EXPLANATORY MEMORANDUM TO THE

VALUE ADDED TAX (DISCLOSURE OF AVOIDANCE SCHEMES) (DESIGNATIONS)(AMENDMENT) ORDER 2005

2005 No. 1724

1. This explanatory memorandum has been prepared by the Commissioners for Her Majesty's Revenue and Customs on behalf of the Treasury and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 This Order, which comes into force on 1st August 2005, amends the Value Added Tax (Disclosure of Avoidance Schemes)(Designations) Order 2004 (S.I. 2004/1933) ("the principal Order"). It designates and allocates a reference number to two new tax avoidance schemes and designates one new provision included in or associated with avoidance schemes.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 No Regulatory Impact Assessment has been made for this Order. See section 8.

4. Legislative Background

4.1 Schedule 11A to the Value Added Tax Act 1994 (c. 23) (inserted by section 19 of, and Schedule 2 to, the Finance Act 2004 (c.12)) provides for the notification to the Commissioners of VAT avoidance schemes.

4.2 The principal Order designates eight tax avoidance schemes for the purposes of paragraph 3(1) of Schedule 11A ("designated schemes"). It also designates seven provisions included in or associated with avoidance schemes ("hallmarks") for the purposes of paragraph 4(1) of that Schedule. This Order amends the principal Order by adding two new designated schemes and one new hallmark to those designated by that Order.

4.3 Schedule 11A provides for the Commissioners to prescribe the time within which notification of designated schemes and hallmarks must be made, to lay down the form and manner of notification, and to prescribe the information that must be provided in relation to hallmarks. Only an allocated reference number need be notified for designated schemes.

4.4 These powers have been exercised by The Value Added Tax (Disclosure of Avoidance Schemes) Regulations 2004 (S.I. 2004/1929). Those regulations will be amended to provide that there will be no duty to notify a new scheme or hallmark designated by this Order where the prescribed accounting period in which the claimed tax advantage occurs begins before 1st August 2005.

4.5 Where there has been a failure to fulfil the obligation to notify the Commissioners may assess a penalty; of up to 15% of the tax advantage in respect of a designated scheme and up to £5,000 for a hallmark.

4.6 During the course of the Standing Committee debate on clause 19 of the Finance Bill 2004 the Economic Secretary to the Treasury, the Rt. Hon. John Healey MP, made the following undertaking: "Customs will publicly announce its intention to list any new scheme or hallmark, and will allow one month for representations to be made on why listing is not appropriate"[1]. That commitment has been met; see section 7.

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Paymaster General, the Rt. Hon. Dawn Primarolo MP, has made the following statement under section 19(1)(a) of the Human Rights Act 1998:

In my view the provisions of the Value Added Tax (Disclosure of Avoidance Schemes)(Designations)(Amendment) Order 2005 are compatible with the Convention rights.

7. Policy background

7.1 Tackling tax avoidance is a key element of the Commissioners' VAT Compliance Strategy, which is aimed at making compliance easier for businesses to comply with their VAT whilst tackling those who abuse the system.

7.2 The role of tax avoidance in producing the VAT Gap between VAT receipts the Commissioners could expect to receive given the level of economic activity and the amount they do receive is significant. It is not possible to estimate losses from avoidance activity by constructing effects from individual elements, but the Commissioners' latest estimate is that £2.5 to £3.0bn a year is lost through VAT avoidance.

7.3 Avoidance tends to be concealed within other business activities and therefore is often difficult to identify.

7.4 The Commissioners' anti-avoidance strategy has four main elements:

- To discourage taxpayers from using schemes. This includes a critical appraisal of all new legislation to reduce the potential for tax avoidance as well as publicising successes in closing down avoidance schemes.
- To identify as early as possible schemes that are being used.
- To challenge avoidance schemes by raising assessments and, where necessary, pursuing the matter through the Courts.

[1] Standing Committee Debate on the Finance Bill 2004, House of Commons Standing Committee A, Report of Proceedings on the afternoon of Thursday 6th May 2004, Column Number 72.

- To produce legislative changes that will close down avoidance schemes where litigation is not appropriate or where the amount of tax at stake is particularly large.

7.5 Schedule 11A and instruments made under it are intended to achieve early identification of avoidance schemes.

7.6 Schedule 11A requires VAT registered businesses with a turnover above £600,000 a year to notify use of designated schemes, allowing the Commissioners to identify users and target litigation. This order designates two new schemes. The first scheme seeks to exploit differences between the UK and another member State's VAT treatment of face -value vouchers. The second scheme attempts to remove the effect of an election to waive exemption on supplies of land and property, so that VAT is avoided on rental receipts from the property.

7.7 Schedule 11A also requires VAT registered businesses with a turnover above £10m a year to notify schemes with a main purpose of obtaining a tax advantage, if they include or are associated with a hallmark of avoidance. Notification is not required if a promoter of the scheme has registered it with HMRC (previously Customs), and the reference number allocated to it has been provided to the business. This Order introduces a new hallmark concerning face-value vouchers issued with low redemption rates or issued to other bodies in the same corporate group. Such vouchers are increasingly being included within schemes as a means of avoiding tax.

7.8 A draft of the Order was published on the HM Customs and Excise website on 24 March alongside a Tax Avoidance Impact Assessment (see paragraph 8.2 below) and comments were invited by 29 April. Comments were received from the Institute of Indirect Taxation and these have been taken into account in the final version of the Order.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument. This is the established policy for anti-avoidance measures, such as this, where the impact on business, charities and voluntary bodies that do not engage in tax avoidance is minimal. The Commissioners have agreed with the Regulatory Impact Unit of the Cabinet Office that this measure does not call for a Regulatory Impact Assessment for this reason.

8.2 The Commissioners issued a Tax Avoidance Impact Assessment, which replaces a Regulatory Impact Assessment in respect of this Order, on 24 March 2005. An updated Assessment can be found on the H M Revenue and Customs website (www.hmrc.gov.uk) and a copy is annexed to this memorandum.

8.3 The impact on the public sector is negligible.

9. Contact

David Easton at HM Revenue and Customs Tel: 0207 147 2418 or e-mail: David.Easton@hmrc.gsi.gov.uk can answer any queries regarding the instrument.

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