

Follower Notices

(Lecture P1079 – 7.58 minutes)

Disclosure of tax avoidance schemes (DOTAS)

DOTAS has been around for a while (since 2004 – time flies). Without going into DOTAS in any detail, the regime is designed to help HMRC keep up to date with the types of tax avoidance schemes that are doing the rounds. DOTAS requires the scheme promoter to make a disclosure of a “notifiable arrangement”. This in turn gives HMRC the opportunity to review that arrangement and, where they consider the scheme to be on the wrong side of the invisible “tax planning” boundary, to make amendments to the legislation to counter or block the scheme. It’s a clever idea. We think up a way of saving tax, tell HMRC about it and they duly stop it.

Arrangements are notifiable if their main purpose is to obtain a tax advantage and the scheme falls within one of a number of descriptions or “hallmarks”. The DOTAS rules are long and complex and are constantly changing with new hallmarks seemingly being added every time we turn our backs, so practitioners are advised to seek specialist assistance if unsure about whether an arrangement is or is not notifiable.

DOTAS had limited success to begin with so the government upped the ante in 2013. Consultations called ‘Raising the Stakes on Tax Avoidance’ (August 2013) and ‘Tackling Marketed Tax Avoidance’ (January 2014) were set out with the stated aims of “changing the economics of entering into tax avoidance schemes” and “changing the behaviour of people and promoters in relation to tax avoidance”.

Following that consultation process, the measures on Follower Notices and Accelerated Payments were introduced in Finance Act 2014. HMRC has made no secret about the objective of these rules which is to ensure that the tax in dispute in relation to the use of an avoidance scheme sits in the Government’s bank account until such time as the dispute is resolved. So we pay now and argue later. In many cases this is a long time later as these processes tend not to be swift. There is something slightly sinister and Orwellian about it all but there is no doubt that it’s a vote winner.

Follower Notices

Follower Notices are part of the Government’s “drive to accelerate litigation”.

The plan was that once HMRC had taken a representative case to the Courts, obtained a favourable ruling and recovered the requisite tax from the protagonist, other taxpayers using the scheme (their “followers”) would dutifully throw in the towel and offer up the tax which they had hoped to avoid.

However, there was little incentive for other taxpayers using essentially similar arrangements to accept the Court’s findings and surrender arms. These taxpayers would invariably argue that the decision in the case of *HMRC v Mr. A Tax-Avoider* (2012) did not apply to them as their arrangement was slightly different.

This in turn meant further litigation, adding years to the time taken to resolve the dispute and meaning that the money needed to fund Hinkley Point, HS2 and other essential government projects was not forthcoming.

A person who is a “follower” will now be given a Follower Notice. The Follower Notice is the equivalent of HMRC “sending the boys round”. What the boys are trying to persuade the taxpayer to do is to take “corrective action”. Corrective action typically means amending the return or claim which is under enquiry or coming to a final agreement with HMRC to determine the appeal, but in essence is an acceptance that the tax arrangements previously entered into do not work. Corrective action is therefore surrender.

A Follower Notice can only be issued if 5 conditions have been met:

1. There is an open enquiry into the taxpayer’s return or claim or the taxpayer has made an appeal that has not yet been determined;
2. The taxpayer made the return, claim or appeal on the basis that a tax advantage (the “asserted advantage”) arises from the particular tax avoidance arrangement (the “chosen arrangement”);
3. HMRC is of the opinion that there is a final judicial ruling that is relevant to the chosen arrangement;
4. HMRC has not previously issued a Follower Notice to the taxpayer for the same arrangement; and
5. The notice is issued within the statutory time limit which is 12 months from the date of the judicial ruling becoming final or 12 months from the day that HMRC received the taxpayer’s return, claim or appeal (whichever is later).

A Follower Notice can only therefore be issued if there is a “final judicial ruling” which, in HMRC’s view, is “relevant to the arrangements entered into” by the recipient of the notice.

A ruling can be final at any stage in the legal appeal process, including the First-tier Tribunal, provided that it is not appealed further. The ruling does not have to set a strict legal precedent in sense that a judgment of a senior court would.

A ruling is “relevant” if it would deny the tax advantage sought by the taxpayer when applied to the taxpayer’s tax arrangements. The definition of “relevant” in this context makes it highly likely that Follower Notices will be issued to users of packaged or marketed avoidance schemes as opposed to cases against one person with a small number of followers.

Follower Notices should not be issued as an automatic response to a tax avoidance scheme being defeated. Before a Follower Notice is given in relation to a relevant judicial ruling, a HMRC governance panel must consider whether it is appropriate to apply the reasoning or principles established by the ruling to that taxpayer’s arrangements. However in most packaged schemes, this will be self-evident. The Follower Notice must identify the judicial ruling in question and explain why that ruling is relevant to the taxpayer’s own arrangements.

What some taxpayers perhaps don’t realise is that the Follower Notice does not strictly require “corrective action” to be taken (it is a suggestion rather than a demand), so taxpayers can pop the notice in their green recycling bin if they feel such action is merited. This depends on how confident the taxpayer feels in the case going his way.

So while the notice is HMRC's subtle way of "leaning" on the appellants in the hope they will give up the ghost, resistance is possible.

However the notice will then go on to explain that, if the necessary corrective action is not taken within the prescribed period of 90 days, the person may be charged a penalty. The maximum penalty is 50% of the 'denied advantage' that is the tax advantage that would have been obtained had the scheme been successful. The penalty is 20% for partnerships (divided between the partners).

The penalty can be mitigated down to 10% (4% for partnerships) based on co-operation, although one imagines that if a taxpayer decides not to take corrective action on receipt of a Follower Notice (typically on the basis that his tax arrangement will work and ultimately the case will be decided in his favour), he is perhaps not minded to be particularly 'co-operative' once the penalty notice comes through. Bear in mind that the penalty is a percentage of the denied advantage. So if HMRC eventually fail to deny the tax advantage, there can be no penalty.

In summary, on receipt of a Follower Notice, a taxpayer can either:

- Comply with the notice, do whatever is required to bring the case to a close and forfeit any tax advantage they had hoped to return. This is an irrevocable decision after which there is no going back. It's an admission of defeat.
- Challenge the notice. There is no formal right of appeal against a Follower Notice although the person can make representations to HMRC if he disagrees with the validity of the notice normally on the basis that one of the conditions described above has not been met (for example, the judicial ruling referred to in the notice is not relevant to the taxpayer's own arrangements). At this point HMRC could, of course, accept that the notice has not been validly issued and duly withdraw it, but bearing in mind that a senior governance panel had to be convened to issue the thing in the first place, one imagines that such instances are rare. If HMRC does not accept the representations made and the Follower Notice is upheld, an application for Judicial Review may then be sought.
- Throw the notice in the bin and take whatever consequences then "follow" (one of which will be a 50% penalty as ignoring the notice is hardly an indication of taxpayer co-operation).

It is important to note that the Follower Notice does not itself crystallise a payment of tax. All the Follower Notice does is try to persuade the taxpayer to take action to help bring their case to a close. There is nothing in the Follower Notice rules that requires the taxpayer to pay any tax. That is the job of the (increasingly infamous) Accelerated Payment Notice....

Contributed by Steve Sanders