

Bad Tax Planning—and how to deal with it (Lecture B1439 – 25.20 minutes)

2024 marks twenty years since Dawn Primarolo as Financial Secretary to the Treasury threatened retrospective legislation if taxpayers continued to engage in what the Treasury considered as aggressive tax avoidance. The avoidance related primarily to transactions in shares and securities. This led to larger accountancy reviewing and reducing some of the tax planning activities that had been commonplace.

Since 2004 we have seen other changes which have made aggressive tax planning considerably less attractive. This includes the implementation and expansion in DOTAS (Disclosure Of Tax Avoidance Schemes) where promoters, under pain of penalties, need to notify HMRC of tax planning schemes. We have also seen general anti-abuse rule and the GAAR Panel formed. To date, they have only given one ruling in favour of the taxpayer. We have also seen the attitudes of the courts towards tax planning change with 90% of tax avoidance cases being won by HMRC. In terms of legislation, we have seen a plethora of targeted anti-avoidance rules. Perhaps one of the more notable legislative changes has been to deny a tax advantage where a taxpayer is taking advantage of a failing in the legislation.

You would have thought that this would have deterred advisors from pursuing aggressive tax planning, they also have to contend with the Code of Conduct which had been imposed on them with regards to tax planning. However, it does not seem to stop a minority of tax advisors who seem to possess more marketing than technical skill in promoting various plans which are not necessarily to the advantage of the taxpayer.

The regular advisor – as opposed to the fly by night promoter, has a duty of care which may extend over decades; if not generations. When it comes to aggressive tax planning prevention is better than cure.

The client needs to be made aware that not only are they likely to incur substantial professional fees but in circumstances where they lose, they could end up with interest and penalties as well as potentially paying more tax than would have been the case if no planning had been undertaken.

A number of cases have shown how tax planning can go horribly wrong. The Bhaur Case was where a couple transferred 35 properties into a Trust which was conveniently offshore. The details are covered in more depth in Tolley's updates. When the plan was shown not to be effective for IHT purposes, the couple tried to get the arrangement rescinded. Both the High Court and the Court of Appeal refused the application. This not only meant that the couple had spent substantial fees on an ineffective plan, but it also meant that the properties were not held directly by the family which could lead to substantial issues in the future.

In the Darvel Case a company tried to pay monies as dividends, which the courts agreed was remuneration subject to income tax and national insurance. The company tried then to get a tax deduction for the "dividends" paid. This was refused meaning that the company had not only suffered a corporation tax disallowance but was also on the hook for the national insurance and under deducted PAYE as well.

Spotlights

Sometimes HMRC becomes aware of a plan and tries to warn taxpayers from implementing it because they do not believe that this works. In this case HMRC often issues spotlights, which highlight schemes which are being marketed and which HMRC believes are ineffective.

Any advisor who has a bright idea should as a matter of course consult the spotlight to see if HMRC has had the same idea and has taken a view as to whether the plan works or not (usually not!).

Recent examples of this included a plan for school fees which routed money or shares via the grandparents in order to avoid the settlement charges on the parents. Unfortunately, if the funds have originated from the parents and there is a transfer of value via shares at discounted values, then the scheme is ineffective. By all means, grandparents can settle funds and assets on their grandchildren without creating a settlement charge. However, the funds cannot originate from the parents of those grandchildren. Another perhaps more alarming plan is one which involves a hybrid partnership to which landlords transfer their properties. The partnership is supposed to be constructed as a mixed partnership where individuals are paid up to the higher rate threshold and beyond that the company recognises the income at CT rates. This plan is designed, according to the promoters, to:

1. Achieve the full interest deduction on the loans as they are supposedly with the company.
2. Achieve a step up in the CGT base cost.
3. Avoid SDLT on the transfer of properties and
4. Achieve Business Property Relief (BPR) from IHT.

HMRC's analysis is, in the author's view, pretty spot on to show that none of these tax advantages actually stack up. Indeed, the very expansiveness of the claims covering so many taxes should lead most tax advisors to go back to the old adage that if it sounds too good to be true it almost certainly is.

The unfortunate fact is that these plans are still being punted by here today gone tomorrow advisors who conveniently disappear when HMRC start asking questions.

Clearing the Mess

So, what should respectable advisors do where a client has been lured into one of these plans.

The first element is to obtain all the details of the plan and arrangements, however painful that is for the client.

Secondly, one needs to prepare a case to try and settle with HMRC.

The third point is to manage client expectations that this is unlikely to be an easy process or without some painful consequences. Stories that end happily ever after tend to be fairy tales, although it is quite possible that your client has already fallen for one.

Dealing with HMRC

It is important to take the initiative and be on the front foot for HMRC. Unprompted disclosures will always be more favourably treated than disclosures prompted by HMRC. Building up, if possible, a relationship of trust and within limits openness with HMRC will often be the best strategy where the client has clearly messed up in a right royal fashion.

Realism

For those devotees of the Lincoln Lawyer who seems to get his clients out of impossible scrapes, I would remind them that that is fiction and that generally life does not follow that path particularly in tax planning matters that go wrong. Preparation of the case is likely to result in a better position for clients, but no one should be under any illusion that bad tax planning normally ends in tears.

Contributed by Jeremy Mindell