of the case" and would enable "the rules to apply while taking into account the history of the promoter's behaviour and its business":

> In certain cases some of these factors may carry more weight than others when determining if a promoter is high-risk. For example, all of a promoter's business may be in marketing products but if the promoter complies with its DOTAS obligations this alone would not be significant enough to make the promoter high-risk. However, if the promoter markets a product that is not notified under DOTAS when it should be, and the product has several hundred users and significant amounts of tax at risk then it is likely that the promoter will be high-risk. [Alternatively] there may be circumstances where it would be appropriate for HMRC to immediately designate a promoter as high-risk, for example if the directors of the firm have been charged with criminal tax offences.[99]

The paper gave a number of examples of the sort of objective criteria that could be used:

> - HMRC has used an information power to obtain information in relation to that promoter or their products

98 *Raising the stakes on tax avoidance: consultation document*, 12 August 2013 p10. The Government had first announced it would consult on measures to target this type of firm the year before (*Autumn Statement*, Cm 8480, December 2012 para 1.178).

99 *op.cit.* p13

- the promoter has failed to notify a scheme under DOTAS, whether or not there was a penalty for the failure

- the promoter has designed, sold or implemented an avoidance scheme that is caught, or appears to be caught, by the GAAR, or that fails due to the Halifax abuse of law principle[100]

- the promoter has breached a voluntary undertaking with HMRC

- the promoter is offshore in, for example, a UK overseas territory or a crown dependency, but has users that are subject to tax in the UK

- the promoter has been subject to a relevant fine or disciplinary action by a regulatory authority such as the Financial Conduct Authority, the Solicitors Regulation Authority or the Bar Standards Board, or a representative body for accountants or tax agents.[101]

As noted in the previous section of this paper, in December the Government confirmed it would proceed with these proposals.[102] It published draft legislation and a summary of the responses it had had in January 2014. A majority of respondents supported this reform, "tempered by the view that the proposals need to be carefully targeted", and favoured the option for a 'case by case' approach. In turn the Government proposed that HMRC would employ the statutory criteria for high-risk promoters in the following way:

> After an objective criterion has been triggered, the approach will provide for HMRC to issue a "conduct notice", setting out the expected behaviours from the promoter around, for example, ensuring the promoter gives a clear explanations of the risks when marketing its products and being transparent with HMRC. Only where the promoter continues the high-risk behaviour and fails to comply with a conduct notice would they be designated as high-risk by the issue of a "monitoring notice" and the new information powers and penalties will then apply to the promoter … Importantly, a conduct notice will not be issued if the objective criterion triggered was for failure to comply with an information power or a DOTAS obligation <u>and</u> the failure was insignificant. Additionally a conduct notice will not be issued if the tax at stake, in relation to the promoter's products, is not substantial ...
>
> A conduct notice may run for up to two years. If the promoter's behaviour improves during the period of the conduct notice then the conduct notice may be amended or all or part of it withdrawn to reflect that improved behaviour. HMRC will have a power to monitor the promoter to ensure that it is complying with the conduct notice. If a promoter does not comply with a conduct notice then it will be designated as high-risk through the issue of a monitoring notice.[103]

Most respondents also agreed with the proposal in the consultation that the criteria for high-risk promoters should include the test that the business concerned was a successor of, or associated with, an existing high risk promoter. One described this as "an absolute requirement in order to ensure those promoters targeted don't just hide under a new entity." In turn the Government agreed that including these entities was vital: "an associated entity

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[100] An important principle established by the European Court of Justice with regard to EU VAT law, that the application of Community law cannot be extended to cover transactions carried out solely for the purpose of wrongfully obtaining advantages provided for by Community law: *Halifax plc v HM Customs & Excise*, ECJ Case C-255/02 (*Tolley's Value Added Tax 2014-15* para 4.1). See also, HMRC Brief 56/09, 26 August 2009.

[101] *Raising the stakes on tax avoidance*, 12 August 2013 p11

[102] *Autumn Statement*, Cm 8747, December 2013 p74

[103] *Raising the stakes on tax avoidance - summary of responses & draft legislation*, January 2014 paras 3.8, 3.19, 3.53, 3.56

will be defined in terms of common interests such as shareholding or the involvement of the same individuals. A successor entity will be defined in terms of succession to all or part of the high-risk promoter's business."[104]

Statutory provision would be made to allow the objective criteria to be updated by secondary legislation, to "help counteract attempts by potential high-risk promoters to avoid designation by marginally changing their behaviour."[105]

An "overwhelming majority of respondents" were concerned that promoters should not be designated "high risk" until they had had an opportunity to appeal HMRC's decision. The Government agreed that this would be premature, and proposed that appeals would be heard by the First-tier Tax Tribunal. In addition, the operation of the new regime would "be confined to a small number of individuals with relevant experience. Designation will only be made and monitoring notices issued by a specially authorised officer of HMRC."[106]

The consultation had also asked for views on the powers that HMRC would have to deal with businesses that had been designated as high risk: to obtain information, to publicise a firm's 'high risk' status, to impose penalties and to set higher standards for both promoters and their clients. On the question of information, promoters would be required to respond to specific requests from HMRC and automatically provide material on the firm's products and clients. Apparently "one characteristic of high-risk promoters is their unwillingness to volunteer information" so that although providing information on a continuing basis would be more burdensome, the Government took the view that this was "proportionate to counter the effect of HMRC not having the relevant information at an early stage." Most respondents agreed that high-risk promoters should be named "to facilitate the goal of warning individuals about their existence and activities", though there were concerns that taxpayers would remain in the dark "because most people are unlikely to check the HMRC website and will trust their advisers." The Government decided that HMRC would name promoters only once they had exhausted their rights to appeal against designation:

> The naming will initially be publicised on the HMRC website with the promoter required to inform all its clients that it is high-risk. If the client is an intermediary then the intermediary will be obliged to pass the warning on to its clients that have used the high-risk promoter's products. Alongside the designated promoter's name, the publication will note which aspects of the conduct notice the promoter failed to comply with, so that prospective customers have more information about why the promoter has been listed, and are able to use this to inform their choices. To make sure that the correct message is given by the high-risk promoter the Government intends to introduce a power to make a statutory instrument that prescribes the words to be used by the high-risk promoter as well as the form and size of the warning.[107]

Taxpayers who continue to use products sold by a designated promoter would be required to inform HMRC that they were doing so, in the same way as taxpayers must declare if they are using a scheme registered under DOTAS. In general, there is a four-year time limit for HMRC to challenge someone's tax assessment for a previous year, though this limit can be extended to six years, or 20 years, where, for example, there has been a loss of tax due to the taxpayer's careless, or deliberate, actions.[108] The Government proposed that the 20 year

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[104] *op.cit.* paras 3.61, 3.63

[105] *op.cit.* para 3.20

[106] *op.cit.* paras 3.39, 3.47

[107] *op.cit.* paras 4.6, 4.10, 4.14-5. The Government acknowledged that, in this context, the term 'intermediary' would have to be "carefully framed to exclude those who merely pass on the contact details of a high-risk promoter to a third party without knowing anything about the high-risk promoter's products." (para 4.23).

[108] HMRC's online *Compliance Manual* sets out these time limits; in particular, see para CH53000.

extended limit should apply to clients of high-risk promoters, as “this should be one of the risks that [clients] … should consider before using [the promoter’s] products.”[109]

Finally, the consultation had looked at the process for promoters and clients appealing against penalties imposed for a failure to provide required information. It proposed that when individuals claimed they had a ‘reasonable excuse’ for their failure or that they had taken ‘reasonable care’ in responding to a request, the standard of proof should be higher than normal. The consultation document gives some background on when these two concepts come into play generally:

> <u>Reasonable excuse</u>
>
> When there is a penalty for failing to comply with an information notice, the penalty can only be avoided if there is a reasonable excuse for not complying.[110] … [Some tax advisers] will use the defence of reasonable excuse to avoid any penalty for not [failing to disclose a certifiable avoidance scheme under DOTAS by arguing] it has been given advice, for example a legal opinion, which says that it does not have to notify HMRC of the scheme, and that the existence of such advice provides it with a reasonable excuse. HMRC’s view on reasonable excuse is that the existence of legal advice is not sufficient, in itself, to provide a reasonable excuse … If the legal advice includes assumptions, it is the responsibility of the person relying on the advice, be it the high-risk promoter, intermediary or user, to ensure that the assumptions apply to their own particular circumstances.
>
> <u>Reasonable care</u>
>
> When a person supplies information to HMRC, for example in response to an information power or in completing a tax return, then they are under an obligation to take reasonable care to make sure that the information provided is accurate. The level of reasonable care depends on the level of knowledge of the person providing that information.
>
> Where there is doubt about the tax treatment of a transaction, legal or other professional advice is often taken. Reputable taxpayers and advisers will ensure that the advice is based on a full assessment of the facts, correctly described, and does not make assumptions. But typically high-risk promoters will not provide the full facts and may make assumptions so that the ability of the adviser to provide a fully informed opinion is constrained. In these circumstances it is difficult to see that the person relying on the advice has demonstrated reasonable care.[111]

It went on to argue that it would be fair to apply a higher standard of these defences for high-risk promoters and their clients:

> The proposal is that no advice will be admissible as part of a defence of reasonable excuse or reasonable care unless it can be demonstrated to the Tribunal’s satisfaction that:
>
> - the advice is based on an accurate description of the facts; and

[109] *Raising the stakes on tax avoidance*, January 2014 para 4.36

[110] There is no statutory definition of the term, but HMRC take the position that it is “normally an unexpected or unusual event that is either unforeseeable or beyond the person’s control, and which prevents the person from complying with the notice or leads to the obstruction.” In addition, “it is necessary to consider the actions of the person from the perspective of a prudent person, exercising reasonable foresight and due diligence, having proper regard for their responsibilities under the tax acts.” For further details see HMRC’s *Compliance Manual* – from para CH26300.

[111] *Raising the stakes on tax avoidance*, 12 August 2013 p24

> - it makes no assumptions on matters that may be relevant; and
> - the advice concludes that if the case went before the courts that the courts were more likely than not to decide in the person's favour.
>
> The higher standard would apply to high-risk promoters, not only to the information powers that are specific to the high-risk promoter regime, but also to other circumstances where there is a reasonable care or reasonable excuse defence, such as for not notifying an avoidance scheme under DOTAS.
>
> Users commonly rely on assurances from the high-risk promoter and intermediaries that they have advice that the product achieves the tax benefit, but this advice may not be available to the user to consider or share with their own tax advisers. As noted above, the advice may not be based on a full assessment of the facts, it may make assumptions that are untested and may not conclude that the scheme has a realistic chance of succeeding.
>
> The Government proposes that the higher standards for reasonable excuse and reasonable care should apply to users when they have relied upon on advice provided by or for the high-risk promoter, unless they can demonstrate, to the Tribunal's satisfaction, that the advice meets the criteria described above.[112]

Respondents raised two concerns: first, that changing the definitions of these terms would make for unnecessary confusion, and second, it would be unfair to disregard any assumptions that had been made by the parties concerned, particularly by scheme users:

> It was thought that making assumptions inadmissible as evidence may prove unworkable. Nearly all advice on avoidance schemes will be based on some assumptions and if there is to be a higher standard it should apply only to advice that is found to be based on unreasonable assumptions … In particular respondents were opposed to applying the higher standard to the users of the schemes on the grounds that unsophisticated users are unlikely to be able to judge whether an assumption is reasonable or not and will likely trust the opinion that they have given.[113]

In turn the Government decided to introduce a higher standard for promoters, with certain revisions, while taxpayers who wished to use this defence would have to show they had obtained independent advice on doing so:

> The Government does not consider that requiring a high-risk promoter to demonstrate to the Tribunal that the advice it is relying on reflects the facts and does not make unreasonable assumptions makes the defences of reasonable excuse and reasonable care confusing. On the contrary, allowing the Tribunal to satisfy itself on these points ensures that the advice is directly applicable to the penalty proceedings …
>
> [Taking respondents suggestions into account] the Government proposes that when considering any advice submitted by the high-risk promoter to the Tribunal for the defence of reasonable excuse or reasonable care, the Tribunal must be satisfied that the advice:-
>
> - is complete having regard to the facts of the case;
> - does not make any assumptions that are material to the case; and
> - reaches a conclusion that is reasonable.

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[112] *op.cit.* p25
[113] *Raising the stakes on tax avoidance*, January 2014 para 4.55

> … Instead of applying the same standard for reasonable excuse and reasonable care to clients that applies to high-risk promoters the Government … [has] decided to implement a rule that a client of a high-risk promoter can only rely on the defences of reasonable excuse and reasonable care against a penalty when they have taken independent advice about the high-risk promoter's product.[114]

It is anticipated that about 20 businesses could potentially be designated in this way.[115] The extra Exchequer receipts from taxpayers giving up this type of avoidance are not expected to be particularly large: £5m in 2014/15, rising to £35m a year in later years.[116]

Provisions to introduce these rules were included in the *Finance Bill 2014*, and were debated, and agreed, in Committee with a number of relatively minor Government amendments.[117] On this occasion the Exchequer Secretary, David Gauke, set out these provisions in detail:

> There are two stages to the legislation. First, clauses 227 to 235 and schedule 30 give the promoter the chance to change their behaviour before the serious consequences in the second stage apply. Secondly, clauses 236 onwards and schedule 31 allow HMRC to use significant new information powers on the promoter, with penalties of up to £1 million for failing to comply.
>
> The legislation identifies promoters by using objective threshold conditions, which are described in schedule 30. If the promoter triggers a threshold condition—for example, by being charged with a criminal tax offence—clauses 230 and 231 allow HMRC to issue the promoter with a conduct notice that requires them to change their behaviour. The conduct notice can cover the avoidance schemes that the promoter sells, the way they treat their customers and their compliance with their tax obligations, and it can last for up to two years. HMRC has the power to check whether the promoter is complying with the conduct notice. If at any time during that period the promoter breaches the terms of the conduct notice, the second stage is triggered.
>
> Clause 235 gives HMRC the power to apply to the tribunal for approval to issue a monitoring notice, which allows it to use information powers against the promoter to get full details of their schemes and clients. Once a monitoring notice has full effect, clause 241 allows HMRC to name the promoter as subject to a monitoring notice, and clause 242 requires the promoter to tell their intermediaries and customers. Failure to comply with those obligations can lead to penalties of up to £1 million. The penalties are described in schedule 31.
>
> Clauses 248, 251 and 253 extend the information powers and penalties for intermediaries who continue to act for the monitored promoter. It is not only the promoters and intermediaries but their clients who get new responsibilities under the legislation. Clause 246 requires clients to tell HMRC that they have used the monitored promoter, and clause 270 introduces an extended 20-year time limit for HMRC to bring assessments on them if they fail to do so.
>
> There will be a higher standard for reasonable excuse and reasonable care for promoters and their clients, which will prevent promoters from hiding behind poor quality legal advice as a justification for their behaviour. Schedule 31(9) prevents

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114 *op.cit.* paras 4.58-9, 4.61-2

115 HMRC, *Promoters of tax avoidance schemes – tax information & impact note*, 17 July 2014

116 *Budget 2014*, HC 1104, March 2014 p59 (Table 2.2 – item be). See also, HM Treasury, *Budget 2013 policy costings*, March 2013 p49.

117 HM Treasury, *Amendments 39-51 to clauses 227-276 and schedules 31-32: promoters of tax avoidance schemes*, 6 June 2014

> clients of high-risk promoters from relying on legal advice provided to them by the promoter to avoid penalties. Those clients are required to seek independent legal advice on their rights and obligations.
>
> To encourage better communication with HMRC, intermediaries and clients can also rely on clause 266, which overrides confidentiality agreements with the promoter and allows them to talk to HMRC voluntarily about any of the monitored promoter's schemes. Finally, schedule 32 describes how the legislation applies to high-risk promoters who are partners in partnerships, and how the behaviour of a partner may have consequences for the partnership.[118]

Speaking for the Opposition, Shabana Mahmood said that she supported "the motives behind the new regulations", but asked if HMRC's existing powers were not sufficient to tackle the avoidance schemes sold by these firms. Ms Mahmood also raise concerns that the new information powers might call on more resources, if they resulted in HMRC being "inundated with a huge volume of material." In response, Mr Gauke underlined that "the legislation before us is about promoters, not schemes":

> The aim is to reduce the supply of avoidance schemes by tackling promoter behaviour. To do that effectively, HMRC needs specific powers to require promoters to comply with conduct notices and when a monitoring notice is in place HMRC will be able to use new information powers and penalties.[119]

The Minister went on to address the question of HMRC's resources to operate the new rules:

> The high-risk promoter rules will be operated by the new counter-avoidance directorate in HMRC, consisting of 800 experienced HMRC officers, who will be responsible for tackling marketing avoidance. We believe that the resources are sufficient. It is worth pointing out that, going back to the comprehensive spending review of 2010 and subsequent Budgets and autumn statements, as a Government we have invested £1 billion over this period to ensure that HMRC can do more to deal with avoidance and evasion. So far that seems to be working well, with record levels of HMRC yields.[120]

These provisions now form Part 5 (ss 234-283) of the *Finance Act 2014*.

4.2 The Bill

As with follower notices & accelerated payments, **clause 3** introduces **Schedule 3**, which would apply extend the tax provisions for high risk promoters to NICs. The provisions would come into effect two months after Royal Assent. HMRC have not published any *separate* estimates of the Exchequer impact of these rules as regards NICs.[121] Where changes have been made to the tax rules regarding high-risk promoters, **clause 4** would allow the Treasury to make consequential changes to NI legislation by Order. Secondary legislation made under this provision would be subject to the affirmative procedure if this legislation amended or repealed primary legislation, under **clause 4(4)**.

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[118] Public Bill Committee (Finance Bill), *Fourteenth sitting*, 17 June 2014 cc523-4
[119] *op.cit.* c522, c525
[120] *op.cit.* c526
[121] HMRC, *Promoters of tax avoidance schemes – tax information & impact note*, 17 July 2014

5 Employment intermediaires: a Targeted Anti-Avoidance Rule

5.1 Background

In the 2013 Budget the Government announced that it would consult on proposals to tackle tax avoidance by 'intermediaries', based offshore, who provided labour services to UK companies.[122] An intermediary is an entity which interposes itself between a worker and the engager – such as an employment business or agency. A review of these arrangements had found that at least 100,000 individuals working in this country were employed through an intermediary company that had no presence, residence or place of business in the UK. In many cases employees were unaware that their payroll was located offshore and tax was being avoided on their earnings.[123] In October 2013 the Government announced changes to both income tax and National Insurance rules to tackle the problem, as well as a special certification scheme for the oil and gas sector.[124]

Legislation to make this series of changes has been split three ways: the necessary changes to income tax, and the new requirements regarding record-keeping and returns, were included in the *Finance Act 2014*; second, changes to NICs were made by secondary legislation; third, provision for the certification scheme for the oil and gas sector was included in the *National Insurance Contributions Act 2014*.

In December 2013 the Government published a second consultation, on proposals to prevent intermediaries based in the UK labelling workers as self-employed, by means of contrived contractual terms, so as to avoid tax and NICs.[125] In the past this has been a problem in the construction industry but the evidence suggests the practice is becoming more widespread:

> The use of intermediaries to facilitate false self-employment started in the construction industry as a way to reduce the risk to engagers of incorrectly engaging workers on a self-employed basis. However, this type of avoidance facilitated through intermediaries is now widespread in a number of other sectors including driving, catering and the security industry. In those other sectors, there is evidence of existing permanent employees being taken out of direct employment and being moved into false self-employment arrangements involving intermediaries. These intermediaries often require the worker to pay a fee of between £10 and £25 per week, further reducing any benefit to the worker of these arrangements.
>
> There are a number of ways which intermediaries are exploiting the legislation to facilitate the avoidance of employment taxes. Sometimes the worker is simply labelled as self-employed. In other cases the intermediary will set up the contract with the worker so it allows that the worker could send someone else to do their job. In reality this could not, and does not, happen.[126]

The consultation document set out the way that employment agencies have been required to account for tax and NICs in relation to payments made to a worker they have placed with a client, *if* the worker meets certain criteria – principally, that they provide their services personally (these rules are commonly known as the Agency legislation). The existing legislation in this area comprises separate legislation which applies to Income Tax and NICs. For income tax it is as follows:

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[122] HC Deb 18 March 2013 c34WS

[123] In late 2012 it came to light that large numbers of teachers employed in the UK had an employer in Sark in the Channel Islands ("State school teachers employed by tax-avoiding firm", *BBC News*, 4 November 2012).

[124] *Offshore employer intermediaries – summary of responses*, October 2013

[125] HMRC, *Onshore Employment Intermediaries: False Self-Employment*, December 2013

[126] *op.cit.* p7

> **Income Tax Legislation**
> The income tax legislation is contained at sections 44-47 of the *Income Tax (Earnings & Pensions) Act (ITEPA) 2003* [the 'Agency legislation']. For the legislation to apply to a person's engagement, four conditions (under s44(1)(a)–(d) of the legislation) **all** must be met:
>
> (a) The worker personally provides, or is under an obligation personally to provide, services to another person. This is where an intermediary supplies a worker to an end client;
> (b) The services are supplied by or through an intermediary or third party under the terms of an agency contract;
> (c) The worker is subject to (or to the right of) supervision, direction or control as to the manner in which the services are provided; and
> (d) Any payments are not already taxed as employment income.
>
> The worker must be providing their services under the terms of an agency contract. The legislation defines an agency contract as being: "A contract made between the worker and the agency under the terms of which the worker is obliged to personally provide services to the client."
>
> Where the above conditions are met, the payment received by the worker is treated as being in consequence of an employment between the intermediary (agency) and worker. This means that the intermediary (agency) must deduct Income Tax at source from the worker. Similar provisions apply for National Insurance.

For NICs it is the following:

> **National Insurance Legislation**
> The relevant National Insurance legislation is contained within the *Social Security (Categorisation of Earners) Regulations 1978*:
>
> - Schedule 1, Column (A) paragraph 2 and Column (B) paragraph 2; and
> - Schedule 3 Column (A) paragraph 2 and Column (B) paragraph 2.
>
> and the Northern Ireland equivalent (*The Social Security (Categorisation of Earners) (Northern Ireland) Regulations 1978*).
>
> These Regulations dictate that a person (the worker) will be treated as being an "employed earner" for the purpose of NICs when they meet the conditions in the Regulations. When someone is an employed earner for NICs then employer NICs is payable by the employer (or deemed employer for NICs purposes i.e. the intermediary) and the worker has to pay Class 1 employee NICs rather than Class 2 and Class 4 NICs that apply to the self-employed.
>
> The tests in the NICs legislation are very similar to those in the tax legislation. They require the worker to be subject to, or the right of, direction, supervision or control and that the worker provides their services personally.[127]

Intermediaries were successfully avoiding tax by exploiting the test that agency workers should provide their services *personally*:

[127] *op.cit.* pp13-14. Annex A to the document sets out the legislation. Guidance on its application is given in HMRC's *Employment Status Manual*, from para EMS2000.

> [These intermediaries] … attempt to sidestep this test by claiming that there is no obligation for the worker to provide their services personally. This may be done by including a clause in the contract that states the worker is able to send someone else to do their work. In fact this is often not the case because in reality the engager wants that specific worker. There is often collusion between the parties, as they all benefit from presenting the worker as being self-employed. In such cases it can be difficult for HMRC to prove that the reality of the situation is different from that presented in the contracts.[128]

The consultation document set out three scenarios that intermediaries had used to disguise the worker's employment status:

> In the first scenario the employer of the worker moves a number of their existing employees from being employed directly to engaging them through an intermediary on a self-employed basis. The duties that the workers undertake remain the same; it is only the employment status of the worker that changes.
>
> In the second scenario a new worker may agree terms with the engager including pay but the engager then stipulates the worker must be paid by a specific employment intermediary or they will not be engaged.
>
> A third scenario involves the supply of temporary labour to an end client by an Employment Business. The Employment Business sources the labour, (possibly via other intermediaries) but will give the worker no choice other than to be self- employed. This happens even where the worker is clearly under the control of the end user and has to perform the work personally.[129]

This practice often resulted in the individual worker losing their employment rights because they are not classified as an employee, and receiving little or no financial reward:

> In all of these scenarios the worker may be unaware that they are engaged on a self-employed basis and may only discover they are not employed when they attempt to claim holiday pay, sick pay or redundancy pay. In such circumstances the worker will not register with HMRC as self-employed and may have a large unexpected tax bill at the end of the year. In other cases the worker is aware that they are being engaged as self-employed and are incentivised to do so for a small increase in pay. This rarely makes up for the important benefits that the worker has given up. On other occasions the worker is given little choice but to accept the engagement terms as this is the only way they are able to find work.
>
> The worker is usually charged a fee by the intermediary of between £10 and £25 per week. This is charged even where the worker is only working for one day a week; meaning the worker takes home very little for their day's work. HMRC have seen examples where workers have mistaken the fee to the intermediary for a deduction at source for tax.
>
> The engager and employment intermediary often share between them the employer NICs and employment rights savings, with the worker receiving very little, if any, financial benefits from these arrangements.[130]

As a solution the Government proposed that the personal service test should be removed, and the legislation focus on "whether the worker is subject to, or the right of, supervision,

[128] *op.cit.* p10
[129] *op.cit.* pp11-12
[130] *op.cit.* p12

direction or control as to the manner in which the duties are carried out." For these purposes, control would mean "that anyone is able to exercise control, or have the right to exercise control about how the work is carried out":

> Other factors will also be considered such as the worker being able to decide when to carry out the work or where but these on their own will not be sufficient to bring someone within the legislation. So if a worker has to carry out their work between certain hours because, for example, this is the only time that the site is open, and has to carry out the work on site but can decide how to do their work and beyond complying with the specification there is no checking of the work then they would be outside of the legislation. However, if someone is able to supervise and could ask for the work to be done in a different way or different work to be done then the worker would be within the legislation.[131]

The onus for proving that someone did *not* meet this control test – and was, in fact, self-employed – would lie with the intermediary. As with the Agency legislation, the Government did not anticipate the new rules applying to personal service companies (PSCs) – as those supplying services through a PSC would not, generally, meet all of the relevant criteria. Draft legislation and guidance were included in the consultation document, and the Government proposed the new rules would take effect from 6 April 2014.[132]

The Government confirmed it would proceed with these proposals in the 2014 Budget; these changes are projected to raise £445m in 2014/15, falling to £425m in 2015/16.[133]

Legislation to give effect to these proposals was included in the *Finance Bill 2014*, with certain amendments in the light of the responses received. Respondents had raised concerns that the legislation was being introduced too quickly, and that the control test would be difficult to operate in practice. The Government resisted any delay in the implementation date, but acknowledged the difficulty of operating the control test where parties had been actively misled as to whether a worker met the control test or not:

> The majority of respondents thought the control test would be difficult to operate in practice. Some accountancy firms, accountancy bodies and recruitment representative bodies were concerned about a company's ability to prove a negative i.e. that there is no control over the worker. In response to these issues HMRC is developing extensive guidance to illustrate the control test.
>
> Stakeholders were particularly concerned that they may be provided with fraudulent documents purporting either no control or right of control or that the worker had had income tax and NICs deducted through PAYE by a business further down the contractual chain. The Government recognises the concerns which have been raised about the level of due diligence required in order to try and ascertain supervision, direction or control. The Government has therefore amended its proposal such that where the company has been provided with fraudulent documents PAYE liability will sit with the body providing these documents.[134]

The response document gave an illustration of how this would work in practice:[135]

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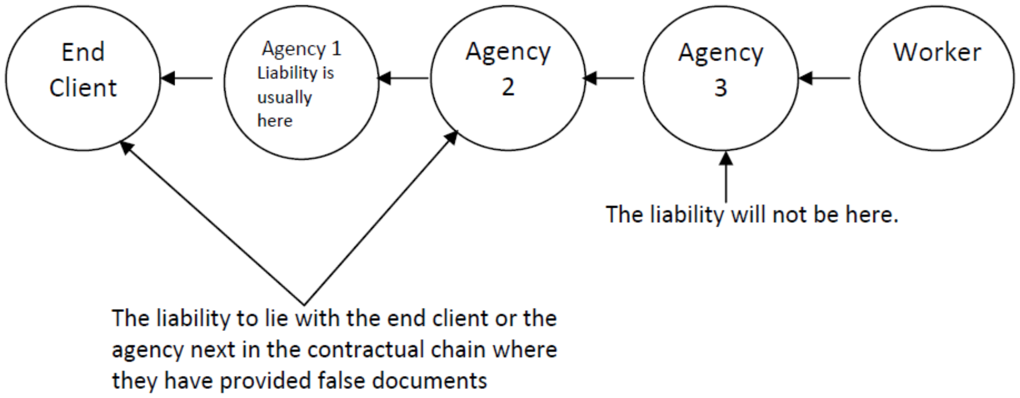
131 *op.cit.* p15
132 *op.cit.* para 4.4, para 4.8, Annex C
133 *Budget 2014*, HC 1104, March 2014 p58 (Table 2.2 – item s).
134 *Onshore Employment Intermediaries: False Self-Employment - Summary of Responses*, 13 March 2014 p4
135 *Onshore Employment Intermediaries*, 13 March 2014 p15



Following the publication of the Bill, the Exchequer Secretary, David Gauke, announced that both the income tax provisions and their NICs counterpart would be supported by a TAAR, a Targeted Anti-Avoidance Rule. For some years Governments have introduced legislation of this type to frustrate avoidance schemes exploiting a *specific* area of the tax code, rather than introducing provisions to reverse the effect of a single scheme.[136] As with a General Anti-Avoidance Rule – discussed in section 3.1 of this paper – TAARs allow the the courts to look at the *purpose* of the arrangements in question in determining whether they comply with the law. In general there has been less controversy over TAARs, because they are restricted to self-contained areas of the law, rather than the tax code as a whole, though there have been concerns about the degree to which they may have to be underpinned by official guidance.[137]

The Minister's statement is reproduced below:

> **The Exchequer Secretary to the Treasury (Mr David Gauke):** The Government are fully committed to tackling tax and national insurance avoidance and will take the necessary steps to protect the Exchequer and maintain fairness in the tax system.
>
> We have introduced legislation which amends the agency legislation in the *Social Security (Categorisation of Earners) Regulations 1978* ("the 1978 regulations") to tackle avoidance, through false self-employment facilitated by intermediaries, of national insurance contributions ("NICs"). We have also introduced legislation, in the *Finance Bill 2014*, to tackle the same problem in relation to income tax. The amendments to the 1978 regulations will come into force on 6 April 2014, as will the legislation relating to income tax (Budget Resolution No. 11, recorded in the Votes and Proceedings of the House of Commons for 25 March 2014).
>
> The income tax legislation is supported by a targeted anti-avoidance rule ("TAAR") which is intended to ensure that those workers who would be employees, but for the imposition of artificially constructed intermediary arrangements, are treated as employees for the purposes of tax.
>
> I am today announcing that we intend to introduce a TAAR for NICs, with retrospective effect to 6 April 2014, at the next available legislative opportunity. This will support the 1978 regulations and ensure that those workers who would be employed earners but for the imposition of artificially constructed intermediary arrangements are also treated as employed earners for the purposes of NICs.

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[136] For a discussion of the introduction and operation of TAARs across the UK tax code see, Institute for Fiscal Studies, *Countering tax avoidance in the UK*, February 2009 pp25-28.

[137] See, Michael Devereux, Judith Freedman and John Vella, *Tax Avoidance*, Oxford Centre for Business Taxation, December 2012 p18.

> The TAAR for NICs will follow the TAAR for income tax, details of which can be found at clause 16, section 46A of the *Finance Bill 2014* which was introduced into the House of Commons on 27 March 2014.[138]

The Government set out its reasons for introducing a TAAR in its response document to the consultation:

> The Government is aware that certain elements in the temporary labour market are quick to react to any legislative changes and to find new vehicles to reduce their income tax and NICs. The Government therefore intend to introduce a TAAR in the legislation to deter such avoidance. It is designed to enable HMRC to consider both
>
> (i) the motive for setting up the arrangements – whether it is set up with the motive of avoiding income tax, and
>
> (ii) what it achieves – whether it results in less income tax being paid.
>
> This means that people who set up personal service companies (PSCs) for a reason other than reducing tax – such as the limited liability protections incorporation provides – would not be within the TAAR. However, HMRC would be able to use the TAAR in the most egregious cases where, for instance, an agency requires all of their workers to set up a PSC to avoid the new legislation. HMRC will continue to monitor activity in these areas.[139]

The provisions in the Finance Bill to make these changes were debated, and agreed, without amendment, on 1 May 2014.[140]

Speaking for the Opposition on this occasion Cathy Jamieson, said that "in general terms, we are pleased that the Government are introducing these measures" but raised concerns as to whether HMRC had sufficient resources to monitor and police the new arrangements, particularly in relation to bogus self-employment:

> Legislation can be one thing, but the how guidance is framed and offered to people to enable changes to be made is also important … Perhaps the Minister will say something about the guidance that will be provided to ensure that the large numbers of people affected by the changes are aware of their new obligations and absolutely clear about the penalties for non-compliance. It needs to be made abundantly clear not only that people will be expected to comply, but that action will be taken against those who choose to ignore the new arrangements.[141]

In response the Exchequer Secretary David Gauke gave an overview of these clauses:

> The avoidance [targeted by these provisions] … takes two forms: falsely presenting employees as self-employed, and placing the employer or employment business of the UK worker outside the UK. Both those models rely on standardised substitution clauses within contracts in an attempt to avoid existing agency legislation, and clause 16 strengthens the existing agency rules to stop that.

[138] HC Deb 3 April 2014 cc89-90WS

[139] *Onshore Employment Intermediaries*, December 2013 para 4.12; *Onshore Employment Intermediaries*, 13 March 2014 para 3.67-9

[140] Public Bill Committee (Finance Bill), *Fourth Sitting*, 1 May 2014 cc112-128

[141] *op.cit.* c113, cc115-6

> The clause also introduces a targeted anti-avoidance rule to prevent people from setting up even more convoluted arrangements in an attempt to avoid the changes. We recognise that there may be times when fraudulent documents are provided to employment intermediaries. Such documents might claim that the worker is either already having pay-as-you-earn deducted, or is not subject to supervision, direction or control. To deal with that possibility, we have included a provision that deems the person who provided the fraudulent documents to be the employer for tax purposes.
>
> Clauses 17, 18 and 20 support clause 16. Clause 17 allows HMRC to transfer a company's outstanding pay-as-you-earn debts to directors where HMRC has used the targeted anti-avoidance rule or the provision relating to fraudulent documents. Clause 18 provides HMRC with the power to create legislation requiring employment intermediaries to keep records, to provide them to HMRC and to penalise the intermediaries if they fail to do so. The clause supports HMRC's compliance work, ensuring that it is targeted where the risk is highest. Clause 20 clarifies that where a UK employment intermediary has placed workers who are being employed or engaged outside the UK, it is the UK employment intermediary that is responsible for administering pay-as-you-earn.[142]

Mr Gauke went on to address Ms Jamieson's concerns as to the level of awareness across the industry of the new rules, and HMRC's work to ensure compliance:

> HMRC and the Treasury have met extensively with people in the industry and representative bodies. Guidance has been published to ensure that people know when and how the changes will apply. As to whether this could affect the genuinely self-employed, while the absence of any obligation to provide a personal service has long been held as an indicator of self-employment, and it is also most unlikely for a person who is personally providing their services in a genuinely self-employed capacity to be under the supervision, direction or control of someone else, the inclusion of a standardised substitution clause within contracts has for too long been used as a way of avoiding being caught by the agency legislation …
>
> In terms of monitoring compliance in the construction sector specifically, all subcontractor payments made are returned to HMRC under the construction industry scheme. That will enable a close monitoring of the extent of non-compliance. On the impact on business generally, particularly in the construction sector, the measure will create a level playing field for businesses, ensuring that compliant UK businesses that facilitate the UK's extremely flexible labour market are not undercut by those seeking to avoid tax.[143]

Guidance on the income tax TAAR for agency workers is given in HMRC's *Employment Status Manual*; this gives a short summary of the new rule:

> The income tax TAAR will apply where a worker personally provides services (which are not excluded services) to another person (the client) and a third person enters into the '**arrangements**,' under which the main purpose, or one of the main purposes of the third person's involvement, is to ensure the worker's arrangement does not fall within the provisions of the agency legislation.
>
> When the TAAR is applied it will provide that **unless** the following two criteria apply:
>
> (i) the worker is not subject to (or to a right of) supervision, direction or control as to the manner in which their services are provided, **or**

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[142] *op.cit.* cc122-3

[143] *op.cit.* c127. In the event these provisions were agreed without division.

> (ii) remuneration receivable by the worker in consequence of providing their services constitutes employment income apart from the agency legislation being applied,
>
> then the worker's remuneration, received as a consequence of those arrangements involving the third person, will be treated as being employment earnings from an employment between the worker and the third person.
>
> The third person will therefore be responsible for operating PAYE and paying Class 1 employees/employer's National Insurance contributions on all remuneration received by the worker (from any person) in consequence of providing their services via that arrangement in place.[144]

5.2 The Bill

The rules determining the employment status for agency workers for the purposes of NI are set out in the *Social Security (Categorisation of Earners) Regulations 1978 (*SI 1978/1689), as amended. As noted, from 6 April 2014 agency workers no longer need to be in a position where they are providing their "personal service" to be classified as employees.[145] When agency workers are classified as employed earners, regulation 5 specifies the person who will be treated as the secondary contributor – and thus responsible for administering PAYE, and paying secondary Class 1 NICs.

Clause 5 inserts a new regulation – 5A – that introduces a TAAR, equivalent to the income tax TAAR introduced under s16(5) of the *Finance Act 2014*.[146] In addition **clause 5** would extend the scope of two existing regulation-making powers, as established by sections 2 & 7 of the *Social Security Contributions and Benefits Act 1992* for (i) treating a person as being either employed or self-employed, and (ii) treating a person as a secondary contributor; this would allow regulations to be made under these provisions to provide for TAARs. It is not expected that these changes will have a significant Exchequer impact, further to the other avoidance measures regarding employment intermediairies, or to have any additional operational impact on HMRC.[147] The clause would also make equivalent amendments in the relevant legislation for NI in Northern Ireland.

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144 "Agency and temporary workers: agency legislation - provisions from 6 April 2014" *Employment Status Manual* para 2041

145 SI 2014/635 amended the 1978 regulations accordingly

146 The income tax TAAR is consolidated in s46A of the *Income Tax (Earnings and Pensions) Act 2003*.

147 Bill 80-EN, July 2014 para 160