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Significant changes proposed to tax avoidance and the penalty regime

In a consultation document, 'Strengthening Tax Avoidance Sanctions and Deterrents', for which the response period closed on 12 October 2016, HM Revenue & Customs ("HMRC") detailed their proposals in respect of the following major policy shifts:

- A significant restriction on the circumstances in which a claim for taking reasonable care in relation to the implementation of a tax avoidance scheme will be allowed
- Shifting the burden of proof from HMRC to the taxpayer to demonstrate that reasonable care has been taken

The 'reasonable care' defence

The law states that a penalty may be imposed for the submission of an incorrect tax return, so long as the error was the result of either careless or deliberate behaviour. While those who have used tax avoidance schemes subsequently defeated by HMRC will of course fall into the category of submitting an incorrect return, the deciding factor in relation to the imposition of a penalty will be the behaviour which led to the inaccuracy.

At present, aside from those using schemes in which the implementation has been deemed particularly poor, it is generally accepted that a 'reasonable care' defence will be sufficient to avoid a penalty for the majority of scheme participators. This will include reference to the various professional opinions obtained and relied on by the promoters or designers of the scheme, from independent financial advisors, accountants, solicitors and 'eminent QCs'.

Clearly, HMRC is keen to turn this tide, particularly when factoring in the levels of tax entering their coffers through failed tax avoidance schemes. The consultation document makes clear that a continued reliance on such opinions will no longer, in isolation, provide a sufficient defence against careless behaviour.
The following are to be excluded from any reasonable care claim:

- Advice addressed to a third party or without reference to the taxpayer's specific circumstances and use of the scheme
- Advice commissioned on the basis of incomplete or leading facts
- Advice commissioned or funded by a party with a direct financial interest in selling the scheme or not provided by a disinterested party
- Material produced by parties without the relevant tax or legal expertise/experience to advise on complicated tax avoidance arrangements

The burden of proof

Making matters worse still for scheme participators, HMRC is also proposing to shift the burden on to the taxpayer in demonstrating that they have taken reasonable care. It is felt by HMRC that the current position, under which they carry the burden of proof, is being abused by both scheme users and promoters.

Abuse occurs by withholding vital information from HMRC, in the knowledge that without it an argument in favour of careless behaviour will be difficult to substantiate. With the burden shifted across to the taxpayer, this will no longer present a problem for HMRC.

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Advice for those affected

At this stage, these proposals are contained within a consultation document rather than the legislation. However, when looking at the track record for consultations which later find their way into the Finance Act, it is no stretch of the imagination to see these initiatives in force by April 2017. With that in mind, those who have used schemes which are currently under enquiry or en route to an appeal hearing should consider their position in relation to not only the tax that may be due, but also a potential penalty. They should also be prepared to put forward their own case to support a reasonable care position.

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