DISCLOSURE

Patrick Way

GETTING STARTED

Essential Reading

You will need to have read the following:

(a) the legislation which is found at Part 7 of the Finance Act 2004 (being ss.306 to 319);

(b) the statutory instruments being –

- the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2004 (SI 2004/1863). In this article I refer to this statutory instrument as "the Schemes Regulations".

- the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) (Amendment) Regulations 2004 (SI 2004/2429). This amends the Schemes Regulations by adding a premium fee and confidentiality exclusion for employment products, there already having been such an exclusion for financial products;

- the Tax Avoidance Schemes (Information) Regulations 2004 (SI 2004/1864);

- the Tax Avoidance Schemes (Promoters and Prescribed Circumstances) Regulations 2004 (SI 2004/1865). In this article I refer to this statutory instrument as the Promoters Regulations; and

(c) the Inland Revenue's Guidelines on Disclosure which run to 49 pages.

If you would like me to e-mail the above to you, please send me a message at pw@taxbar.com.

I will return to the important parts of the legislation, the Regulations and the Guidelines but for now it is important to note that the word "schemes" encompasses notifiable proposals together with notifiable arrangements. "Notifiable arrangements" means any prescribed arrangements which enable or might be expected to enable the obtaining of a prescribed tax advantage and (and this is the important point) are such that the main benefit, or one of the main benefits, that might be expected to arise from the arrangements is the obtaining of that advantage. A notifiable proposal is a proposal for arrangements which, if entered into, would be notifiable arrangements.

The starting date

Broadly, the starting date was 18th March for employment-related products and 22nd June for the financial products. As will be seen, no other products are caught by the disclosure rules. Disclosure for "old" schemes (being those marketed between 18th March or 22nd June and 31st July) had to occur on or before 31st October 2004. Perversely, more recent schemes, being those marketed between 1st August and 24th September, had to be disclosed on or before 30th September. All schemes marketed after 24th September, involving a promoter, broadly speaking, are subject to a five-day disclosure rule as explained subsequently.

What is covered

Here is the crux. The only taxes which are caught are income tax, corporation tax and capital gains tax (Regulation 2 of the Schemes Regulations). Further, the only arrangements which are caught, as already mentioned, are those connected with employment

and those in relation to financial products (the Schedule to the Schemes Regulations).

Promoters

Bear in mind, of course, that if there is no scheme then you do not have to concern yourself with who might be a promoter. But if there is a scheme it has to be disclosed at some stage and the issue is simply whether there is a promoter, or more than one promoter who is obliged to disclose, failing that the client must disclose.

SCHEMES

The simplest thing is to take a scheme and then apply the above ground rules, as expanded by some more information. The most common question that I have been asked recently is in relation to the disclosure requirements (if any) concerning film schemes. This is a good question because it highlights how the rules operate in practice. In a typical film scheme individuals will contribute money to a partnership. That partnership will then acquire or produce a film. The partnership will then claim relief under s.41 or s.42 Finance (No.2) Act 1992, or s.48 Finance (No.2) Act 1998. The effect of obtaining those film reliefs under ss.41, 42 and 48 is that there are likely to be significant initial losses which will flow through to the individual members which may then be utilised by them pursuant to ss.380 and 381 Taxes Act 1988 and s.72 Finance Act 1991. Pausing here, it can be seen that there is no reportable scheme by virtue of those facts alone because although a tax advantage has been obtained in relation to a prescribed tax (income tax) the arrangements are not prescribed by the Schemes Regulations since they are not connected with employment and are not in relation to financial products. However, virtually all film partnerships provide that the individuals will subscribe for the partnership using partly their own money (let us say, as to 25% of the total subscription) and partly monies lent by a third party for the purpose (a 75% loan). The question is whether the 75% loan is a financial product for the purposes of the Schemes Regulations such that the arrangements in relation to the loan fall to be disclosed.

So let us work through this aspect step-by-step.

Step 1 – Is a loan a financial product?

Yes, patently a loan is a financial product. See para.7 of the Schedule to the Schemes Regulations.

Step 2 – Would a proposal or an arrangement in relation to a loan be a notifiable proposal or arrangement?

The answer is that such a proposal or such arrangements would be notifiable if the arrangements enabled a tax advantage to be obtained and are such that the main benefit or one of the main benefits that might be expected to arise from the loan arrangements is the obtaining of that advantage.

At this point the position becomes difficult. It has to be said that the main advantage in a film scheme arises by virtue of the film reliefs which in turn produce allowable losses but those advantages would arise whether a loan were used or not. So it is probably reasonable to say that the existence of the loan does not intrinsically produce as a main benefit or one of the main benefits the tax advantage. However, the use of the loans may increase the quantum of the income tax relief if an individual would not otherwise be able to subscribe to such a large degree and, depending upon the nature of the loan arrangements, may also postpone a clawback of reliefs under the new Finance Act 2004 legislation. However, in my view, on balance, I think it unlikely that the main benefit or one of the main benefits in relation to the loan is the obtaining of the tax advantage. I think the benefit emanates from the simple fact of subscription. This will, however, be a question of fact in each situation.

Step 3 – Even if there is a notifiable proposal or notifiable arrangements does the exclusion in the Schemes Regulations apply?

It is indeed in the Schemes Regulations that the relevant exclusion is found; in relation to financial products at para.8 of the Schedule and in relation to employment products, at para.5A.

In the circumstances under review, the exclusion applies where

(a) the arrangements are such that it might reasonably be expected that no promoter (and no person connected with a promoter) of the arrangements or similar arrangements would be able to obtain a **premium fee** and

(b) the tax advantage does not arise from any element of the arrangements which, disregarding any degree of confidentiality owed to any person, a promoter might reasonably be expected to wish to keep confidential from other promoters.

In other words, there is a two-tier test – does the scheme involve (or could it involve) a premium fee and is the scheme kept confidential from other promoters? Remember that we are only concerned with the loan. So the two-tier test is applied exclusively to that, not to the film scheme generally.

The Schemes Regulations contain no definition of premium fee but the Guidelines are useful and should be consulted on a case-by-case basis by reference to the particular facts. On the face of it, however, it is unlikely that any promoter could charge a premium fee in relation to the loan element of a film scheme. There may be a premium fee charge in relation to the advice as a whole but it is unlikely that the fee would be any different without a loan. As stated, however, this is always a question of fact. In addition, in virtually all cases, the relevant information memorandum sets out in

detail the way in which the loan arrangements operate and in any event the loan documentation is available for inspection by other parties. So, there should be no confidentiality. On this basis, it is my view that a typical film scheme involving a loan is unlikely to fall within the disclosure requirements; there is unlikely to be a premium fee and it is unlikely that elements of the loan are kept confidential from rival promoters. This, in any event, ought to be the position because my understanding is that the Inland Revenue's rationale for introducing the disclosure rules is to obtain details of schemes:-

(a) which are marketed for a very large fee, typically being one in which the promoter shares in the tax savings; and

(b) where the client is obliged to sign a confidentiality agreement.

A film scheme does not typically involve these elements.

PROMOTERS

Having ascertained that there is a scheme it is then necessary to consider whether there is a promoter because this is important in determining by whom and when a scheme should be disclosed. It is worth emphasising that whatever the position concerning promoters, all prescribed schemes must be disclosed at some time, since if there is no UK promoter, the client must disclose himself. The starting point is s.307 Finance Act 2004 which defines a promoter in relation to a notifiable proposal as being somebody who, in the course of a relevant business, (broadly a tax advisory business) is to any extent responsible for the design of the proposed arrangements or somebody who makes the notifiable proposal available for implementation by others. In relation to notifiable arrangements, a person is a promoter if he is already a promoter by virtue of making a notifiable proposal available and such a proposal is implemented or, in the course of a relevant business, he is to any extent responsible for the design of the arrangements or the organisation or management of the arrangements.

These definitions have caused problems in practice particularly by reference to the Promoters Regulations where the definitions are expanded. Thus, by virtue of paras.4 and 5 of those Regulations the following persons are not treated as promoters:

(a) someone who advises but does not design;

(b) someone who works in a tax advisory business, is a designer, but is not acting as an adviser;

(c) someone who is not a designer and could not reasonably be expected to:-

  (i) have sufficient information to know if a scheme is notifiable; or

  (ii) be able to comply with the reporting regulations; or

(d) someone who is only an organiser or a manager but is not connected with a designer or a marketer.

Frankly, if you are not thoroughly confused by now, you have not been reading this article carefully enough. So allow me to elucidate.

The Guidelines temper the Promoters Regulations by introducing three exclusions in relation to promoters being the benign tax advice test, the non-tax adviser test and the ignorance test. For example, assume that a scheme involves borrowing and a third party is consulted who suggests the use of a Eurobond to avoid withholding tax. Such a person is not a promoter because again he is not at the heart of the scheme: he is giving "benign tax advice". Or, assume that a scheme is to be launched which involves the use of an employee benefit trust. A solicitor who drafts such an employee benefit trust will not be caught: he is non-tax adviser for these purposes. Finally, assume that a scheme involves a financial product and a bank is asked to assist. The bank will not be a promoter if it is ignorant of the tax advantage and merely advising on, say, the

banking aspects of the financial product. Hence the ignorance test would apply.

TIMING OF DISCLOSURE

The promoter is bound to disclose the scheme within the appropriate time limit. Where there is a notifiable **proposal** he must do so within the period of five days beginning with the day after the relevant date. Here, the relevant date is the earlier of the following:

(a) the date on which the promoter makes a notifiable proposal available for implementation by any other person; or

(b) the date on which the promoter first becomes aware of any transaction forming part of notifiable arrangements implementing the notifiable proposal.

In relation to a notifiable **arrangement**, the prescribed period is again the period of five days but here beginning with the date after that on which the promoter first becomes aware of any transaction forming part of reportable arrangements. Where there is a promoter outside the United Kingdom, or legal professional privilege prevents a lawyer/promoter from disclosing, then the client who enters into the transaction is obliged to make the disclosure and must do so within the prescribed period of five days beginning with the date after that on which the client enters into the first transaction forming part of notifiable arrangements. If there is no promoter then the client must make a return with the relevant self-assessment return. As an aside, if a promoter chooses not to disclose (which is a breach of the law) then the client is under no obligation to make any disclosure apart from the general requirement that he includes all information on his self-assessment return as is relevant. Thus, this means that he is in effect back to the old rules prior to disclosure. If there is more than one promoter then disclosure by any promoter will do. Employees of a promoter are not obliged to make any disclosure and where a partnership is concerned, any one partner, or the partnership itself, may make the disclosure. Failure to disclose results in a penalty of £5,000

CONCLUSION

The main points to observe are that the only schemes which are caught are those in relation to the three prescribed taxes (viz, income tax, capital gains tax and corporation tax) and then only those schemes which concern employment or financial products. If those prescribed taxes and schemes exist, then the principal question in practice is whether there is a premium fee and if not, whether there is any element of confidentiality. If there is no such premium fee and no such confidentiality, then there is no scheme after all.

It's as simple as that.