Contractor guide to tax-avoidance legislation

Contractors using legal tax avoidance schemes are increasingly encountering anti-tax-avoidance legislation that is becoming more effective at shutting down such schemes. The legislation is also becoming more draconian and may threaten some contractors' livelihoods.

"One of the main criticisms of the UK tax code is that it has become too complex," explains James Abbott, founder and head of tax at contractor accountant Abbott Moore. "Underlying much of this complexity are the legislative 'sticking plasters' used to tackle tax avoidance."

The measures introduced in the 2014 Finance Bill, such as HMRC's powers to take money direct from taxpayers' bank accounts, accelerated payments and follow-on notices, are highly contentious and could lead to avoidance scheme participants, including contractors, facing financial ruin.

Ongoing and targeted anti-avoidance

"As scheme promoters develop new anti-avoidance schemes based on exploiting loopholes in existing tax legislation, HMRC and the Treasury continually generate legislation to close those loopholes," continues Abbott.

"There is a good reason for most of this legislation being there. One example relevant to contractors is the anti-avoidance legislation enacted to end the strategy of closing a contractor limited company to benefit from entrepreneur's relief (ER) on the funds retained in the company, only to launch another company doing the same business shortly after. Anti-avoidance legislation was introduced to stop the practice."

In 2012, the Targeted Anti Avoidance Regulations (TAAR) initiative was launched by HMRC. It is designed to enable HMRC to swiftly legislate against specific tax avoidance the taxman views as abusive.

Disclosure of tax avoidance schemes (DOTAS)

"If a scheme has certain hallmarks, then under the Disclosure of Tax Avoidance Schemes (DOTAS) legislation the scheme's promoter must by law tell HMRC about the scheme and get an HMRC reference number," says Abbott.

"This enables HMRC to know what's going on and also allows the scheme members to add the scheme's reference number to their self-assessment tax return. The promoter is also required every quarter to notify HMRC of who has used the scheme."

Abbott notes that there are many misconceptions about DOTAS: "Some contractors believe that having a DOTAS number means that the scheme is 'approved' by HMRC. But HMRC never approves tax schemes.

"HMRC may sometimes provide a ruling on whether legislation applies to a specific transaction that a contractor is considering or has done, but never approves tax avoidance schemes. The DOTAS number is simply a reference number that shows that HMRC has been alerted to the scheme's existence."

General Anti Abuse Rule (GAAR)

According to Abbott, GAAR was introduced in 2013 as a 'plan B' for when all other anti-avoidance measures don't apply to a particular scheme. He puts it in context: "Imagine a club that has specific rules saying pink ties, blue ties and ties with polka dots can't be worn. Then the management gets fed up chasing all the wrong tie-wearing offenders and introduces a new blanket rule that says if it is not a black tie, then it can't be worn. That's how GAAR works.

"GAAR turns the 'sticking plaster' approach on its head and is basically applied if there are arrangements where a panel considers it reasonable to conclude that obtaining a tax advantage was the main purpose, or one of the main purposes, of the arrangement."

GAAR is policed by a panel of HMRC and tax experts. If HMRC thinks a scheme is caught by GAAR, then it takes the scheme to the panel. This is made up of HMRC members and people with tax and business experience who will issue a binding opinion on whether or not the scheme is caught by GAAR.

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> James Abbott, Abbott Moore

Accelerated payments

The accelerated payments legislation introduced in the Finance Bill 2014 says that for enquiries into tax avoidance schemes already open or for returns submitted within the last 12 months, HMRC can send out a notice requiring the contractor to pay the tax potentially in dispute upfront.

Abbott explains: "The problem with accelerated payments is that you can do little apart from pay the tax or try to challenge it. HMRC says if you hand over the tax and subsequently win, then the contractor will be repaid with credit interest."

"The accelerated payments legislation applies to DOTAS schemes, schemes deemed to be caught by GAAR and any open enquiries into tax avoidance. Because it applies to open enquiries, this legislation has been heavily criticised as being retrospective."

Follow-on or follower notices

Follow-on or follower notices are where someone using the same scheme as, or one similar to, a scheme that has lost a judicial ruling then has to pay the tax and interest owed as if they had lost the case themself.

"Follower notices also apply to cases won in the first tax tribunal and above," says Abbott. "The first tier tribunal is typically used for straightforward and less complex non-tax-avoidance related cases. This is a very 'low' court to be bringing in the follow-on procedure."

Basically, contractors are required to hand over the tax they would have paid if they had not used the scheme and then try to take HMRC to court to prove that the scheme they are or were using is legitimate.

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James Abbott is the owner of Abbott Moore LLP and often speaks on freelancer / contractor tax matters. He has his own growing portfolio of contractor clients.

Abbott Moore LLP are PCG Accredited Accountants and specialise in providing tax advice to freelancers as well as dealing with their year end accounts and tax returns. **Read Full Profile...**

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"When coupled with the powers HMRC has been granted to take tax owed directly from taxpayers' bank accounts, all of these measures are really quite frightening," notes Abbott. "HMRC can use its powers to take money direct from bank accounts to recover unpaid income tax, but also tax owed on accelerated payments.

"The major concern is that there is no court involved. In every other debt recovery process a court has to decide, but not in HMRC's case."

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