



## Goodbye to the Commissioners

Many contractors will be aware of the General Commissioners and the Special Commissioners, as this was the route that had to be taken when appealing against a decision made by HMRC, most commonly IR35.

From April 2009 this process will be replaced by a new appeals procedure to a new body; The Tribunals Service.

The current system for appealing decisions made by HMRC has four separate tax tribunals, the General Commissioners, Special Commissioners, VAT & Duties and Section 706 Tribunals. The General and Special Commissioners hear appeals against HMRC in relation to direct tax, the VAT and Duties, in relation to indirect tax, the one most commonly used by contractors.

The aim of tax appeals modernisation is the creation of a single, coherent, cost-effective and user-friendly tax appeals jurisdiction that meets the needs of all users. These range from individuals to large multi-nationals, and matters that range from the relatively simple, to the complex, across both direct and indirect tax.

Under the current proposals, all current tax appeal rights will be heard by a unified tax chamber in the new two-tier tribunal system.

Every case will now be heard by the service, initially by the First Tier Tribunal. Where the decision reached by The First Tier is disputed, and permission is granted, an appeal can be made to The Upper Tribunal. Appeals will only be allowed where the disputed issue is centred on a point of law.

Any contractor who has a case pending is likely to find this automatically transferred to be heard by the new process.

### **Cases will be dealt with in two ways:**

Submission of all relevant papers by both sides, without the need for a formal hearing. The papers will be reviewed and a decision reached based on the evidence provided.

Or

A traditional style hearing with all parties in attendance.

Whilst the process has changed, the experts haven't; existing Special Commissioners will be transferred in to the new system. So whilst it may promise a simpler, user friendly approach, this is unlikely to translate in to any change of attitude or different interpretation and application of the laws.

We have always recommended that contractors seek expert professional advice at the earliest point of any HMRC enquiry, these changes do not alter our advice in any way.

### **Tax Avoidance or Tax Deferred**

Whilst we have previously written articles on the subject of Tax Avoidance, in an attempt to explain the risks for contractors, this still remains one of the most frequently asked question areas.

In this article we explore how it is that tax avoidance schemes are still widely available and look more closely at the question of whether they really are delivering what they promise. *Continued on page 2*

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### **Useful Links**

[www.professionalpassport.com](http://www.professionalpassport.com)

[www.hmrc.gov.uk](http://www.hmrc.gov.uk)

[www.icaew.co.uk](http://www.icaew.co.uk)

[www.lawsociety.org.uk](http://www.lawsociety.org.uk)

[www.pcg.org.uk](http://www.pcg.org.uk)

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### Background

Prior to December 2004 tax avoidance was the legitimate right of every taxpayer to take steps to reduce their tax liabilities. So long as their actions were within the legislative framework.

There was a clear division between tax avoidance and tax evasion. Tax evasion has always been a crime with severe penalties.

The Pre Budget statement in December 2004 changed this. The Government made it clear that their view of tax avoidance was similar to that of tax evasion and the lines between the two became blurred.

Subsequent Government actions have supported this statement where we have seen retrospective changes to legislation impacting on historic schemes.

With this background it would be fair to assume that tax avoidance schemes would have died and vanished from the landscape, so why are there still so many available and being openly marketed?

### Why are they still available?

One of the unintended consequences of the MSC legislation was the fact that it allowed many tax avoidance schemes to re-enter the market.

Prior to MSC many providers had, at that time, legitimate models, returning higher returns and therefore a lower tax burden. The differential between the providers returns and tax avoidance schemes was small and many felt that the small increase in returns offered by tax avoidance models did not match the increased risk they represented.

Post MSC compliant providers' returns to contractors have typically fallen and this has increased the perceived benefit of using tax avoidance schemes, although the risks are probably greater now than ever before.

The promoters of the schemes typically look to market their offerings on sites recognised, and widely used, by contractors, often using this as an unofficial endorsement, and a way of legitimising their offering.



They also approach consultants of recruitment firms offering high cash incentives for introductions, once again as a way of legitimising their offerings.

Furthermore, existing clients will have high incentives to introduce more clients to the provider and this is seen as one of the best ways to acquire new business.

The hope of most of these providers is that the contractors will accept their reassurances and lack the knowledge to fully understand either the risks or the offering.

Professional Passport has also been approached by a number of these providers looking for audits, we have made our views clear.

### Will I get Caught – How will HMRC know?

All schemes we have seen have an element of PAYE income attached to them. This single fact alone means that the providers make annual returns to HMRC of every individual who was paid during the preceding tax year.

So quite simply, when HMRC identify the scheme; they already have the lists of everyone that has been part of the offering. It is a relatively straightforward job for HMRC to match those lists to current details they hold on file.

The combination of a number of factors, including the blurring of the lines between tax "avoidance" and "evasion", as well as the budgetary shortfalls, means that HMRC are pursuing individuals more aggressively than ever before.

*We would suggest it is not **if** you get found out but **when**.*

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### **Do they work?**

The \$1,000,000 question!

The common offering now is for an element of PAYE, a low salary, topped up with a series of loans.

The key word in the sentence is LOANS.

Loans have to be repaid at some point, if you look closely at the terms of the schemes you will find this.

Let us ignore the technical aspects of compliantly reporting the loans and just look at the principles that would apply on repayment.

If the loan arrangement works, then in theory the returns will be similar to the headline returns in that particular year; BUT what will be the long term position.

Every financial expert is predicting increases in tax rates as a result of the economic downturn. These will be required as a means to repay the vast amounts of borrowing incurred in an attempt to limit the damage of the recession. If you accept this principle then a very different picture emerges on these schemes.

When a loan is repaid you have to declare it on your tax return as income. The tax rate that applies to that income is the prevailing rate for the year that the loan is repaid. Therefore if you share the view of increasing tax rates in the future why would you defer tax to a time when you will ultimately pay more?

If you fail to disclose the repayment, this is tax evasion. Failure to disclose is likely to incur a penalty close to 100% of the tax liability, ignoring the fact that it could also put you in prison.

If you fail to disclose the loan repayment and as a result effectively pay double the prevailing tax rate, you are likely to find your overall returns in a negative position – meaning you are currently working for free.

### **Will agencies have any issues?**

Agencies typically will only make payments into UK bank accounts. If the money is subsequently transferred offshore, then they would not be aware or involved.

However many agencies are aware of a number of these schemes, and the companies offering them, and will not allow contractors to use them. Some end clients also prevent contractors using some of these providers and ask the agencies to police it for them.

Agencies have a wide range of legislative and regulatory responsibilities and can themselves become exposed to risk if they knowingly allow contractors to avoid tax. For this reason many have restrictions in place for their own protection.

### **Summary**

The majority of schemes currently marketed are no more than tax deferred schemes; deferring tax to a time when the tax rates are likely to be higher!

Loan agreements have the ability to demand repayment at any time, with no requirement to pay the money back to you the individual. Whilst this would seem unlikely in the short term, what is their incentive when these schemes can no longer attract new clients?

HMRC already have all the users' details, so avoiding being caught is unlikely. HMRC have limited resources, so it is more about when they get round to investigating that particular company.

HMRC are likely to apply MSC legislation to these schemes, meaning your returns would be significantly below the returns if you operated compliantly from the outset.

The providers know they have a limited window of opportunity which explains why they are offering such large incentives and marketing so aggressively.

The tax landscape changed, initially in December 2004 and more recently in April 2007 with the MSC legislation. The combination of these two factors clearly shows both the Government's and HMRC's intentions.

We have always taken a position that if any provider has to use a barrister's opinion as a reassurance that their offering works, then they are operating in grey areas. Operating in these areas, we believe, presents an unacceptable risk for contractors.

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