House of Commons

Committee of Public Accounts

# Tax avoidance: tackling marketed avoidance schemes

## Twenty-ninth Report of Session 2012–13

*Report, together with formal minutes, oral and written evidence*

*Ordered by the House of Commons to be printed 28 January 2013*

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## Committee of Public Accounts

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### Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/pac. A list of Reports of the Committee in the present Parliament is at the back of this volume.
Additional written evidence may be published on the internet only.

### Committee staff

The current staff of the Committee is Adrian Jenner (Clerk), Sonia Draper (Senior Committee Assistant), Ian Blair and James McQuade (Committee Assistants) and Alex Paterson (Media Officer).

### Contacts

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# Summary

Tax avoidance—using tax law to gain a tax advantage not intended by Parliament—reduces the money available to fund public services and is completely unfair to the majority who pay the tax due. HM Revenue & Customs (HMRC) estimates that in 2010-11 the tax gap due to avoidance was £5 billion. HMRC further estimates that the present total tax at risk from avoidance over time is £10.2 billion. There is a proliferation of contrived schemes which exploit loopholes in legislation and abuse available tax relief schemes. Promoters are currently winning what appears to be a game of cat and mouse with HMRC and deliberately taking advantage of the time lag between the launch of a scheme and the closure of the scheme by HMRC. Promoters and providers sign up as many clients as possible before HMRC changes the law and shuts the scheme. They then move on to a new scheme and repeat the process. Far too much public money is lost through avoidance and HMRC needs a much more robust approach.

HMRC has allowed a system to evolve where the die are loaded in favour of the promoters of tax avoidance schemes. The complexity of tax law creates opportunities for avoidance, there is no effective deterrent to stop people from promoting avoidance schemes, and HMRC is ineffective in challenging promoters who obstruct its attempts to investigate. All too often Government introduces new policies through tax incentives to stimulate economic activity and the design of these policies become an opportunity for tax avoidance providers and promoters to create a new set of schemes. Promoters collect their fees even when the schemes are found not to deliver a tax advantage. Few schemes are covered by mis-selling regulations, even though people might be put off buying them if they fully understood the risks. We welcome HMRC's consultation on applying the model of financial services mis-selling to tax avoidance.

Those who promote a tax avoidance scheme are required to notify HMRC of the scheme to comply with its disclosure regime. This has allowed HMRC to act quickly to close some schemes down. However, HMRC does not know how much avoidance is not disclosed but should be and has only issued 11 penalties for non-disclosure of a scheme. A small number of promoters appear determined to avoid disclosure and refuse to engage with HMRC. It is alarming that some QCs' opinions are being used by promoters as a "reasonable excuse" for non-disclosure which prevents HMRC from applying a penalty.

HMRC could learn from the variety of measures used in other counties to deter and tackle tax avoidance. In Australia, promoters have to get clearance for schemes before they introduce them. An advance ruling system of this type could deter contrived avoidance schemes and increase certainty in the tax system. Australia has also introduced powers to fine those who promote schemes that could not reasonably be expected to work or comply with the advance ruling system. We encourage HMRC to look seriously at whether these and other measures could be effective in the UK.

Government needs to use its influence wherever possible to deter tax avoidance. HMRC needs to consider whether by naming and shaming those who promote tax avoidance schemes, it could harness public opinion and reduce the appetite of companies to promote or use avoidance schemes. Major banks, accountancy firms and leading lawyers all play

their part in supporting and advising on tax avoidance schemes. The Government should examine ways to combat this. Government can influence behaviour by refusing to do business with those who promote tax avoidance or fail to pay their fair share of tax. We welcome the announcement that HMRC and the Cabinet Office will be consulting on how Government should change its procurement rules to deter tax avoidance and evasion, and will watch the outcome closely.

HMRC has a lot more work to do to successfully tackle tax avoidance. It needs to know how much it spends on anti-avoidance work and properly evaluate the effectiveness of its strategy. It needs to get a stronger grip on the large number of avoidance cases it is investigating and find a way to reduce them. The number of cases it litigates is tiny compared to the number of enquiries. HMRC needs to build its capacity and capability to take on avoidance in the courts, especially as we heard from one company that in light of previous successes, having taken and won two cases in the courts, it makes sense for scheme users to litigate. HMRC also needs to investigate cases quickly to deter more people from using them and reduce the advantage to those who do.

On the basis of a Report by the Comptroller and Auditor General[1] we took evidence from HM Revenues and Customs, Tax Trade, Future Capital Partners and Ingenious Media on marketed tax avoidance schemes.

1 Tax avoidance: tackling marketed avoidance schemes, Session 2012-13, HC 730

# Conclusions and recommendations

1. **Promoters of avoidance schemes run rings around HMRC.** There are no penalties for promoting avoidance schemes, and businesses make substantial sums of money from doing so. Part of the problem is the UK's highly complex tax law, but simplifying the system alone will not solve the problem of tax avoidance. HMRC told us that the proposed General Anti-Abuse Rule is designed to stop highly artificial schemes, but acknowledged that a wider range of measures is needed to combat tax avoidance. Australia, for example, has successfully applied a system requiring advance rulings on whether a scheme will work, combined with penalties for promoting schemes that don't. HMRC should assess the effectiveness of the full range of measures available to reduce avoidance, including those used in other countries, and identify the measures it will introduce to reduce the tax lost to avoidance, reporting to us on its progress.

2. **There is insufficient transparency about those who market or use tax avoidance schemes.** The complexity of avoidance schemes and use of offshore structures makes it difficult to know who is involved. HMRC publicise details of schemes that do not work to deter their uptake, but do not name the companies that market, operate and use schemes, despite evidence that public opinion can have a significant impact on the actions of large companies. The Government should consider how to increase transparency by naming and shaming those engaged in the business of tax avoidance and use it to discourage such activity.

3. **The Disclosure of Tax Avoidance Schemes (DOTAS) regime has helped HMRC close some avoidance schemes quickly, but does not effectively deter promoters, or penalise non-compliance.** DOTAS captures less than half of known tax avoidance. Although HMRC has other ways of detecting avoidance, it does not know how much avoidance is not disclosed through DOTAS but should be. Promoters are able to use a QC's opinion that a scheme does not have to be reported as a "reasonable excuse", preventing HMRC from applying a penalty. HMRC is consulting on how it could strengthen its disclosure regime, including by raising the hurdle for pleading a reasonable excuse. It should model the impact of the changes under consideration and should design an evaluative framework to measure the effectiveness of DOTAS, including by assessing the level of compliance.

4. **HMRC is not doing enough to tackle those promoters who are determined to avoid disclosure, or to prevent promoters from mis-selling schemes.** We are not convinced that HMRC is making full use of its powers to tackle promoters who are deliberately obstructive or that are selling schemes which do not work. It should ensure it is making full use of its existing, or potential, powers to tackle un-cooperative promoters and should publicise what it is doing to make clear that it is serious about addressing this problem.

5. **HMRC does not know how much it spends on its anti-avoidance work, and has not evaluated the effectiveness of its efforts.** HMRC does not know the level of resources and costs it commits to tackling tax avoidance and has not evaluated its anti- avoidance strategy. With at least £5 billion lost to tax avoidance each year, this

is far too large a part of HMRC's business for it not to know what it spends tackling it, or what return it gets. HMRC urgently needs to know what it spends on combatting tax avoidance and the return on its investment. Without this information, HMRC has no evidence that it is delivering value for money from these resources. HMRC should improve its recording and monitoring of the cost of its anti-avoidance work and set out clearly how it will evaluate its anti-avoidance strategy.

6. **The Committee welcomes the additional resources for HMRC to tackle avoidance but HMRC has a lot more work to do.** HMRC needs to make good use of the additional £77 million it has been given to tackle avoidance and evasion in the next two years. HMRC must act more quickly to identify and close down new tax avoidance schemes. HMRC has a good success rate when it takes cases to court but the number of cases it litigates is tiny compared to the overall caseload. HMRC has committed to strengthening its capability and capacity to litigate more. It should produce a plan showing how it will manage and reduce the stock of open cases, including how it will prioritise its resources to maximise yield, and monitor progress against this at a senior level.

# 1 Marketing tax avoidance schemes

1. HM Revenue & Customs (HMRC) estimates that in 2010-11 the annual tax gap due to avoidance across all taxes and customers was £5 billion.[2] Our hearing focussed on marketed avoidance schemes that are sold to one or more high worth individuals with the aim of reducing their tax liability. At 31 March 2012, the total tax at risk from avoidance by individuals and smaller companies over all tax years was £10.2 billion.[3] In each of the last two tax years, around 10,000 people reported the use of a marketed tax avoidance scheme, and there were at least 324 different schemes in use in 2011-12.[4]

2. The Committee took evidence from representatives from three companies involved in designing and selling schemes or arrangements that use tax reliefs or avoid tax. We were told that there is a lot of money to be made in selling avoidance schemes. Commissions paid to promoters can be up to 20 per cent of the tax saved.[5] Tax Trade confirmed that it was in the business of selling tax mitigation schemes, and that one of the schemes it promoted— 'Working Wheels'—was effectively a device that allows investors to avoid tax.[6] We were told that companies will sign up as many clients as possible and will continue to sell a scheme until HMRC changes the law to remove the tax advantage and closes the scheme down. All the schemes Tax Trade has sold—including 'Working Wheels'—have now been closed down but once this happens promoters simply move on to the next scheme.[7]

3. The other two companies, Future Capital Partners and Ingenious Media, were involved in schemes which use tax relief that Parliament has introduced, including the relief introduced in 1997, to encourage investment in the British film industry. These included using sale and leaseback to acquire completed films and lease them back to the films' producers, and creating partnerships to invest in films. These schemes often involve the use of loans to increase the amount invested and therefore the tax relief claimed. For example, the Terra Nova scheme involved investors being loaned 85% of the investment to increase the trade losses that, as partners to the investment, they could use to offset tax liabilities.[8] Future Capital Partners stated that since 1997 it had been involved in partnerships involving £6.5 billion.[9]

4. Both Future Capital Partners and Ingenious Media asserted that their organisations existed to raise money to invest in the British film industry and denied that they exploited tax reliefs to get a tax advantage that Parliament never intended.[10] Ingenious and Future Capital Partners also denied that they were involved in "exit schemes" to allow partners to

2 Figure 1.3, HMRC, Measuring Tax Gaps 2012, October 2012

3 Figure 4, C&AG's Report, *Tax avoidance: tackling marketed avoidance schemes*, Session 2012-13, HC 730

4 C&AG's Report, Figure 9 and Figure 10

5 Qq 13, 147 -149, Q 158,

6 Qq 4, 19 - 22

7 Qq 50, 103, 104, 111

8 Q 122

9 Qq 152 - 153

10 Qq116, 120, 121, 124, 125, 197, 203, 204, 224

leave partnerships to avoid the tax liability that arises when the partnerships become profitable.[11] We were not convinced that this is the case in practice. The legislation introduced in 2007 to limit the use of tax reliefs in partnerships was introduced because they were not being used as Parliament intended, including in the film industry.[12]

5. People seeking to avoid paying tax often use offshore structures to make their affairs less transparent. Partnerships deliberately use offshore structures in Jersey and other countries to avoid the requirement to register at Companies House, thus maintaining the confidentiality of those involved.[13] Offshore companies are also used for administration to avoid consolidating all profits and losses in one set of accounts. While there may be valid reasons for using offshore structures, this contributes to a lack of transparency about the finances of some investment partnerships and makes it hard to see how much tax they are paying or how much profit they are generating.[14]

6. Tax Trade told us that the complexity of the tax system contributed to the opportunities for tax avoidance, and that simplifying the tax system could reduce avoidance.[15] The witness accepted that this complexity allows legislation to be used in a way that was not intended by Parliament, as summarised by the ruling by Justice Henderson in 2007 that: "This is in my view one of those cases, which will inevitably occur from time to time in a tax system as complicated as ours, where a well-advised taxpayer has been able to take advantage of an unintended gap left by the interaction between two different sets of statutory provisions."[16] HMRC said it was always actively engaged in planning future legislation and evaluating existing legislation and that the Office of Tax Simplification (OTS) was working to simplify the tax system, but we understand that there are only six people in the OTS.[17] HMRC told us that tax simplification would not remove all avoidance as some avoidance, in areas such as the film industry, took place through the abuse of Parliament's intention in introducing the relief.[18]

7. A General Anti-Abuse Rule (GAAR) is being introduced in the 2013 Finance Bill. HMRC expects the GAAR to act as a further deterrent against tax avoidance, and cited evidence of a firm withdrawing from the market in anticipation of it becoming law.[19] However, HMRC acknowledged that it will take a considerable time for the first case to be litigated under the new legislation, and does not expect the GAAR to remove the need for other anti-avoidance legislation or for DOTAS.[20]

8. Other countries, for example Australia, use an advance rulings system where promoters apply to the tax authorities to get a ruling on whether tax structures are within the law

11 Qq 175-180, 205-214

12 Qq 123 -125, 202, 223

13 Qq 139-143, Ev 37

14 Qq 256-267

15 Qq 6, 9, 36, 52-54,

16 Q 48, Ev 38

17 Qq 303, 305

18 Q 303

19 Qq 328, 332, 333

20 Qq 328, 333

before implementing them.[21] We were told that this practice could reduce the uncertainty about what is tax avoidance and what is not. It could also reduce investment in avoidance schemes, as it is not possible in Australia to raise money for investments seeking to exploit a tax advantage unless there is an advance ruling from the Australian Tax Office approving the scheme.[22] Furthermore, Australia has penalties for promoters who do not comply with the advance ruling system or who promote a scheme in a way that is artificial in relation to that scheme, unlike the UK where there are no penalties for promoting tax avoidance. HMRC admitted that the Australian system had worked well in tackling mass marketed avoidance schemes.[23]

21 Appendix 3, C&AG's Report, *Tax avoidance: tackling marketed avoidance schemes*, Session 2012-13, HC 730

22 Q 323

23 Qq 323, Appendix 3, C&AG's Report, *Tax avoidance: tackling marketed avoidance schemes*, Session 2012-13, HC 730

# 2 The disclosure regime

9. The Government introduced a disclosure regime, the Disclosure of Tax Avoidance Schemes (DOTAS), in 2004. The purpose of DOTAS was to provide early information about tax avoidance schemes to HMRC, identify the users of tax avoidance schemes and reduce the supply of avoidance schemes by altering the balance of financial advantage gained from avoidance. DOTAS requires the promoter of certain types of avoidance schemes to disclose information about the scheme to HMRC within five days of making it available for use. Taxpayers who use these schemes are required to report the scheme reference number on their tax return.[24]

10. There have been 93 changes to tax law as a result of information from DOTAS since its introduction.[25] Tax Trade told us that DOTAS appears to be working, citing an example where HMRC changed legislation to close down a tax avoidance scheme within two weeks of disclosure. It said the early warning it provided to HMRC was unhelpful for those promoting tax avoidance schemes.[26]

11. HMRC told us that the majority of promoters are upfront about what they are selling and co-operate fully with HMRC's investigations into avoidance schemes, but that there is a small number of boutique promoters who as part of their strategy throw every obstacle in the way of HMRC finding out what they are doing.[27] In these cases HMRC told us it has powers to get the information it needs. However, we are not convinced HMRC is making enough use of its powers to make life much more difficult for uncooperative promoters, for example by investigating all their tax affairs closely to discourage this behaviour.[28]

12. DOTAS only captures 46% of tax avoidance. HMRC has other ways of detecting avoidance through gathering market intelligence and through its risk assessment work, but does not know how much avoidance is not disclosed but should be.[29] HMRC has only issued 11 penalties for £5,000 to promoters for non- disclosure of a scheme under DOTAS since its introduction.[30] The maximum penalty was increased to £1 million in 2010, but HMRC has yet to apply this.[31] HMRC has also yet to apply a penalty to an individual taxpayer for failing to disclose a scheme on their tax return.[32]

13. We were alarmed that promoters have been able to use some QCs' opinions' to protect themselves from fines for not disclosing schemes under DOTAS.[33] HMRC is not able to fine promoters or taxpayers for not disclosing a scheme where they have a legal opinion

24 C&AG's report, para 2.1, 2.2

25 Q 301

26 Qq 29, 65

27 Q 326

28 Qq 326 -328

29 Qq 289-291, 317

30 Q 285

31 Q 318

32 C&AG's report, fig 12

33 Q 36

that the scheme does not need to be disclosed as it constitutes a “reasonable excuse” for not disclosing.[34] HMRC agreed that the “reasonable excuse” practice was being used more widely than it thought was appropriate and told us that it is consulting on whether it can make it more difficult to use a legal opinion to provide protection from breach of the DOTAS rules.[35]

14. The majority of avoidance schemes are not covered by the Financial Services Act. We were told that some promoters continue to sell highly contrived avoidance schemes and receive the fee for the scheme regardless of whether they work.[36] The only risk to promoters from mis-selling schemes is that their clients may litigate.[37] We questioned Tax Trade about the dangers of promoters mis-selling avoidance schemes to ordinary taxpayers who are not high wealth individuals.[38] We were told that some promoters may not have told their clients the risks involved in the avoidance schemes they are using.[39] HMRC told us that it is consulting on whether the model of financial services mis-selling could be used for avoidance schemes.[40] HMRC acknowledged that it needs to do more to make the risks of involvement in avoidance more overt and visible to people.[41]

34 Qq 31-36, 193

35 Q 294

36 Q 353

37 Qq 82, 83, 85-87

38 Qq 80 - 81

39 Qq 79 - 82

40 Q 324

41 Qq 342-344

# 3 HMRC's response to tackling tax avoidance

15. In March 2011 HMRC and HM Treasury published a joint strategy "Tackling Tax Avoidance," setting out their approach to the issue. The strategy is designed to prevent avoidance at the outset where possible, detect avoidance early where it persists, and counter avoidance effectively through challenge by HMRC.[42] However, the strategy does not include any performance measure or indicators, and HMRC has not evaluated its performance against the strategy, meaning it has no way of knowing if the strategy is working.[43]

16. HMRC does not have adequate management information to allow it to manage its approach to tackling tax avoidance effectively. It does not know how much tax is at risk from avoidance, what resources it has deployed to tackle it, or the trend in the number of open cases.[44] HMRC's management information does not distinguish between evasion, avoidance and tax planning.[45] HMRC accepted that it needs to improve its management information and that a better time recording system would enable it to make more informed judgements on its deployment of resources.[46]

17. We heard mixed evidence on the efficiency with which HMRC investigates tax avoidance cases. Ingenious Media reported that HMRC had responded to its cooperation over film partnerships "with repeated inefficiency and, by its own admission, mismanagement", citing numerous changes of tax inspectors throughout investigations.[47] It thought that HMRC did not have the ability to differentiate between commercial transactions and tax avoidance and was under- resourced.[48] Tax Trade told us that whilst legislative changes made as a result of DOTAS disclosures were effective, HMRC did not seem to rigorously pursue all disclosures.[49] Future Capital Partners felt that HMRC had become tougher in cracking down on instances of tax avoidance and that the uncertainty this created had resulted in fewer people using avoidance schemes.[50] We welcome the Chancellor's announcement in the 2012 Autumn Statement that HMRC has been awarded an extra £77 million over two years to tackle tax avoidance, but look to HMRC to demonstrate it is used to good effect.[51]

18. HMRC has a good rate of success when it does litigate, winning 51 out of the 60 cases it has litigated since April 2010. However, this number is tiny compared to the number of

42 C&AG's report, para 1.16

43 Q 307, 310

44 Qq 307, 309, 310

45 Qq 307, 313, 314

46 Qq 309, 311, 312, 315

47 Q 251

48 Q252

49 Qq 63-4

50 Q 175

51 Q 361

open enquiries. HMRC stated it has 8,000 live litigation cases, of which 1,000 involve tax avoidance.[52] Future Capital Partners told us that the litigation process is attritional for both HMRC and users and was not an ideal set of circumstances but, having taken and won two cases in the courts, it makes sense for scheme users to litigate.[53] Investigations can take many years to complete, as demonstrated by Ingenious Media which confirmed it had a seven year investigation open on three of its biggest film partnerships.[54] HMRC told us that it has committed to looking at building up its capability and capacity to litigate more cases.[55]

19. It is clear from Starbuck's reaction to our hearing on their tax practices that public opinion can influence the activities of many organisations.[56] Despite this, HMRC does not publish the names of the firms promoting tax avoidance schemes, even where it considers the schemes contrive to avoid tax.[57] It is keeping under review whether publishing their names would deter companies from promoting avoidance.[58] HMRC publishes its success in litigation through press releases and its online publication "Spotlights".[59]

20. We pressed HMRC on what it was doing to ensure it did not employ companies that were not paying their fair share of tax in the UK. HMRC claimed that there were some limitations on its ability to pick and choose its suppliers imposed by UK government and European rules for running big competitions. HMRC confirmed that it would now make sure it went further by seeing what more it could do that was consistent with procurement rules, following the announcement of a consultation on this issue in the Autumn Statement.[60] We welcome the Chancellor's announcement that HMRC and the Cabinet Office will be consulting on the use of the procurement process to deter tax avoidance and evasion, with a view to new arrangements coming into effect from April 2013.[61]

21. We are concerned by the involvement of large accountancy and law firms and banks in the promotion and facilitation of avoidance schemes. HMRC told us that it was talking to these firms and noted the reputational risk faced by accountancy and law firms from involvement in avoidance.[62] It also stated that the work done through the disclosure regime had reduced the involvement of the top end of the market in avoidance and that the proportion of disclosures of tax avoidance schemes by the largest firms had declined from 25% in 2004 to less than 10% in 2011.[63]

52 Q 292

53 Q 242

54 Q 268

55 Q 350

56 Q 299

57 Q 298

58 Q 299

59 Q 297

60 Qq 367 -369

61 Qq 366-368

62 Q 343

63 Q 334

22. We are surprised that HMRC does not do more to ensure that the banks are not facilitating avoidance through the provision of loans.[64] HMRC accepted that in the past some banks were heavily involved in designing or facilitating tax avoidance. It told us that in 2009, 236 banks signed the voluntary Banking Code of Practice whereby banks undertake not to engage in, promote or facilitate tax avoidance.[65] HMRC monitors banks' compliance with the code, but admitted that it needed to closely monitor the extent to which banks question the purpose of the loans they provide.[66]

64 Qq 192, 336,337

65 Qq 337 - 340

66 Qq 339-341

# Formal Minutes

## Monday 28 January 2013

Members present:

Mrs Margaret Hodge, in the Chair

Guto Bebb
Chris Heaton-Harris
Meg Hillier
Fiona Mactaggart
Austin Mitchell
Nick Smith
Justin Tomlinson

Draft Report (*Tax avoidance: tackling marketed avoidance schemes*), proposed by the Chair, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 22 read and agreed to.

Summary agreed to.

Conclusions and recommendations agreed to.

*Resolved*, That the Report be the Twenty-ninth Report of the Committee to the House.

*Ordered*, That the Chair make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report (in addition to that ordered to be reported for publishing on 14 January 2013).

[Adjourned till Thursday 31 January at 9.00 am

# Witnesses



# List of printed written evidence

# List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

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| Twenty-Eighth Report | Department of Health: The Franchising of Hinchingbrooke Health Care NHS Trust and Peterborough and Stamford Hospitals NHS Foundation Trust: | HC 789 |

# Oral evidence

## Taken before the Committee of Public Accounts

## on Thursday 6 December 2012

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon
Stephen Barclay
Guto Bebb
Meg Hillier
Fiona Mactaggart
Austin Mitchell
Nick Smith
Ian Swales
Justin Tomlinson

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**Amyas Morse**, Comptroller and Auditor General, **Gabrielle Cohen**, Assistant Auditor General, **Rob Prideaux**, Director, National Audit Office, and **Marius Gallaher**, Alternate Treasury Officer of Accounts, were in attendance.

**REPORT BY THE COMPTROLLER AND AUDITOR GENERAL**

**Tax avoidance: tackling marketed avoidance schemes (HC 730)**

**Examination of Witnesses**

*Witnesses:* **Aiden James**, Director, Tax Trade, **Tim Levy**, Director, Future Capital Partners, and **Patrick McKenna**, Chief Executive, Ingenious Media, gave evidence.

**Q1 Chair:** Welcome. Thank you for agreeing to come and give evidence. We are looking at the tax avoidance of marketed avoidance schemes—the sort of things that you guys are involved in. Just for the record, I worked with Patrick McKenna when I was a culture Minister—in a rather different context, I hope. I will start with you, Mr James. Will you describe to the Committee the purpose of your business?

***Aiden James:*** Yes, sure. First, I would like to thank the Committee for allowing me to join in on the debate on tax avoidance. My business is essentially set up to provide an independent review of tax avoidance structures in the market. We particularly specialise in income tax avoidance.

**Q2 Chair:** So you market yourselves as a tax avoidance business. That is your business model. You are in the business of avoiding tax?

***Aiden James:*** Yes.

**Q3 Chair:** Okay. Will you describe in particular how your sale and leaseback schemes work so that the Committee understands the mechanism?

***Aiden James:*** I have never been involved in designing in any way, shape or form. We are not a film company. Film sale and leaseback is, I guess, what you are referring to.

**Q4 Chair:** So what sort of things do you do? How does your business model work?

***Aiden James:*** As I said, we review products out in the market from various different providers. In the NAO Report, we are probably best described as an introducer rather than a creator. There is a myriad of different firms that design structures—some would say that they are commercial and others would say that they are avoidance motivated. Essentially, they are all fulfilling a need from a client who has a large tax liability and is seeking to mitigate it.

**Q5 Chair:** Let me put to you the HMRC's view on tax avoidance. Do you think that you are "using the tax law to get a tax advantage that Parliament never intended"?

***Aiden James:*** That is a very subjective question. We will follow the guidance that is provided from an eminent QC.

**Q6 Chair:** We will come on to the QCs, but do you think that the schemes that you devise, or sell—or whatever your role is—use the tax law to get a tax advantage that Parliament never intended?

***Aiden James:*** The tax law is a very complicated area.

**Q7 Chair:** Do you mind answering the question?

***Aiden James:*** I am trying to.

**Q8 Chair:** Do you think that your schemes use the tax law to get a tax advantage?

***Aiden James:*** What I am trying to say is that tax avoidance and tax planning is a grey area. You could argue that both achieve the same thing.

**Q9 Chair:** I will ask you the question again, because I really want an answer to it. I apologise if you find it a difficult question. Do your schemes use the law to get a tax advantage that Parliament never intended?

***Aiden James:*** As I said, that is a subjective question.

**Q10 Chair:** Do you think that that is what you do?

***Aiden James:*** I think that tax schemes and tax planning can achieve the same thing. So, in answer to your question, yes, but it is not exclusive to tax schemes. It also encompasses tax planning, and I can give you some examples of that if you wish.

**Q11 Chair:** We understand the difference between tax planning and tax avoidance.

***Aiden James:*** I am not so sure that the NAO Report does, and I am happy to give examples.

**Q12 Chair:** We want to understand what you do, and then we will come to the Report. What commission do you work on?

***Aiden James:*** The commission varies depending on which product we decide to endorse.

**Q13 Chair:** Between what and what?

***Aiden James:*** It varies between product and product. Some scheme providers will charge as much as 20% or more, and some will charge almost as much to enter into a scheme as the tax that it can shelter. Others charge a much lower percentage.

**Q14 Chair:** How many schemes have you been responsible for?

***Aiden James:*** As I said, we are not responsible for any schemes.

**Q15 Chair:** How many schemes are you selling, how many have you sold, how many have you been involved in—whatever word you would like me to use?

***Aiden James:*** Okay, Tax Trade has been in business for approximately six years. We typically do one scheme a year, and that is not through choice, but because there are a lot of schemes in the market right now. Sometimes there may be 20 or 30 different structures in the market that arguably achieve the same thing, and we will not promote any of them. We prefer not to promote a structure that we feel is not robust.

**Q16 Chair:** What you mean by "robust"?

***Aiden James:*** Able to achieve its means.

**Q17 Chair:** How do you judge that?

***Aiden James:*** We look at an eminent QC's opinion, and take a technical view.

**Q18 Chair:** You haven't given me an answer on the number, and it would be useful to have the number. You have one a year.

***Aiden James:*** As I said, roughly.

**Q19 Chair:** Roughly, and you have been going for six years, so you have six. The one I have here, working wheels, is the one you introduced when?

***Aiden James:*** That is a very good question. We were not the only firm that promoted that structure, but I think working wheels was probably 2005–06 or 2006–07.

**Q20 Chair:** Can you explain working wheels a bit?

***Aiden James:*** I cannot give you details of any of the structures we have promoted.

**Q21 Chair:** Why?

***Aiden James:*** Simply because, as is standard across the industry, the scheme providers who create these structures insist that each firm and individual who are allowed access to the structures sign a confidentiality agreement.

**Q22 Chair:** I have got it. It involves "the taxpayer commencing a new trade in the sale of second-hand cars through a joint arrangement agreement where the taxpayer takes a high-level role." The introduction says that "the purpose of this planning arrangement is to offer an individual—the taxpayer—an opportunity to mitigate his tax liability by structuring his affairs in such a way to take advantage of the tax legislation in case law currently in place." It is basically that "the taxpayer will pay an irregular manufactured dividend under certain loan and security arrangements such that the manufactured payment represents an allowable trading deduction." So the scheme purports to trade in second-hand cars, but in effect is a device that allows investors to avoid tax.

***Aiden James:*** I think that is a fair summary. It is also fair to acknowledge that that structure was disclosed as a tax avoidance scheme.

**Q23 Fiona Mactaggart:** What happened when it was disclosed?

***Aiden James:*** It was a long time ago, and I honestly cannot remember, but the scheme provider would send a DOTAS form to HMRC's anti-avoidance unit, which would acknowledge it within 30 days, allocate a scheme reference number to it, and if it had further questions to ask, it would do so, as statute allows it to do.

**Q24 Fiona Mactaggart:** What happens when it asks further questions?

***Aiden James:*** By law, the provider is compelled to provide it with a response.

**Q25 Fiona Mactaggart:** I want to know what happens, and what it is like.

**Q26 Meg Hillier:** When did you tell HMRC?

**Q27 Chair:** Do you tell HMRC about all your schemes?

***Aiden James:*** We wouldn't; the developer—

**Q28 Chair:** Do you ever tell HMRC about a scheme you are dealing in?

***Aiden James:*** Only if we were aware that the product provider had not done so.

**Q29 Chair:** Do you ask the provider whether they have done so?

***Aiden James:*** Absolutely. We take it very seriously. The penalty used to be £5,000; it is now £1 million. We have always taken it very seriously. The view that we have taken is that clearly DOTAS is not a particularly helpful system for those promoting tax avoidance schemes, because it enables HMRC to see details of the scheme almost immediately—within five working days.

**Q30 Chair:** So, to the best of your knowledge, for every scheme in which you deal, although its main purpose is to avoid tax, HMRC has been informed through DOTAS.

***Aiden James:*** Absolutely. Categorically.

**Q31 Chair:** Can I tell you what really shocked me about you? I have another bit of paper here headed "Rushmore: the arrangement". A client signs this document, which says, "Please accept this as my instruction to create gross tax relief of," in this case, "£250,000 through the Rushmore income tax and chargeable gains tax mitigation arrangement developed by NT (Jersey) Ltd". In 2007–08, this person put down £125,000. In 2008–09, they wanted £125,000, and they sign it. If the public knew that this was the sort of business you were in—deliberately avoiding tax—they would consider you to be completely, utterly and totally immoral in the work that you are doing.

***Aiden James:*** The product has been settled by an eminent QC. Perhaps the week before he settled that opinion, he was working for HMRC.

**Q32 Chair:** I don't think the QCs do work for HMRC. Which QC? A handful of QCs appear to be active in this field. Jonathan Peacock—is that who you are referring to?

***Aiden James:*** That's not who I am referring to.

**Q33 Chair:** Rex Bretten?

***Aiden James:*** I believe he was the QC there.

**Q34 Chair:** Andrew Thornhill?
***Aiden James:*** I could give you a list of QCs.
**Q35 Chair:** The four I have are Jonathan Peacock, Rex Bretten, Andrew Thornhill and Giles Goodfellow. They seem to be the guys who prostitute themselves to these schemes.
***Aiden James:*** It is not limited to them; there are more—David Ewart.
**Q36 Chair:** Again, it seems completely, utterly and totally unacceptable that you just get a lawyer to sign this off, and that gives you the protection to run a business that makes money for you out of this, when this is, I repeat, purely about using tax law to get a tax advantage that Parliament never intended.
***Aiden James:*** As I say, the tax legislation is very complicated. It is complicated to the extent that it allows these products to work in the way that they do. As I am sure you are aware, these products have been challenged by HMRC, and the courts have, on a number of occasions, found for the taxpayer, despite the fact that these are blatantly tax avoidance arrangements.
**Chair:** We will come to HMRC. We don't think they do very much challenging.
**Q37 Nick Smith:** I want to return to working wheels, this dodgy second-hand car deal you seem to be manoeuvring around the country. How many of your clients used it?
***Aiden James:*** I honestly could not tell you. As I said before, it was quite a few years ago. I could find out. We are not the only firm that promoted that structure. You would probably be better off directing that question to the developer of that structure.
**Q38 Nick Smith:** You talked just now about having only one scheme a year. You must have some idea of how many clients participated in that scheme.
***Aiden James:*** I honestly could not tell you.
**Q39 Nick Smith:** Five, 10, 20?
***Aiden James:*** I would say the low hundreds.
**Q40 Nick Smith:** Low hundreds? Do you mean 200, 300?
***Aiden James:*** Yes.
**Q41 Chair:** What is the minimum amount they put in?
***Aiden James:*** As I say, it varies from product to product. It could be £100,000, it could be £500,000 of gross shelter.
**Q42 Mr Bacon:** What happened to that scheme? Is it still extant, or did it get closed down?
***Aiden James:*** It got closed down.
**Q43 Nick Smith:** How much money did you make on it?
***Aiden James:*** Again, I could not tell you.
**Q44 Nick Smith:** So you don't know how many customers and you don't know much money you made. You are not a very good finance adviser, are you?
***Aiden James:*** It was 2005–06, 2006–07—we are talking about five years ago. I can find the information out, and I can come back to you.
**Q45 Nick Smith:** We would like to see that information, please.
***Aiden James:*** But as I said, it would be limited to my business. It is not the only business which promoted that structure. It does feel a little unfair, given that we have abided by the law, that you are asking me to provide information.
**Q46 Chair:** I am not sure you have abided by the law. What you have done is sought a legal opinion to give yourself cover, which is very different. ***Aiden James:*** We haven't; the product provider has.
**Q47 Chair:** I hope to goodness that none of these schemes is in the spirit of using the tax law in the way Parliament intended.
***Aiden James:*** As I say, the courts have taken a different view.
**Q48 Chair:** On which case?
***Aiden James:*** I could name you a few abusive—if that is the word you want to use—tax structures. There is the D'Arcy case back in 2007, where Justice Henderson summarised that structure: "In short, this is in my view one of those cases, which will inevitably occur from time to time in a tax system as complicated as ours, where a well-advised taxpayer has been able to take advantage of an unintended gap left by the interaction between two different sets of statutory provisions."
**Q49 Chair:** That is one that you have won. How many have you lost?
***Aiden James:*** I couldn't tell you right now, simply because the jury is out. These structures take quite a few years before they reach their conclusion.
**Q50 Chair:** If you get a challenge from HMRC—if HMRC asks you a question about it—and they start saying, "This looks to us like a scheme that's avoiding tax", do you carry on selling it?
***Aiden James:*** The product provider tells them, and we tell clients that these are tax avoidance structures.
**Chair:** So you do carry on selling it.
***Aiden James:*** If the product is still workable within the law—
**Chair:** I have asked a different sort of question. You have raised a scheme and HMRC finally get on to it. They say that they are going to challenge it. At that point, do you carry on selling it?
***Aiden James:*** Yes. Why not? The law hasn't changed.
**Q51 Mr Bacon:** If you were trying to reduce the amount of tax avoidance, what would be your solution to reduce the number of unintended gaps? I think that was the phrase you used.
***Aiden James:*** That is a good question. The general anti-avoidance rule that is scheduled to come in next year, as I am sure the Committee is aware, is something that has been in debate since—goodness—the 1980s. In my opinion, with targeted avoidance rules, which are what we have had over the years, as legislation has been tightened up where they have been abused, as and when each of those parts of legislation have been changed, that has been enough to take avoidance practice out of the game.
There are still some players who would continue and argue that they are commercial arrangements, and therefore they are not caught by an avoidance rule. Those structures may continue beyond the general anti-avoidance rule. But we would certainly take the view that if there is a tax motive test introduced in the legislation, we would not entertain it.
**Q52 Mr Bacon:** A lot of it seems to arise out of the complexity of the legislation—in fact, all of it, really.

***Aiden James:*** Yes. As I said, I am happy to give some examples of some situations where there are, some would argue, imbalances within the tax legislation, and areas in the NAO Report that are shown as accepted tax planning where HMRC have argued, "Those areas are actually avoidance". That is what exasperates the problem.

**Q53 Mr Bacon:** Exacerbates. What I was getting at was, if complexity is the problem, surely the solution is simplicity.

***Aiden James:*** Agreed.

**Q54 Mr Bacon:** So if you swept away thousands of pages of tax law and made it very clear and black and white, without loopholes, would that, in your opinion, reduce the problem?

***Aiden James:*** Yes, I think it would.

**Chair:** I think we all agree with that.

**Q55 Nick Smith:** I want to tease out a bit more information about these so-called eminent QCs who provide information. How many of these eminent QCs do you have on your particular books? How big is your particular brothel?

***Aiden James:*** As I said, we are an independent firm. We do not instruct counsel. The scheme product providers will instruct their own QCs. Clearly there are some QCs whom some people may favour more than others, but ultimately they are all doing exactly the same job, which is to analyse legislation against the particular structure that is in front of them. Not only will they analyse the legislation and how it applies, they will also look at case law. It might well be that you have a structure in front of you that looks, on the face of it, to work; it is another thing to see if aspects of that have been tested in the courts previously.

**Q56 Nick Smith:** How many of the QCs you employ have previously worked for HMRC? You talked about one. Are there others?

***Aiden James:*** I believe so. As I said, we do not employ them; I cannot stress that enough. We do not design the schemes.

**Q57 Justin Tomlinson:** You obviously advertise these products. When they are then challenged in the courts, and HMRC are successful, what happens retrospectively to your clients who have been using the schemes that have been found to be unlawful?

***Aiden James:*** We advise all our clients to pay their taxes, irrespective of the fact that they may engage in a tax structure.

**Q58 Chair:** Pay which taxes?

***Aiden James:*** Pay their income tax. Pay the tax that they are seeking to shelter.

**Chair:** Say again?

***Aiden James:*** Pay the tax that they are seeking to shelter.

**Q59 Chair:** You advise them to pay and then you help to shelter?

***Aiden James:*** Yes. That way, their taxes are paid. If the structure subsequently fails—

**Q60 Stephen Barclay:** In essence they are taking a punt. You say that there is a high risk around the scheme—we know that it is at risk of being artificial and at risk of being found at odds with the intent of the legislation, therefore don't spend it, put it on one side and take a gamble. We know that HMRC don't really have the resources to fight a sufficient number of them. Some of them will go through and therefore some of the time you get to keep the money.

***Aiden James:*** Yes.

**Q61 Justin Tomlinson:** And that is the business model? Presumably you will not tell us this, but you would know roughly how often you are going to get caught out and how often your clients are able to put that money aside and never have it called upon.

***Aiden James:*** What do you mean by "caught out"? Can you explain?

**Q62 Justin Tomlinson:** By them going to the court and being tested, and then your clients being found against.

***Aiden James:*** As I said, what you have to look back at is the counsel's opinion to get a view of how robust a structure is. We would only favour those structures that we view as robust and sufficient to withstand charge from HMRC.

**Q63 Meg Hillier:** I know how rigorous HMRC is at pursuing it when a scheme has been ruled illegal. How many of your clients then get pursued and how quickly, percentage wise?

***Aiden James:*** It is a good question. Under DOTAS, the product provider has to submit his DOTAS declaration to the anti-avoidance unit of HMRC. I was quite surprised by the statistics in the NAO Report, in that only 4% of those products that have been disclosed are actually leading to a change in legislation. In my experience, it is a much higher percentage. Perhaps income tax is more on the radar than the other taxes that are covered, but HMRC could make a lot more progress if they were to follow up immediately after that disclosure has been received.

As I said, the legislation does allow them to sit down with that product developer and fully understand the details of the structure in order that they can introduce legislation that is effective in preventing it and really get to the heart of the problem.

**Q64 Meg Hillier:** So you are saying that they are not that rigorous at pursuing?

***Aiden James:*** They do not seem to be.

**Q65 Mr Bacon:** Are you saying basically saying, Mr James, that DOTAS works in theory but not in practice, because HMRC has the information, but then sits on it and really does not do much with it in many cases?

***Aiden James:*** It definitely works. Some structures that we promote only last for two weeks.

**Q66 Mr Bacon:** So it is really egregious—they notice it, and they do something, but there are many cases that they don't get to, which if they did get to, some of them might end up failing in the courts.

***Aiden James:*** Sorry, can you say that again?

**Q67 Mr Bacon:** You say that it definitely works, but plainly some cases are not fight for them and which they feel are so dreadful, so egregious that they deal with them straight away. They are then stamped on and closed down pretty quickly. Are you saying that there are lots of other cases that might not be quite so black and white, but that are obviously flawed, and were they to have more resources, devote more attention to them or to get on with it more quickly, more might end up being challenged, many possibly successfully?

*Aiden James:* Yes, that is a fair point. On the flip side of the coin, putting yourself in HMRC's shoes, if they issue a press release, and actually change the law to counter that structure, it is arguable whether the law was defective in the first place. Some would say, "Actually, that scheme or arrangement wouldn't work". We dismiss a lot of structures that other firms don't.

**Q68 Mr Bacon:** You look at structures and you don't introduce them because you feel that they are flawed before you even get to that point.

*Aiden James:* Agreed. We subsequently see them in the courts.

**Q69 Mr Bacon:** I want to ask you about the legal advice. The provider—the creator—has already taken legal advice and got an opinion from a QC before you look at it, but you are saying that, in some of those cases, you look at it and say, "We don't think that that will work" so you do not introduce it.

*Aiden James:* Yes. Some structures rely on legislation that includes an avoidance motive test.

**Q70 Mr Bacon:** In so doing, you are essentially doubting the worth of the opinion of the QC, who backed the scheme, aren't you?

*Aiden James:* A QC can only look at what is given to him to make that conclusion.

**Q71 Mr Bacon:** Do you think that the providers sometimes do not provide the full information, get the rubber stamp from the QC and then go out and market the scheme that contains things that the QC didn't know about?

*Aiden James:* There may be certain assumptions that the QC works upon.

**Q72 Mr Bacon:** That turn out not to be correct?

*Aiden James:* It then becomes a matter of do you accept those assumptions or don't you.

**Q73 Mr Bacon:** Or were you given the full information. Do you think that QCs are sometimes not given the full information? If they were doing their job, they would ask for it, wouldn't they?

*Aiden James:* If there is an avoidance purpose test in the legislation, you are expecting there to be a commercial aspect within that structure. Does it need to be 5% commercial? Does it need to be 100% commercial? The QC is not going to give an opinion on whether he views something as being commercial or not. We would much prefer to promote something that does not have that level of subjectivity. Either it technically works or it does not.

**Q74 Mr Bacon:** Do you seek, do you obtain, your own independent legal advice on the worth of a scheme that some provider has created and had tested and looked at by a QC? Do you then go to a lawyer and ask separately what your—

*Aiden James:* We have resources within the team to do that.

**Q75 Mr Bacon:** But you do not go out and get a silk's opinion.

*Aiden James:* I am trying to think of a situation where we may have done. Usually—

**Q76 Mr Bacon:** So what do you have—an in-house lawyer?

*Aiden James:* Yes, various staff.

**Q77 Chair:** Do you use some of the companies, such as Freshfields, Herbert Smith, Mishcon and Reed Smith?

*Aiden James:* As I say, we are not the product provider. We will simply do our own due diligence—

**Q78 Chair:** So you never use those lawyers who are well known for giving advice: Freshfields, Reed Smith, Mishcon—

*Aiden James:* There are a lot of law firms that will look at these structures—

**Q79 Mr Bacon:** You say you have resources within the team. Do you also go out and take external, independent legal advice on something that a provider is offering that you are thinking of introducing?

*Aiden James:* No. On the whole, we will manage it internally. We feel we have direct experience in this field to be able to make our own balanced opinion.

*Amyas Morse:* I just want to pick up something that I heard you say. It might be quite useful to get this out. You mentioned that some promoters charge very high fees. Are they more than the tax you might save?

*Aiden James:* Generally not more than the tax that you would save—generally less.

*Amyas Morse:* I am just trying to establish this point. When people go and buy these schemes, there is a possibility of going into this area and getting ripped off.

*Aiden James:* Yes, I think that is very fair; yes, I agree.

*Amyas Morse:* Do you think that happens a reasonable amount?

*Aiden James:* Yes, I do. I think some people do not understand the risks involved with the structures that they use. I would like to think that because we are keeping focus to avoidance legislation and an avoidance structure, the risks are more black and white.

**Q80 Mr Bacon:** So there is a form of mis-selling going on.

*Aiden James:* I think there is in the industry.

**Q81 Chair:** I have been approached by a whole load of not necessarily high-wealth individuals who have put in their money: teachers, doctors—just ordinary people who put their savings in and are exploited by guys like you, I am afraid, and lose the lot.

*Aiden James:* We are very clear when we talk to a potential client that the fees they pay in any structure are what they are risking and that individuals engaging in this type of activity ought not to participate if they cannot afford to lose those fees.

**Chair:** It is interesting to hear that, but I think a lot of ordinary people are being scammed.

**Q82 Stephen Barclay:** It is the mis-selling I want to focus on. If an introducer, as opposed to a promoter, mis-sells, is there any risk for them other than the loss of confidence of the client?

*Aiden James:* I think they are potentially opening themselves to litigation from their client.

**Q83 Stephen Barclay:** Even though they are introducing a scheme that has been backed by a QC.

*Aiden James:* As you said, it is mis-selling you are talking about. It is how you communicate the risk to that client. If that client is engaged in a structure and has not understood those risks, then—regardless of whether an eminent QC has settled that arrangement or not—if the client has not been made aware of what the risks and the facts are, he is putting himself at risk of mis-selling, yes.

**Q84 Ian Swales:** But you would not be covered by the Financial Services Act for the types of things you do.

***Aiden James:*** I think some tax structures do fall into the Financial Services Act. Partnerships may do. The FSA has what are called unregulated collective investment schemes, and partnerships may fall into that, in which case only regulated entities can promote those structures.

**Q85 Ian Swales:** So do you know which things that you sell are covered by the Financial Services Act and which are not?

***Aiden James:*** Yes, we do, and it is something we take very seriously when looking at a structure.

**Q86 Chair:** How many are covered? All the schemes I have looked at say very clearly there is no FSA cover at all. What proportion of yours are covered? Give us a rough guide as to the proportion of yours that have FSA—

***Aiden James:*** I think one of the structures that we have promoted over the years—as I said, we tend only to do one a year.

**Q87 Chair:** One. Out of how many?

***Aiden James:*** Maybe six or seven.

**Q88 Chair:** That is unusual. What is that one called?

***Aiden James:*** Now you are asking me a question.

**Q89 Nick Smith:** You only have six schemes.

***Aiden James:*** I know. I cannot remember the name; sorry.

**Nick Smith:** It cannot be that hard.

***Aiden James:*** What I am also thinking is whether legally I am allowed to tell you what it is called, because we have signed a confidentiality agreement on that structure. HMRC is aware of it, so perhaps you should ask HMRC.

**Q90 Nick Smith:** I ask you again: what is it called?

***Aiden James:*** As I have said, I would need to take legal advice but I do not know if I can tell you because we have signed a confidentiality agreement for that structure.

**Chair:** You can tell us the name of the scheme.

***Aiden James:*** Ask HMRC.

**Q91 Mr Bacon:** They certainly will not tell us.

***Aiden James:*** Well, they are probably right—

**Mr Bacon:** You will be pleased to know that they plead confidentiality all the time. Probably a very good thing—

**Q92 Chair:** This is a bit odd, Mr James. You flog this scheme to individuals and you cannot tell the public. What does that tell you?

***Aiden James:*** If the public were to sign a confidentiality agreement then, yes, we would be happy to tell them.

**Q93 Fiona Mactaggart:** Do you ask everyone who purchases a scheme to sign it?

***Aiden James:*** Our product provider insists upon it.

**Chair:** I do not know how you sell these.

**Q94 Meg Hillier:** If I come to talk to you about it, and you advise me and I decide not to take it, then I still know about it.

***Aiden James:*** True, but you would have signed a confidentiality agreement before—

**Q95 Meg Hillier:** Just to have a conversation?

***Aiden James:*** About that structure, yes.

**Meg Hillier:** I think that might give me the warning sign—

***Aiden James:*** Indeed. It does, it definitely does. Some individuals will not want to sign one—

**Q96 Chair:** Why do you need a confidentiality agreement on a scheme that you are trying to sell?

***Aiden James:*** Why?

**Chair:** Yes.

***Aiden James:*** Because, as I said, it is not us that puts these NDAs or confidentiality agreements in place, it is the product provider—

**Chair:** Why?

***Aiden James:*** They spend a lot of money developing—

**Chair:** You are in this industry, I am not, explain to me why.

***Aiden James:*** I am trying to tell you. The product developers have spent a lot of money developing these arrangements. They have competitors out in the market—

**Q97 Chair:** The name of the scheme, that is all we are asking you at this point.

***Aiden James:*** I will take—

**Nick Smith:** What is it? Come on, what is it?

***Aiden James:*** I am sorry but I will take legal advice and am happy to come back to you afterwards on that?

**Q98 Ian Swales:** If I came to see you about one of your schemes and then went off to talk to my financial adviser about it, would I be able to explain it to him or her?

***Aiden James:*** They would also need to sign a confidentiality agreement, but then yes.

**Ian Swales:** Right, okay.

***Aiden James:*** Most likely, the financial adviser—

**Q99 Chair:** Why does the name have to be confidential? Why? This is not a question with a catch, I just do not understand this.

***Aiden James:*** I do not have a copy of the confidentiality agreement in front of me to know whether—

**Q100 Chair:** Well, loads of these confidentiality agreements have reached me, and they all say, "This is in confidence", but I am happy to read them out because I think the public should know.

***Aiden James:*** I am happy to share it with you, but I just need to double-check that I am allowed to do so.

**Nick Smith:** Chuck him off the stand. He should tell us what the names of these schemes are, chuck him off the stand.

**Q101 Guto Bebb:** May I have a quick clarification after the point you made earlier? You challenged the figure of 4% of these schemes resulting in tax changes. You thought it was higher. Can you offer a view as to how high you think it was?

***Aiden James:*** I would expect it to be 80% to 90%. I would expect HMRC, when it receives a DOTAS declaration, to look at it seriously and to issue an HMRC-Government press release about changing the law, to prevent that structure from being effective going forwards.

**Q102 Guto Bebb:** Is that your view? Or do you have—

***Aiden James:*** That is genuinely my view.

**Q103 Ian Swales:** How many of the schemes you have marketed are now illegal?
***Aiden James:*** Most of them.
**Ian Swales:** Most of them?
***Aiden James:*** All of them, I suspect.
**Q104 Ian Swales:** All the schemes you have marketed are now illegal, so you are now looking for the next loophole—is that a fair description of your business?
***Aiden James:*** That is how it works, yes.
**Q105 Mr Bacon:** May I just be clear? When you said 80% to 90%, do you mean that that is what you would have expected?
**Guto Bebb:** The 4% is correct then.
***Aiden James:*** The 4% is the figure that is in the NAO Report. I was amazed, I was quite astonished by that. Based on my experience, I would have expected HMRC to be issuing an awful lot more press releases changing the law to counter these arrangements. My experience is that they have done.
**Q106 Chair:** We have to move on. Mr James, I am very grateful for the honesty of the evidence you have given, but it is pretty gobsmacking. I just wonder, have you any ethical basis for the business model on which you are making money?
***Aiden James:*** The law is very complicated. I am happy—
**Chair:** What is the ethical basis?
***Aiden James:*** I am happy to give you some examples of situations of employees doing exactly the same job. If you happen to have two people working in, say, an insurance company and they both do international travelling as part of their job, if one of them is non-UK domiciled and the other is British, one could be paying half the income tax that the other one is doing, and yet they are doing exactly the same job.
**Q107 Chair:** What is the ethical basis? When you lie in bed at night and you are dreaming up the next device to avoid tax, do you think about whether you are doing the right thing for the world in which you live?
***Aiden James:*** Individual clients contribute an awful of money in tax, and a client may do one scheme or lots of schemes—
**Q108 Chair:** They do not contribute a lot, because you help them to avoid it as long as you can. I am just trying to think, what goes through your brain, being in this business? We are a country that believes that it is right that, according to your income and assets, you contribute to the common good so that services can be provided. You would not be in this place if it was not funded by the taxpayer. It is very simple: you would not have got here this morning if you had not come on the tube, or whatever you came on. All those things that all of us use, yet your job is to—
***Aiden James:*** These individuals have paid an awful lot of tax over their lifetime. Considerably, x-fold times more than the average person.
**Q109 Chair:** Why is that for you to judge?
***Aiden James:*** It is not for me to judge; it is for each client to judge.
**Q110 Stephen Barclay:** The model, if I am understanding correctly, Mr James, is that most of the schemes that you introduce get closed down within a relatively short period of time.
***Aiden James:*** Yes.
**Q111 Stephen Barclay:** So then you aggressively target a client base and get as many as you can through in a short period of time on the basis that HMRC cannot pass retrospective legislation. Therefore, your clients will get a tax window where they can reduce their tax until HMRC wake up and close that scheme down, by which time you have moved the game on to the next scheme. Is that a fair summation?
***Aiden James:*** I would agree with all that you said apart from "aggressively market". Individuals make their own decisions based upon the risks of that structure. It is—
**Q112 Chair:** How do you market, then, if you do not aggressively market?
***Aiden James:*** We work through a network of accountants, lawyers and financial advisors. We make them aware of a structure—
**Q113 Chair:** Are you able to share with us the accountants that you use?
***Aiden James:*** Pretty much any—
**Q114 Stephen Barclay:** Accountants have a duty to their clients to minimise their tax as best as possible. They know that you are going to come up with innovative schemes, and they can get a year or two years' worth of reduced tax before HMRC move.
***Aiden James:*** Yes, but they will know whether one or more of their clients are interested in doing it. But it is not necessarily something that they would push upon all their clients—that goes back to the point I mentioned before about risk.
**Q115 Chair:** Right, thank you. We might come back at the end. Mr Levy, let us turn to you. How do you describe the purpose of your business?
***Tim Levy:*** Good morning, Madam Chair, and good morning Committee. I set up my business in 1997, and I set it up because the Government at the time introduced film tax relief, which accelerated capital allowances that allowed expenditure to be written off on British qualifying films in one year.
My business has gone through two quite separate iterations: from 1997 to 2007, it was entirely about raising money for films and television programmes.
**Q116 Chair:** The purpose of your business was to raise money for films, or to provide tax avoidance for high-net-worth individuals?
***Tim Levy:*** The purpose of the business was to raise money to invest in the film industry. The mechanisms by which we raised that money often involved tax advantages for those investors who invested—
**Q117 Chair:** Let us explore that a little bit. I am particularly angry with both you and Mr McKenna because I was part of the ministerial team that was trying really hard to create a strong UK film industry; we responded to the film industry by introducing a tax relief system. So it is particularly galling to me to find that it was exploited for other ends by people like the two of you.
***Patrick McKenna:*** It wasn't, actually.
**Q118 Chair:** We will come to you in a minute, Mr McKenna. Let's deal with you, Mr Levy. Talk me through your sale and leaseback model. I have got one of them here: Terra Nova. Has that been shut down?

***Tim Levy:*** Terra Nova was a transaction which took place in 2007.

**Q119 Chair:** Has it been closed down by HMRC?

***Tim Levy:*** Yes. The rules which permitted individuals in partnership to take losses in passive partnerships, and set them off against their other income, were closed down in 2007.

**Q120 Chair:** It was a tax avoidance scheme to invest in films, which was closed down by HMRC.

***Tim Levy:*** Let us be specific. In 1997, when the Government introduced the allowances, there was not a particularly clear view as to how the allowances would be used, and there were a few people, such as Mr McKenna and myself, who formed businesses which started to raise money for the film industry.

**Q121 Chair:** To avoid tax. I will read you a key highlight of what must have been an original brochure—it has a pretty picture of somebody on it—that you gave to somebody, probably on the basis of confidentiality. In it, you say to your investors that all they have to do is "a 14.95% initial cash contribution". We will come to where you raised the money, but then you raise a loan for them of 85.05%—

***Tim Levy:*** For which they were fully at risk.

**Q122 Chair:** A full seven-year loan facility. "It is intended that 100% of a partner's capital contribution will be incurred on revenue expenditure in the partnership's first accounting period, resulting in trade losses that partners may use to offset their personal income tax and/or capital gains." That is the top of the key highlights. What you were doing was using an important Government initiative to encourage more films to be created here in the UK. You were exploiting that to support people who wanted, in the words of HMRC, "to use the tax law to get a tax advantage that Parliament never intended." That is why the scheme was closed down.

***Tim Levy:*** If they had never intended sale and leaseback to happen, for example, then why did they issue a business income manual and a statement of practice setting out specifically how—

**Q123 Chair:** Why did they close it down if they intended it? If they had intended it, they wouldn't have closed it down.

***Tim Levy:*** Well, sale and leaseback was closed down because the Government removed the tax relief. HMRC did not close it down. It was closed down because the Government announced that British films would no longer qualify.

**Q124 Chair:** But why did they remove the tax relief? Because it was being exploited for tax avoidance.

***Tim Levy:*** HMRC knew exactly how—

**Q125 Chair:** We were forced to. I remember the conversation when I was a Minister. We were forced to look at the tax relief again because it had been used for tax avoidance, not to support the production of UK films.

***Tim Levy:*** The job that Mr McKenna and I had was to try to raise capital for the British film industry to try to help British films get made.

**Q126 Chair:** Did you buy just British films or also American films?

***Tim Levy:*** About 90% by number of all the films we financed were British-qualifying.

**Q127 Ian Swales:** What about by value?

***Tim Levy:*** I have not run that calculation. It is skewed by the fact that we were involved in acquiring two particularly large films from a US studio.

**Q128 Ian Swales:** So that is 90% by number, but 50:50 British and American by value?

***Tim Levy:*** Possibly, yes.

**Q129 Mr Bacon:** When you say "acquiring a film", do you mean buying the rights to a film that has already been produced, finished, edited and turned into a film that you or I would go see in a cinema? Is that what "acquiring a film" means?

***Tim Levy:*** The two films in question were "Pirates of the Caribbean 2" and "Pirates of the Caribbean 3". The partnerships formed by us acquired worldwide licences to all of the rights to those two films.

**Q130 Mr Bacon:** What I am really trying to get to is—I want to be clear in my own mind—when you use the phrase "acquiring a film", you mean buy the rights to a film that has already been created, finished and made into a product.

***Tim Levy:*** In that context, yes.

**Q131 Mr Bacon:** So it is not spending money on the creating of a film. It is spending money on the buying of a film that has already been created. Yes?

***Tim Levy:*** The majority by far of our transactions were on the making of films, but in this case they were on the acquisition of films.

**Chair:** No. You just said 50% of the value—

**Q132 Mr Bacon:** I am surprised. If the purpose of the legislation was to encourage the making of British films, as I understand it to have been, it sounds like within it there was the capacity to use the scheme to do things other than finance the making of British films. Is that correct?

***Tim Levy:*** No. What happened was that the market for sale and leaseback grew very quickly after the legislation was introduced in 1997, such that by about 2002 there were several features of the market.

First, the Government had to remove television as qualifying within the definition of film. A by-product of the way film was defined in the legislation was that it included all sequences of moving images, so it included television and internet programming, for example. The law was changed specifically at that time to limit it to British qualifying films. That meant that there were a number of investors who were interested in investing in the industry, but there was insufficient supply on the product side. At the same time, we also had a number of investors—

**Q133 Chair:** They are not investing in the industry. This is just potty. The whole purpose was to invest in the making of films in Britain. We have now established that you used this vehicle to purchase British and American films—in value, 50% American films—that had already been made. The only thing that you were then doing was using it as a vehicle to provide tax avoidance capability to the individuals that you sold it to.

***Tim Levy:*** Sorry, if I can clarify, while the transactions we were involved in were, by value, perhaps 50% American and 50% British, by activity, probably 80% of them were production and 20% were buying works.

**Q134 Chair:** In value?

***Tim Levy:*** Yes, in value.

**Q135 Meg Hillier:** A lot of filming is done in my constituency, and there are a lot of creative people there. I think it is still true to say that every job in the film industry creates 20 in the supply chain. Part of the purpose of this scheme was to create other jobs and investment in the UK, so investment in an American production, even if it was in production, was not going to be doing much of that in the UK.

***Tim Levy:*** In the case of the "Pirates of the Caribbean" series, those were not British qualifying films. To the best of my knowledge, they were not shot or made in the UK, although there was significant UK talent involved in them. But that wasn't the reason why we created that transaction. The reason was that investors and their advisers came to us and said, "We have invested in a lot of British films that have not done terribly well commercially. Is it possible that you could design a way to invest in big blockbuster films that actually make a lot of money, or have a good chance of making a very great sum of money? We would be interested"—

**Chair:** We will come to whether they made money at the end.

**Q136 Ian Swales:** Can you clarify, because we have been throwing percentages around? You are saying 50:50 by value is British and American, and then you said it was 80:20 on production versus finished films. I am doing a quick bit of maths here—you were investing in production of films in the US as part of this. Is that right?

***Tim Levy:*** Yes, we invested in carrying out production services in the UK of films that originated in the US, working with US studios.

**Q137 Mr Bacon:** This is post-production and all that?

***Tim Levy:*** This is providing production services.

**Q138 Ian Swales:** But were you paying for production costs that were in the USA through these vehicles?

***Tim Levy:*** Often these films were made all over the world. When I said 50:50, I meant that 50% of the films were not British qualifying according to the legislation defining what a British qualifying film was.

**Q139 Chair:** Okay. We are going to have to move on. We have got three of you, and then we need to go to the main session with HMRC, so I would be grateful for very brief answers. Can you explain to me—Terra Nova was Jersey-based?

***Tim Levy:*** Terra Nova was a business carried out in the UK, but it had a Jersey managing partner.

**Q140 Chair:** Why? It says there is "a series of Jersey general partnerships". This is inviting me—it can't, actually, because fortunately it has been closed down by HMRC—to "a series of Jersey general partnerships". Why in Jersey?

***Tim Levy:*** Jersey partnerships were, in the main, used for two reasons, if I recollect. First, if you were a member in an LLP in the UK, that LLP was registered at Companies House, and all the members' names were listed there. There was therefore full information available about who were partners in these partnerships. If you invested in a Jersey general partnership, the same rules did not apply. The partnership was not registered at Companies House, and therefore the partners who participated in it did not have their information and their names in the public domain.

**Q141 Chair:** That is awful. Absolutely awful. Can I ask you other questions? That is you colluding with supporting individuals to hide from HMRC the true nature of their income and investments.

***Tim Levy:*** Madam Chair, that is absolutely not true. Each of these individuals still had to file a UK tax return, and on that tax return would have been all the details of this investment.

**Q142 Nick Smith:** So why was there this subterfuge?

***Tim Levy:*** Because there was a demand from clients. There were clients who were high-profile individuals who did not want their details as participants in these sort of arrangements in the public domain.

**Q143 Ian Swales:** That can only imply that they were not declaring them to HMRC, surely? If they were declaring them, why would they worry?

***Tim Levy:*** No, because they were high-profile individuals.

**Q144 Chair:** Kelvin MacKenzie?

***Tim Levy:*** I am not aware that he was a client of ours.

**Chair:** He was a client of one of yours, I gather.

**Q145 Mr Bacon:** Mr Levy, you started off by saying that your businesses had two iterations. I understand the reason for it, but you never got to talking about the second iteration and how your business changed.

***Tim Levy:*** Around about 2006, we started to hear noises from the Government that the film tax relief legislation might be changed. We continue to have a regular dialogue with HMRC, and they told us that their approach towards people who participated in arrangements where there were tax benefits was going to change significantly. As a result, we decided that it would make sense to start doing some different types of things.

**Q146 Chair:** Different? Why? To help the film industry or to help tax avoidance?

***Tim Levy:*** No. The first thing we decided to do was that ultimately we realised that our business would have to become a venture capital and project finance business, and that we would have to move away from tax taking such a significant role in some of the transactions as it had historically. We have moved towards transactions where tax plays a far less significant role, often using tax incentives that are created by Government in very mundane ways, such as the enterprise investment legislation, capital allowances and so forth.

Secondly, we realised that the film industry was not going to enjoy the level of support that it had, so we started to diversify into energy, renewables, infrastructure—

**Mr Bacon:** Financing on-shore wind turbines in my constituency. It's a good job Mr Heaton-Harris isn't here—you wouldn't get out alive.

**Q147 Chair:** One of your schemes was this one, wasn't it?

***Tim Levy:*** I was very proud of the work that we did on that but, unfortunately, the law was changed.

**Q148 Mr Bacon:** For the record, because neither the word "that" nor the Chair holding up a photograph will make it into the record, could you explain what you are talking about, Chair?

**Chair:** This is a scheme that took advantage of enterprise allowances. It was called the Foundation Partnership.

***Tim Levy:*** It did not use enterprise allowances.

**Q149 Chair:** I think somebody shopped you before it got off the ground; it may have been somebody in the room who shopped it to HMRC before it got off the ground. It was stopped but it was another tax avoidance scheme based on the Shard, of all things. It is absolutely extraordinary. Tell me how much you paid, how much you spent developing this product.

***Tim Levy:*** Probably £1 million.

**Q150 Chair:** How many schemes have you got? How many partnerships have you got?

***Tim Levy:*** We have created about 255 investment companies and partnerships.

**Q151 Mr Bacon:** And the balance of the business then, between film, which was declining, and renewables, you said. Can you just go through them again? The moment you said "renewable energy", you lit a blue touch paper, I am afraid. Renewable energy and what else?

***Tim Levy:*** Real estate. We have done financial services. We are investing in a number of different sectors. You wanted to know the balance of the business.

**Q152 Mr Bacon:** Yes, between the different parts.

***Tim Levy:*** Up until about 2008 we probably completed transactions with a total value of maybe £5 billion. Between 2008 and 2012, we probably created transactions of a total value of about £1.5 billion.

**Q153 Chair:** £1.5 billion.

***Tim Levy:*** Yes. Since 2008.

**Q154 Chair:** How do you define value there?

***Tim Levy:*** That is the total gross amount being invested in the asset.

**Q155 Chair:** So that is £1.5 billion of tax avoidance.

***Tim Levy:*** No, because some of that has absolutely no tax angle at all.

**Q156 Chair:** How much of that is tax avoidance? You wouldn't tell me, of course, but my guess is most of it.

***Tim Levy:*** That is not true, actually. Most of that involves no tax advantage whatsoever.

**Q157 Mr Bacon:** That number is akin to funds under management for an asset management company.

***Tim Levy:*** Absolutely, yes.

**Q158 Stephen Barclay:** You said you spent £1 million developing this scheme. How long did that take?

***Tim Levy:*** Well, this was a structure that we put together in 2006–07, I recollect. I believe we started probably in mid-2006 and we reached agreement with the developer in January or February 2007, so seven months.

**Q159 Stephen Barclay:** Who was the developer?

***Tim Levy:*** The developer was the developer of the Shard—the Sellar group.

**Q160 Stephen Barclay:** How often do HMRC come to your offices?

***Tim Levy:*** Do you mean how much they come now?

**Q161 Stephen Barclay:** You said earlier that you have a regular dialogue with HMRC. There is nothing wrong with that; that is reasonable. But how often do HMRC inspectors come to your office and inspect files?

***Tim Levy:*** I have 10 people who do nothing other than deal with HMRC day to day. That team probably has meetings at least once a month with HMRC.

**Q162 Stephen Barclay:** That was not my question. I used to work as an FSA regulator and the FSA got into trouble, not least because it had a desk-based system, so it was very reactive. One of the advantages of regulatory visits was not just the visit; it was the knowledge that the regulators were coming and the behaviours that drove ahead of the visit.

If there is a time period of development—my sense at the moment is that HMRC are very reactive, so they wait for you to finish the scheme. We discussed with Mr James that there is a time window in which clients you push through the scheme can benefit before it is then reactively closed down. What I cannot understand is why HMRC are not coming in, inspecting your development phase and understanding the schemes at an earlier stage, and whether legislation allows them to do so.

***Tim Levy:*** The nature of the relationship we have with HMRC has changed over the years, such that we have a very open relationship with them. They regularly come into our office and ask us what we are doing, and we tell them about everything we are doing.

**Q163 Stephen Barclay:** Have they come in, seen a scheme under development, and said, "Actually, we don't think that is in line with the intention of Parliament"?

***Tim Levy:*** No, because they will not give tax advice, so they do not tell us what their view is on a particular arrangement until we have actually executed that transaction, gone through a lengthy process of exchanging information, and a point is reached where they conclude what their view is.

**Q164 Mr Bacon:** Would it be helpful to you if they did?

***Tim Levy:*** I'd like to see an entirely different system operate.

**Q165 Mr Bacon:** Can you tell us what kind of system you would like to see?

***Tim Levy:*** Yes. First, and I have said this to HMRC, I would like to see a voluntary basis of disclosure. I would like to see the current system of DOTAS abandoned—it could continue, I suppose, but I would like to see a system where people who design investment products where there is a tax angle to it voluntarily disclose everything that they do to HMRC. But they can then state on their communications with financial advisers and accountants that they do so—that they voluntarily disclose, before marketing, everything they do. Secondly, I would like to see a rulings system.

**Q166 Mr Bacon:** You mean in advance?

***Tim Levy:*** Absolutely, where the applicant for the ruling pays, because I simply do not understand why we do not have a system like that in place. That would get rid of a lot of the uncertainty about what is acceptable and what is not, and what is tax avoidance and what is not.

**Q167 Stephen Barclay:** You would not see practitioners as part of any panel—who would you see making the ruling? Would it be a high court judge?

***Tim Levy:*** There would probably have to be a degree of control over HMRC, because one would not want

HMRC saying everything doesn't work. You need to have a system that has some degree—

**Q168 Chair:** I would, actually.

**Mr Bacon:** Their computers don't work.

***Tim Levy:*** Madam Chair, a member of the Committee is MP for Grimsby, and in his constituency we are financing the building of an ethanol plant.

**Q169 Chair:** What is the tax avoidance in that?

***Tim Levy:*** The Government give—

**Q170 Chair:** Is tax avoidance involved?

***Tim Levy:*** There is no tax avoidance involved in that at all.

**Chair:** We are only dealing with tax avoidance.

**Q171 Mr Bacon:** You said you would like to see a different system operating in which you could get a ruling beforehand. So you are saying that before you go and pursue the scheme, you get a ruling from HMRC—albeit perhaps with safeguards from HMRC—on whether it is a kosher scheme or not.

***Tim Levy:*** Whether they accept that it falls within the law or not.

**Q172 Mr Bacon:** Isn't one of the advantages of a rules-based system—or shouldn't an advantage be—that you know the consequences of your actions before you take them? Would that not be a better way of doing things?

***Tim Levy:*** I am not quite sure I understand the question.

**Chair:** I think I am going to move us on, because we have a lot to do.

**Q173 Meg Hillier:** Have any witnesses got examples of where they think it works better in other countries?

***Tim Levy:*** I have some knowledge of Australia, and these other gentlemen may have knowledge of elsewhere. I think it works quite effectively in Australia. There is a rulings system. You struggle to raise money in the investment market for anything with a tax angle unless you have an advance ruling.

**Q174 Mr Bacon:** So you get a kind of kitemark on it, before you go out and sell it.

***Tim Levy:*** I suppose, as long as you execute the transaction in the way you explain—

**Q175 Chair:** Mr Levy, I want to move you on because I am conscious of time. You sell these leaseback schemes. The way I understand it works is that if somebody invests in it in the early days they have a huge loss which they can offset against their tax. If they are in the scheme for seven years, which appears to be the length of time they are in your scheme, at the end of it, there would be a profit against which tax is liable. You therefore sell exit schemes.

***Tim Levy:*** Is that a question?

**Chair:** Yes.

***Tim Levy:*** Almost all of the arrangements that we have ever structured have an initial tax benefit, in the sense that there is an expense, an accelerated capital allowance or some sort of deduction that creates an initial benefit for investors. It is very true that, in respect of the film partnerships sold between 1997 and 2007, a number of those arrangements have built into them that there are significant deferred income streams that typically arise year on year over a period of time. For example, in our partnerships there is £2.5 billion in terms of film partnership losses or other deductions, but projected income of £3.5 billion from those transactions.

Several things have happened since 2008 that have changed the dynamic of the way people in these arrangements look at them. The first is that they are being challenged by HMRC, on almost a wholesale basis, so everyone who thought that they were deriving an initial financial benefit is now in a situation of massive uncertainty, because HMRC is actively and vigorously pursuing litigation against many, many such transactions, even though, for those who entered into them until about 2003, those have all been closed, those people got their tax relief and they were not challenged.

A different set of behaviour has been adopted from a certain point in time. So, investors are in that situation; many of these investors have not had their tax relief monetarily, so they have invested but have not had their tax relief, and it is being challenged; and, although I can't talk about specific cases—

**Q176 Chair:** I am letting you go on, but I did ask a question: do you sell an exit scheme?

***Tim Levy:*** I will come back and answer that. I am sorry, but this is complicated and it is important that people understand it. All our arrangements involve people borrowing, at full risk. In some cases, those individuals now have a massive level of exposure to that risk that was never anticipated. For example, one of the big lenders to investors in our arrangements was the Bank of Ireland, and there are fundamental questions that our investors are asking about the solvency of the Bank of Ireland.

**Q177 Chair:** This is such a digression. You are trying to take us off—

***Tim Levy:*** Madam Chair, I am not.

**Chair:** You are. You are.

***Tim Levy:*** Investors have come to us—

**Q178 Chair:** If I had bought in to any of your partnerships in the film industry and invested £1 million, and it got to year 7 and I suddenly found myself with a big tax liability because it had made money, would you offer me an exit scheme?

***Tim Levy:*** Madam Chair, the arrangements that we have put in place—

**Chair:** Would you offer me an exit scheme?

***Tim Levy:*** The arrangements we have put in place have allowed partners, in certain circumstances, to retire from partnerships for good commercial reasons. One of those reasons may have been tax, but there are certainly a number of other good commercial reasons why they retired, and into their place has typically stepped another taxpayer, who is liable to tax.

**Q179 Chair:** Let me tell you who the other taxpayer is. I have a letter here from an Anna Long, who works with you, who is writing to somebody—goodness knows who. It says: "As you are aware, your projected share of partnership profits for the tax year 2012–13 could be in excess of £520,000"—so they are coming to the end of one of the schemes—"on which, assuming you are a higher rate taxpayer, you would face an income tax liability of approximately £260,000. If you were to retire"—and that is what you are offering this person—"from the partnerships effectively from 6 April 2011, the tax arising on these profits and the future risks pertaining to this will fall due to the company." That is right, isn't it?

***Tim Levy:*** Yes, there are arrangements—

**Q180 Chair:** And you said that you would charge "with regards to the cost in respect of which the company has proposed in order to assume your interest"—the company is one owned by you—"and liabilities in the partnership amounts to £60,000". So to get rid of a £260,000 tax liability, you charge £60,000.

***Tim Levy:*** If you tell me that is what is in the letter, that is correct.

**Q181 Chair:** And then the company, which you own, which this partner sells to, is based in Luxembourg.

***Tim Levy:*** That is not correct. I do not own the Luxembourg company and have nothing to do with it whatsoever.

**Q182 Chair:** I can tell you that in these notes, it has your name in it, and that is suggested. Where is it based, then?

***Tim Levy:*** If you are referring to Sirocco, that is a company that is based in Luxembourg. I am one of five directors of that company and I have nothing to do with its ownership—indirectly or directly.

**Q183 Chair:** You are one of the directors. This is the company that buys it and it is based in Luxembourg. Why? To avoid tax.

***Tim Levy:*** It is a very complicated answer to give. That company is a taxpayer in Luxembourg and subject prima facie to about 28% tax in Luxembourg.

**Q184 Chair:** Then why put it into Luxembourg?

***Tim Levy:*** There are a variety of reasons. I would be happy to confirm it in writing afterwards. It would take an extensive amount of time to go through all the details now.

**Q185 Chair:** Try and do it briefly orally, because we would like the public to know how some people avoid tax.

***Tim Levy:*** Firstly, in these particular circumstances, there are real other commercial risks and reasons why the partnership was changed in this way. Secondly, although the managing partner moved from Jersey to Luxembourg, each individual partner who remained in the partnership continues to receive all of their income remitted to the UK and taxable in the UK, so we did not move the partnerships business. The third thing is that this was a transaction that involved a large US studio. That large US studio is very concerned about withholding tax and the way in which withholding tax works. There are some extensive benefits to using Luxembourg from a withholding tax point of view.

Fourthly, there were some housekeeping matters that the partnership needed to deal with, which meant that it was much better to move it from Jersey to Luxembourg. Taken together with the US studio's requirement to use Luxembourg for withholding tax purposes, it was the only place that we could effectively change the managing partner to.

**Q186 Chair:** Amyas, is there anything that you need to ask on that?

***Amyas Morse:*** No.

**Q187 Nick Smith:** Do you pay UK taxes on your Luxembourg directorships?

***Tim Levy:*** I do not receive any remuneration at all from that company.

**Q188 Chair:** He doesn't need to. What is your average commission? What commission do you work on? What does that work out as as a percentage?

***Tim Levy:*** You are alluding to the fact that when we create an investment structure, we then typically have promoted it to financial advisers and accountants and the like, who then have taken it to their clients to explain it to them and advised or otherwise whether their client should invest. So the question you are asking me is what we pay financial advisers in those circumstances.

**Q189 Chair:** No, I am asking you what commission you expect. What commission would you expect to get from a £1 million deal?

***Tim Levy:*** Our business model has changed totally, so, up until 2007, maybe some 2% of the transaction value. Since 2007, most of the transactions we earn much less from initially, and we get our return from the commercial success of the projects and investments that we make.

**Q190 Nick Smith:** Over the life of the product, what is your percentage?

***Tim Levy:*** It depends how well the business does. It is more like a carried interest for a private equity firm these days, whereas in the past it used to be a fixed sum at the start of the life of a transaction.

**Q191 Nick Smith:** You must have an estimate of what it is worth.

***Tim Levy:*** If a business does well, we will earn a very great sum of money, but typically the investor has to get back a certain minimum return first before we start to enjoy a share of profits in the business.

**Q192 Chair:** Okay. I am going to come to Mr McKenna. I just want to be clear: you talked about Bank of Ireland, but you would also deal with HSBC, Barclays and RBS?

***Tim Levy:*** Our firm? Yes, absolutely. They have all been involved in transactions.

**Q193 Chair:** And you would also deal with people such as Jonathan Peacock, Rex Bretten, Andrew Thornhill and Giles Goodfellow as QCs?

***Tim Levy:*** Not the last three at all. We have almost exclusively used Jonathan.

**Q194 Chair:** You use Jonathan Peacock. I have seen his name. And the law firms you deal with—Freshfields, Mischcon and who else?

***Tim Levy:*** We have engaged with all the magic circle law firms at some point in time or other.

**Q195 Chair:** And accountants—you deal with PwC, Deloitte and suchlike?

***Tim Levy:*** All of them.

**Q196 Chair:** Mr McKenna, I am particularly disappointed to see you this morning, because when I was Culture Minister I used to consider that you played an important role in supporting the creative industries. I accept that you were doing some legitimate business, but I now feel that you were using it, on the whole, to see how you could help your clients avoid tax.

***Patrick McKenna:*** I am very disappointed to hear that. I have spent my life in the creative industries, and—

**Q197 Chair:** I do not want to hear about that. We are here about tax avoidance.

***Patrick McKenna:*** I am just about to tell you about tax avoidance, and I can tell you categorically that we are not involved in the business of tax avoidance or the marketing of tax avoidance schemes. We are in the business of creating much-needed commercial investment for the creative industries. We have already brought into UK taxable income from our film production activities £600 million, with a further £1 billion expected. If I am in the business of avoidance, then I am not doing a very good job.

**Q198 Chair:** Well you are, because how much of your business is buying American films from Disney?

***Patrick McKenna:*** None at all.

**Q199 Chair:** How many American films have you bought?

***Patrick McKenna:*** We have not bought films. We have invested; we have produced films—British and non-British films.

**Q200 Chair:** How many completed films have you bought from America?

***Patrick McKenna:*** As far as our production partnerships are concerned, which is our major activity, the answer is none. We don't buy films and sell films. The only buying of a film—

**Q201 Chair:** You buy to market.

***Patrick McKenna:*** No. We do not buy. The sale and leaseback was in 1997. You know about that because you were a Labour Minister that was responsible for that legislation.

**Q202 Chair:** I know, and we had to close it down, because people like you exploited it.

***Patrick McKenna:*** No. You did not have to close it down because of us.

**Q203 Chair:** Well, we had to amend it considerably with HMRC, because people like you used it for a purpose for which Parliament had never intended it. That is terrible—

***Patrick McKenna:*** I am sorry, but that is not true.

**Q204 Chair:** It is 100% true.

***Patrick McKenna:*** No. I will tell you why it is not. First, film sale and leaseback is simply a deferral of tax. You get a tax break at the beginning and then you pay tax over 15 years. The tax is being paid by all of our investors across the whole of that 15-year period.

**Q205 Chair:** Hang on a minute, Mr McKenna. What is Aries Film Partners? What is that? That is an exit scheme, is it not?

***Patrick McKenna:*** No. It is not an exit scheme.

**Chair:** It is an exit scheme.

***Patrick McKenna:*** I am sorry, but we do not have exit schemes.

**Q206 Chair:** If you think it is not an exit scheme, let me read to you. I have an explanatory memorandum and various documents here. Let us get to the best bit: "People involved in this partnership will be entitled to claim capital allowance on the acquisition cost of each new film, which can be set against taxable profits from the original film rental"—so they have been in the original scheme and they are now being exited into Aries Film Partners—"thus reducing your future tax liability, which would commercially mitigate any capital loss on the new film should they have been unsuccessful." That is true. That is in here.

***Patrick McKenna:*** They have not left the film partnership, and they are getting capital allowances because they are reinvesting in the same partnership.

**Q207 Chair:** Yes, but it is to avoid—I understand that the vehicle's purpose is not to invest in films; it is a vehicle to help them mitigate tax liability that they may have gained from their original investment in the first partnership.

***Patrick McKenna:*** I am sorry, but the opportunity was actually to invest in new film—

**Q208 Chair:** It is an exit scheme.

***Patrick McKenna:*** It is not an exit scheme.

**Q209 Chair:** Then why is it being offered to people who were in your original scheme—I apologise, because it was called New Films—for them to then exit into this?

***Patrick McKenna:*** They did not exit in from anywhere to anywhere else. They have always been partners. They remain partners. They have the opportunity—

**Q210 Chair:** They sold their interests in New Films in buying into that.

***Patrick McKenna:*** That is absolutely incorrect. They did not sell any films. They re—they put further investment—

**Q211 Chair:** Go on. They re—?

***Patrick McKenna:*** They put further investment into the same partnership with the same tax liabilities that are attached to it. There is no question of tax avoidance here. It is simply an issue of getting capital allowances when you invest in a film. I cannot see—

**Q212 Chair:** I am sorry if you say that there is no tax avoidance. I will not bore people silly over this, because it is a long document. I read one part, but let me read some more. There is paragraph here headed taxation: "Costs incurred by the partnership in acquiring the new films will create a pool of expenditure on which capital allowances can be claimed and offset against taxable partnership income in each financial year on an 18% reducing balance."

***Patrick McKenna:*** That is absolutely correct.

**Chair:** "This means that 18% of the outstanding pool in any year can be claimed as an allowance against partnership income." It goes on: "The benefit of the capital allowance will rest with those partners who participate in the acquisition of new films in proportion to their allocation of income from both the new films and the original films' rental."

***Patrick McKenna:*** That is correct. The new films.

**Chair:** Then it goes on: "Since the new film rentals are capped in the initial period, the majority of the capital allowances claimed for the benefit of partners that participate will offset"—here we are—"the income from the original films and there will be sufficient capital allowances during that period to offset the majority of the original film rental income of each partner that participates." So they go into this new scheme to offset the tax on the other one.

***Patrick McKenna:*** No. First of all, they have never left, so it is not an exit. That is the first point. The second point is that they are injecting new capital to buy new films—

**Q213 Chair:** To offset tax. Mr James, what is he talking about? It is an offsetting of tax, isn't it?

***Patrick McKenna:*** Excuse me, can I answer?

**Chair:** Isn't it, Mr James?

***Aiden James:*** Semantics, isn't it?

**Chair:** What do you mean, semantics?

***Patrick McKenna:*** It is not semantics.

**Chair:** Let Mr James just answer that.

***Patrick McKenna:*** He shouldn't be commenting on my arrangements.

**Chair:** Yes he can. Why not?

***Aiden James:*** An exit—obviously, I have seen a number of these structures over the years. I might add that I am well aware of Ingenious's structures over the years, and they are one of the most conservative firms that have engaged in this activity, in my opinion.

**Chair:** But this is an exit scheme.

**Q214 Mr Bacon:** Do you introduce to Ingenious?

***Aiden James:*** I have done in the past. In answering your question before, Mr McKenna is absolutely right in what he is saying, but by the same token, you could say that a client could engage in a different tax avoidance structure to exit a scheme. They have not left the old partnership. Is that an exit?

***Patrick McKenna:*** It is not an exit, because further investment is required from the partners, which goes into another film, which generates income, which is taxable. What are we talking about here? Film sale and leaseback was introduced as a deferral. It has been used in a vanilla fashion by us in exactly the way that Parliament intended.

**Q215 Chair:** Have any of your schemes been closed down?

***Patrick McKenna:*** No, they haven't been closed down—unless the legislation has changed, if that's what you mean.

**Q216 Chair:** Have HMRC never challenged any of the schemes? How many schemes have you done?

***Patrick McKenna:*** First of all, they are film production partnerships and there are sale and leasebacks.

**Q217 Chair:** How many partnerships have you got?

***Patrick McKenna:*** Film production partnerships—there are about five or six that apply to individuals. Then there are sale and leaseback partnerships, which are numerous—scores.

**Q218 Chair:** So a total value of what since, let us say—when did the film tax credit stuff come in?

***Patrick McKenna:*** 1997.

**Q219 Chair:** Okay, so from then how much business have you done through that?

***Patrick McKenna:*** Sale and leaseback partnerships since 1997—this is the Government deferral incentive—there is probably about £1.5 billion, or possibly a bit more.

**Q220 Chair:** How much of that has been tax avoidance for individuals?

***Patrick McKenna:*** As far as I am concerned, using the Inland Revenue's own definition of tax avoidance, none. Full tax has been paid and brought in to charge to UK tax.

**Q221 Chair:** But it has not. Maybe Mr James is right and it is semantics.

***Patrick McKenna:*** No, it is not.

**Q222 Chair:** People have invested in your scheme to take advantage of the allowances so they avoid tax. You may say that is legal; I think it's immoral. It's the old argument.

***Patrick McKenna:*** It is not just an issue of legality. The Inland Revenue have a definition of avoidance, which you have referred to several times this morning. Avoidance is something where Parliament did not intend for this to happen. I can tell you that Parliament did intend—

**Q223 Chair:** No, we did not. Why did we amend the film tax? For heaven's sake, Mr McKenna, have a little bit of common sense. I was involved, as Culture Minister, in that film tax. I was involved in trying to encourage a lot of film production here in the UK, and it was the most disappointing thing, particularly from a company such as yours that pretended to be at the heart of supporting the creative industry—

***Patrick McKenna:*** It is not a question of pretence.

**Q224 Chair:** Actually you were exploiting a well-intentioned tax relief to try to get individuals, and God knows who else, to mitigate their taxes.

***Patrick McKenna:*** That is simply incorrect.

**Q225 Chair:** I do not accept that, and I do not think that the evidence supports that.

***Patrick McKenna:*** HMRC have already agreed most of our film sale and leaseback partnerships. Why would they have done that if we were seeking to do something that was improper?

**Chair:** Austin, before I get too cross.

**Q226 Austin Mitchell:** Mr Levy, you mentioned that HMRC is getting tougher and cracking down more. You indicated that this is producing a degree of uncertainty. Has it resulted in any diminution of people coming forward to use these schemes?

***Tim Levy:*** Yes, enormously.

**Q227 Austin Mitchell:** So you have lost customers?

***Tim Levy:*** Well, our business has changed, but our read of the market is that there are far fewer people who are interested in doing anything where tax has a significant role to play in a transaction.

**Q228 Austin Mitchell:** Would that be true for Mr James, too?

***Aiden James:*** Yes, it is.

**Q229 Austin Mitchell:** Secondly, both Mr McKenna and Mr Levy have moved on into alternative energy—you mentioned ethanol, and we are grateful for that in Grimsby—but is that in a venture capital role or in a tax avoidance role? In other words, are there tax incentives to invest in alternative energy?

***Tim Levy:*** I think the Committee knows that we are in a time where it is extraordinarily difficult to raise capital for new projects, new ventures and new businesses; it is amazingly difficult. A firm like ours, and indeed a firm like Mr McKenna's, understands the tax rules well, and we understand that there are incentives created by Government to encourage investment. That is what we do today. We use those incentives, and we use them to try to help raise capital that is much needed in the economy and is creating jobs, businesses and projects.

**Q230 Austin Mitchell:** Particularly in Grimsby. But are they coming forward to invest primarily for tax avoidance reasons?

***Tim Levy:*** It would not typically make a great deal of sense for them, because if they were investing for tax avoidance purposes, the result of their investment would almost always be a loss, whereas the expectation of the returns from the business are typically a multiple of their investment. So it would not be very sensible for them to invest in something for a tax purpose.

**Q231 Austin Mitchell:** Just so that I understand it, you are at the individual, personal end of the business dealing with individuals of high net worth, as it were. That is above my pay grade, although my constituents assume I am as rich as Croesus.

**Chair:** Because of your braces.

**Austin Mitchell:** I am very rich; I think I get £69,000 a year. Do I take it that you deal with individuals, whereas big companies and corporations deal with the big four, who sell them tax avoidance schemes through their auditors?

***Tim Levy:*** Yes, our investors are typically wealthy individuals, as you say. We do not deal with big companies at all.

**Q232 Austin Mitchell:** And they would deal through the big four?

***Tim Levy:*** Well, I suppose so. Or they would have expertise within their own firms.

**Q233 Austin Mitchell:** One final question: if you had what Mr Levy called a ruling scheme—like the Australian single-purpose scheme—would that reduce the amount of investment in tax avoidance schemes?

***Tim Levy:*** Yes, I would hope that it would. That would be the purpose of it.

**Q234 Chair:** You would not hope; you would make less money.

***Tim Levy:*** I do not think so, actually. I think there would be more certainty.

**Q235 Austin Mitchell:** Why don't you think so?

***Tim Levy:*** Because I think those people who do things well, who know where the dividing lines are and who use the tax system properly, like Mr McKenna's firm and like my firm, would do very well in that environment.

**Q236 Chair:** They have just closed down Eclipse 35, which is one of your schemes.

***Tim Levy:*** They did not close it down. We had a tribunal hearing, at which HMRC argued that the partnership was not trading. We argued that it was trading. The judge decided in favour of HMRC, and the partners have decided to appeal.

**Q237 Chair:** That sounds to me like closing. There were 289 members.

***Tim Levy:*** There were.

**Q238 Chair:** And £117 million in tax relief on a £1 billion deal with Disney on the basis that the sole purpose was to avoid tax.

***Tim Levy:*** You will understand that because that is still subject to litigation, I cannot say any more.

**Q239 Stephen Barclay:** Were you all thinking of a rules-based system or a principles-based system?

***Tim Levy:*** I would like to have a ruling-based system. I do not mind if we have a general anti-avoidance rule or a general anti-abuse rule, or whatever we call it. What I want to see is a system where there is clarity and where the investor can know—if I do something, I can know what the outcome is going to be.

**Q240 Stephen Barclay:** But is one of the dangers of the rules-based system how it deals with innovation?

***Tim Levy:*** To be honest, I have not spent an awful lot of time thinking about that, because we have not yet seemed to be very close to a rulings-based system. I am sure there would be consultation if we were going to have one. That would involve all of us sitting down together and working out the best way to do it.

**Q241 Guto Bebb:** I think you mentioned earlier that you had 255 schemes running.

***Tim Levy:*** There have been about 255 investments.

**Q242 Guto Bebb:** How many of them have been investigated or challenged by HMRC?

***Tim Levy:*** I have that information. Of the 255, 127 have been subjected to HMRC inquiries, 13 are in litigation, and two have been fully litigated all the way to the Court of Appeal, and we won both. There are currently four cases in the litigation system, that is, having had cases already and subject to further appeals.

***Amyas Morse:*** Do you fight every one of yours? Is it a policy to fight?

***Tim Levy:*** It is a decision of partners, because we do not control the investment vehicles.

***Amyas Morse:*** But you are influential, I dare say.

***Tim Levy:*** One of the things is that having fought two cases all the way to the Court of Appeal, and having won both of them, the expectation of partners is that litigation makes sense.

***Amyas Morse:*** And it is quite attritional. I am not trying to be unkind, but it means that it's a pretty long old road for HMRC.

***Tim Levy:*** It is attritional for both the partners and HMRC, and it is certainly not an ideal set of circumstances.

**Q243 Mr Bacon:** I'd just like to ask Mr McKenna a question about his letter to the Committee. You wrote to us saying that you have always sought to have a clear and constructive relationship with HMRC and have disclosed full details of all your film partnerships to HMRC and have co-operated fully with them to build their understanding of the associated commercial arrangements. You go on to say: "Unfortunately, we have found that HMRC have responded with repeated inefficiency and, by its own admission, mismanagement." Could you describe the repeated inefficiency and mismanagement?

***Patrick McKenna:*** Sure, I am happy to do that. In so far as the film production partnerships are concerned, we had prior approval of those. Before the DOTAS scheme was ever introduced we had a very transparent and straightforward policy of talking to the Inland Revenue about everything that we did.

**Q244 Mr Bacon:** So you were getting a ruling of the kind that Mr Levy has been talking about?

***Patrick McKenna:*** Yes, an informal indication of whether they supported what we were doing.

**Q245 Mr Bacon:** In writing?

***Patrick McKenna:*** Yes. What happened was that they had a film policy unit, run by two very senior inspectors, so I actually helped them, and so did my colleagues, to understand the film industry and the production tax credit scheme, and we consulted widely on that, as a replacement to film sale and leaseback. We went along and said, "Look, these are the film production partnership arrangements that we are building, and we would like to know that you agree them. Here is why we think that they are perfectly acceptable. They have a very strong commercial engine—a very strong profit motor. These are films that have been created, such as “Avatar”, “The Best Exotic Marigold Hotel”, “Life of Pi”—

**Q246 Chair:** “Avatar” is probably the only one that you put money into properly.

***Patrick McKenna:*** No. To answer your question, we spent time with them and we had very clear approval. We have our own notes of that meeting.

Subsequently, they opened an inquiry, which is standard practice, and in the course of that inquiry I said, “Why are you doing that? Is there anything that you’re unhappy about now?” They said, “Not in principle. We want to see that what you have done equates with what you told us you were going to do.” I said, “Fine, no problem at all. What is it you want?” We co-operated fully and gave them everything they needed.

They spent six months. We suggested that they spoke to our partners if they wanted to, if they wanted an indication of motivation, which they did. They had every type of conceivable document that was available, and at the end of that six-month period they made the tax repayments, which were properly due, to the investors, and the matter went on.

Subsequently, the mood music changes, post 2008, and we then have a situation in which they start to look again at reasons why they might not have wanted to have agreed this.

**Q247 Mr Bacon:** Even though they already had done?

***Patrick McKenna:*** Even though they already had done. So the only thing that they could possibly look at was possible motive—they couldn’t challenge anything other than that. Were we motivated to make a profit? To be able to get the loss relief, it is a condition of the law that you have to be trading with a view to profit—

**Q248 Chair:** I’m going to stop you there, because my note says, “It’s not that they were commercial ventures.” They weren’t challenging that they were commercial ventures—that would be complete nonsense.

**Patrick McKenna:** They did!

**Q249 Chair:** Let me just finish this. What they were challenging was that they were tax avoidance mechanisms. That was their challenge, so don’t pretend that they were challenging that they were commercial.

***Patrick McKenna:*** That is completely incorrect. They were challenging—

**Chair:** Well, that’s not what my note tells me.

***Patrick McKenna:*** I can tell you as a matter of fact, and you can speak to the Inland Revenue as well about this—

**Chair:** We will.

***Patrick McKenna:*** It is simply a fact that they said, “We have cleared all of the points that we wanted to clear, but we need you to prove that you were trading with a view to profit.” It is an inherent requirement to be able to get the loss relief initially.

**Chair:** Absolutely.

***Patrick McKenna:*** So let me just tell you a little bit about that, very quickly. I said, “Well, that’s self-evident. What is it you want to know?” Because here are films—they all use the same waterfall, i.e. the same mechanism for generating income—and here are some that have made profits, and some that have made very big profits. Let me give you the statistics. We claimed, initially, £1.35 billion-worth of tax relief, because of the way you have to write off the expenditure, because of the accounting requirement. You then create an accounting loss. It becomes a tax loss—

**Chair:** £1.7 billion.

***Patrick McKenna:*** £1.35 billion—

**Chair:** Tax relief.

***Patrick McKenna:*** Tax relief over the years in all of those—

**Chair:** £1.35 billion.

***Patrick McKenna:*** And guess what: we are generating £1.6 billion.

**Q250 Chair:** Yes, well that is your Aries scheme: nobody is paying tax on their income.

***Patrick McKenna:*** No, that is not true. Aries has got nothing to do with this. Aries is to do with—

**Chair:** It is, because people reinvest.

***Patrick McKenna:*** No. That is not true. They are not. That £1.6 billion comes from the same films that £1.3 billion was generated on.

**Q251 Mr Bacon:** Hang on a minute. I am still waiting for Mr McKenna to finish answering my question. HMRC responded with repeated inefficiency and, by its own admission, mismanagement. This is what I want to get to: the repeated inefficiency and the mismanagement that was mismanagement by its own admission. You have not yet been able to expand on that.

***Patrick McKenna:*** Okay, I will tell you both. We have had numerous changes of inspectors of taxes. We have numerous stop-start reviews.

**Q252 Mr Bacon:** Did the people with expertise, whom you had been to see in the early days, and explained to them the nature of the film industry, disappear from the scene, so that they were replaced by new people who did not understand the film industry?

***Patrick McKenna:*** Absolutely. People disappear regularly. It is an inherent part of the problem that HMRC have—they are under-resourced. They don’t have the ability, in my view—

**Chair:** To shut you down.

***Patrick McKenna:*** To differentiate between commercial arrangements that are overtly commercial arrangements, where the income is being produced and taxed in the United Kingdom, for the benefit of the UK Exchequer, and tax avoidance. That is why I make it clear that we are not in the business of tax avoidance. We are in the business of generating profits, on which we pay UK tax, and that is demonstrably the case.

**Q253 Chair:** You have admitted this morning to us, Mr McKenna, that there is £1.35 billion of tax relief.

***Patrick McKenna:*** You cannot simply let that go, because £1.6 billion is being brought into charge to tax—

**Q254 Chair:** I wonder. I wonder if we can follow it through.

***Patrick McKenna:*** I am sorry, it is. It is a matter of record.

**Q255 Chair:** Amyas, do you have a question?

***Amyas Morse:*** Can I just clarify something? I understand what you said about changes of inspector and so forth, and discontinuity. I am really not arguing with that, but I am sure the Inland Revenue told you that they are entitled to, I think the expression is "make a discovery". I am sure they told you that when they gave you any provisional comments they were perfectly entitled to have another look at it and change their mind and challenge you later on.
***Patrick McKenna:*** They did indeed.
***Amyas Morse:*** You really have not anything to complain about on that score, do you?
***Patrick McKenna:*** I am not complaining. I just think—
***Amyas Morse:*** I am just trying to make sure we are clear. I am not attacking you. I am just asking you something.
***Patrick McKenna:*** There are two points at which HMRC—I said to them at the very first meeting, "If there is any aspect of this that you are unhappy about, please tell me, because we will either not do this or we can do something about it"; and then, again, they have the ability not to make those tax repayments—and they made them because they were happy with them.
***Amyas Morse:*** I am sorry, just to be clear with you, HMRC is entitled to review the circumstance and take a different view later. It did not do anything that was beyond its entitlement, did it?
***Patrick McKenna:*** I agree, totally. I absolutely agree. It is up to them to change their mind.
**Q256 Ian Swales:** On a question of clarification, are any of your arrangements in any sense offshore? Are any of the partnerships owned, or are any of the arrangements not in the UK compass?
***Patrick McKenna:*** All income is brought into tax in the United Kingdom. In fact, we go one stage further. We are taking worldwide gross income from films into charge into the United Kingdom. Receipts from "Avatar" come into tax in the United Kingdom.
**Q257 Ian Swales:** Can you just answer exactly what I said? Are any of the corporate vehicles involved in your activities—partnerships, companies or whatever—offshore?
***Patrick McKenna:*** No. As far as our film production partnerships are concerned, the answer is no. As far as the film sale and leaseback is concerned yes, but no income stays in there at all, as the Inland Revenue will know. The reason why it is there is simply an unwillingness to want to consolidate sale and leaseback losses into our accounts.
**Q258 Ian Swales:** Hold on. Where are the sale and leaseback companies registered?
***Patrick McKenna:*** All here in the UK.
**Ian Swales:** But you just said that some of them were offshore.
***Patrick McKenna:*** One of the administrating companies is. It is not owned by us and we are not directors of it. It carries out some administration.
**Q259 Ian Swales:** Where is it based?
***Patrick McKenna:*** It is in Jersey, but no income goes into it.
**Q260 Ian Swales:** Why is it there? What does it do?
***Patrick McKenna:*** It carries out an administration function.
**Q261 Chair:** Why?
**Q262 Ian Swales:** Why would you have your administration done in Jersey?
***Patrick McKenna:*** Most of the administration is carried out here. Certain administrative functions are carried out—
**Q263 Ian Swales:** What do they do there?
***Patrick McKenna:*** It is to do with a requirement not to have to consolidate—because of the nature of the partnership—the results into our accounts. It is as simple as that.
**Q264 Chair:** What does that do?
**Q265 Ian Swales:** I am an accountant by the way. Can you explain what you mean by that?
***Patrick McKenna:*** Film sale and leaseback, the very nature of it as a partnership, gives rise to accounting losses. We are a managing partner in the partnership. If we controlled that partnership, we would have to consolidate that into our own UK accounts.
**Q266 Ian Swales:** Why wouldn't you take losses? That would reduce your—
***Patrick McKenna:*** Because they are not our losses. Economically, they are not our losses. But if we controlled it, we would be required to consolidate, and that gives a completely artificial result for our accounts.
***Amyas Morse:*** It would make the balance sheet look very weak.
***Patrick McKenna:*** It would make the balance sheet look ridiculous, but it would also give a perfectly incorrect view of the trading of our company. I am not looking to create tax losses.
***Amyas Morse:*** This is to do with how your company balance sheet looks.
**Q267 Ian Swales:** So what do the accounts of the Jersey company look like?
***Patrick McKenna:*** Zero in and zero out and some administration expenses. The Inland Revenue has these accounts and there is nothing in them.
**Q268 Chair:** May I just ask one question and then a final one from Nick. Is it true that there is a seven-year investigation of three of your biggest film partnerships?
***Patrick McKenna:*** Yes.
**Q269 Chair:** And is it true that that has concluded that they are not commercial ventures but tax avoidance mechanisms?
***Patrick McKenna:*** No, it is not.
**Q270 Chair:** You are litigating it?
***Patrick McKenna:*** We have had to take this to the tribunal. We have had to force the Inland Revenue—
**Chair:** Okay, you are litigating it.
**Mr Bacon:** Sorry, I did not hear the answer.
***Patrick McKenna:*** We could not get HMRC to deal with this in a timely and proper way, so we have said that we have been going on about this for many years, and we want it resolved and referred to an independent tax tribunal as a matter of priority.
**Q271 Mr Bacon:** So you asked for it to be referred to a tribunal?
***Patrick McKenna:*** Very much so. Absolutely.
***Amyas Morse:*** May I just check, your offshore company—
***Patrick McKenna:*** It is not ours, actually.

***Amyas Morse:*** No, all right. I mean the offshore company that you have some relationship with. Does that mean that those sale and leaseback partnerships are effectively non-recourse as regards any liabilities to your group?

***Patrick McKenna:*** Yes, we only manage those partnerships.

***Amyas Morse:*** All right. So if one of the partners was aggrieved, they would have to make a claim against the Jersey company and not against yourselves? Is that right?

***Patrick McKenna:*** No, they would make the claim against us if there was something wrong with that or if we had mismanaged it. We manage those partnerships here in the United Kingdom and we charge fees for that and pay tax on that.

**Chair:** One final question from Nick and then we will move to the HMRC.

**Q272 Nick Smith:** Just a few more questions of clarification from Mr James. I wonder whether you can help me please, sir. Of your five, six or seven schemes, how many of them are now illegal?

***Aiden James:*** I believe that they all are.

**Q273 Nick Smith:** They are all illegal. Every one of your schemes is illegal?

***Aiden James:*** Yes.

**Nick Smith:** I wrote that down, but I could not quite believe it.

***Aiden James:*** May I clarify what that means?

**Nick Smith:** No, illegal is pretty clear. It is okay. Next question.

***Aiden James:*** Maybe it is not clear.

**Nick Smith:** No, really. That is enough, thank you.

***Aiden James:*** At the time, they were executed by the clients that participated in them, before it was illegal and unaffected by the changes in the law. It is only now illegal to do the same transaction again—you would not do it because it would not give the desired tax benefit.

**Q274 Nick Smith:** Tell me what is the average shelf life of these illegal schemes?

***Aiden James:*** When a structure is closed by a change in the law, which tends to be pretty swift in my experience—this does not appear to be reflected in the NAO Report—it can be as little as two weeks.

**Q275 Nick Smith:** Two weeks? That is a very short window in which to police schemes. You are going to talk about the fact that there are fewer clients in this particular game now. How many clients have you had for the last three schemes?

***Aiden James:*** I could not say off the top of my head.

**Q276 Nick Smith:** Ballpark numbers?

***Aiden James:*** Low hundreds, I suppose.

**Q277 Nick Smith:** Low hundreds for the last two schemes? For the last scheme, how many clients did you have?

***Aiden James:*** I do not know. Maybe between 50 and 100. There are a lot less now than there used to be. Perhaps between 50 and 100. It is a lot less now. I ought to clarify, though, that that is purely the individuals who we have referred into the last scheme that we promoted. We are not the sole introducer to that structure; we might be one of 10.

**Q278 Nick Smith:** Okay. But for your clients, how much tax have you helped them to avoid?

***Aiden James:*** Firstly, as I said before, we advise all our clients to pay their taxes and most of our clients pay their taxes through pay-as-you-earn anyway, so they don't get the choice.

**Q279 Nick Smith:** So how much tax have they saved through your schemes?

***Aiden James:*** If those structures are successful, then they will have a tax saving, and that's the question—we need to wait and see. Either they succeed in their outcome through the courts, or they agree a settlement with HMRC.

**Q280 Nick Smith:** One final question. Would you say that the phrases you use—"tax planning" and "tax efficiency"—are just euphemisms for, as they would say in the Ebbw Vale market, tax dodging?

***Aiden James:*** As I said right at the outset, the tax law is very complex. All these structures that we are talking about here today are fully in line with legislation at the time that they are promoted to the individuals.

**Q281 Nick Smith:** But for the two weeks that some of these schemes are alive, would you say that they were tax dodging or not?

***Aiden James:*** I would say that they are legal and above board, and have been settled by an eminent QC.

**Q282 Nick Smith:** For that two weeks?

***Aiden James:*** Yes. Before the law changed.

**Chair:** Okay. Thank you very much indeed. Thank you for coming.

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*Witnesses:* **Lin Homer**, Chief Executive and Permanent Secretary, HMRC, **Edward Troup**, Tax Assurance Commissioner, HMRC, **Jennie Granger**, Director General, Enforcement and Compliance, HMRC, and **Jim Harra**, Director General, Business Tax, HMRC, gave evidence.

**Q283 Chair:** Well, I don't know what your private conversations are. The only thing that was interesting earlier was the degree of honesty of some of the evidence. But they are running rings round you.

***Lin Homer:*** Well, Chair—hello.

**Q284 Chair:** Apologies to start. But you must have found it as fascinating as we did, particularly the one who was most open and honest about what he was doing, Mr James; at least he was open and honest. That is his job—to run rings round you.

***Lin Homer:*** Well, Chair, it was a very interesting piece of work to do with the National Audit Office. We are here because this is an important area of work. I think we would accept that there is a great deal more to do, but I also think that you heard some evidence this morning that we have had an impact on this market, and we want to build on that and develop it. The work we have done already with the consultation that is out at the moment, "Lifting the Lid", is designed to ensure that we continue, as the colleagues you have heard today said, both to increase the risks to people of being involved in these schemes and to diminish the number of people who are interested and prepared to undertake the risks that are involved.

**Q285 Chair:** Okay. It is a pretty damning Report—let's be honest. The Government have now said they want to tackle tax avoidance, and you got a bit more money—we will talk about the money you got in the Budget yesterday during the course of the hearing—but I do not know what to turn to. I was surprised, Lin, when I read this Report. I really was taken aback. I do not want to be aggressive and awful about it, but I was surprised at how appallingly bad the record was. If you look at figure 7 on page 22, it shows the total proliferation of schemes. If you then look at figure 9 on page 24, it shows massive growth in reference numbers. If you then look at the next one, figure 10, it shows the massive proliferation of different schemes. Then you think, how many have they taken to court? You only know about 46%. You have had 11 cases, and that is what really shook me. I do not know where I got that from, but I wrote it down on a bit of paper. You have had 11 cases at tax tribunals for penalties for non-disclosure since 2004. There has been huge growth, and appalling proliferation, and what has HMRC been up to? It has taken only 11 cases to tax tribunals. I know it was before your time—I know you will tell me that—but it is gobsmacking.

***Lin Homer:*** I certainly was not going to tell you that. You have drummed into me my responsibilities as accounting officer, and indeed, as I have said to you on a number of occasions, I think what HMRC has done in the last period has given us space to go forward.

I will, if you are content, ask Jim Harra to comment, but I will speak generally about what you have just described. The very purpose of our disclosure scheme was to bring these cases out into the open, so what you have just described we do not believe is a proliferation. We believe that we are moving it from the murky space out into the open. I think what you heard this morning was some of the people who operate in this business saying that, and that they have decreasing numbers of people using these schemes, and decreasing custom—

**Q286 Chair:** It is still enormous. It is still ginormous.

***Lin Homer:*** Our evidence backs that up, and that the top end of the market is moving out of marketed tax avoidance schemes.

**Q287 Chair:** Why 11 cases? Okay, I accept that there may be more visibility. I accept that argument. That is a fair point to make. Nevertheless, it is ginormous, and there are billions at stake. This Report says you still know about fewer than half of the schemes out there, even with DOTAS. I accept that there will be a new general avoidance rule, and we can chat about that if you like, but if we look now, you only know about less than half. Perhaps Jim is the one to answer, but why only 11 since 2004–05? Why have you tested this in only 11 cases?

***Jim Harra:*** I think we are conflating two things. As Lin said, the disclosure regime is about getting us early information about what these schemes are.

**Q288 Chair:** But you only know about less than half.

***Jim Harra:*** Well, the disclosure regime will apply to those cases, but we know about other avoidance schemes that are not disclosable under the regime. As well as looking at disclosure regimes—

**Q289 Chair:** Are you challenging the NAO figure? It says 46%. I assumed it was on work you yourselves had done that you know about. It was amazingly accurate, given that you do not know. Can you find it for me, Rob? Somewhere in the Report it says you only know about 46%.

***Robert Prideaux:*** To clarify, it was HMRC's own work, not ours, that estimated that. It is in paragraph 2.18 on page 27. That is the estimate of how much tax at risk they learn about through DOTAS. It is true that DOTAS does not cover all types of avoidance, so some of that will be—

**Q290 Chair:** But these sorts of schemes we are looking at now—they only know about 46%.

***Jim Harra:*** Thank you. That was the point I was trying to make—that 46% of the avoidance that we are aware of gets disclosed under the disclosure regime, but we have other sources of finding out about avoidance, such as intelligence from the market, such as the risk assessment work that we do on wealthy people's tax returns, and also on large businesses.

**Q291 Chair:** How many do you know you don't know?

***Jim Harra:*** I think the NAO Report says what it is. We believe that about 46% of avoidance is caught by the disclosure regime and has to be disclosed to us that way. The rest of it we find through intelligence and risk assessment.

If I may go to the question of how many we take to tribunal, I think we are conflating two different things. The disclosure regime is about telling us that these things exist. Promoters are obliged to disclose those schemes to us. We have investigated 365 cases where we have been concerned that a disclosable scheme has not been disclosed to us. In about 90% of the inquiries that we have concluded, we found that, in fact, they did comply with the disclosure rules, but in a small number of cases—30-odd—we believed that they did not, and we got penalties from 11 of those.

**Q292 Chair:** You still have not told me how many you think you do not know about that you should know about, and I imagine that is a difficult question to answer. But the only cases you take to court are those where there is a penalty, not where the scheme is—

***Jim Harra:*** No. That is simply for non-disclosure of the scheme to us. When it comes to challenging the scheme itself and its tax-effectiveness, that is a different matter. For example, in the last two years, we have had 60 decisions in the tribunals and courts, with 51 of those in our favour, but that is quite separate from challenging people for non-disclosure.

**Chair:** Okay, I get that.

***Lin Homer:*** Chair, could I just add one figure? Last time we were here, you asked us about litigation, and Jim inadvertently undersold the number of cases we had in litigation at the time. We have corrected that for you. There are about 8,000 live litigation cases, and about 1,000 of those, we believe, involve large businesses. It is important to distinguish the very specific penalty for non-disclosure which is emerging, because that is not the full picture of litigation on tax avoidance.

**Q293 Chair:** Yes, I understand that now. I will tell you the thing that gets my goat, and then I am going to hand over to Ian. What seems to happen is that companies go off and get a lawyer's opinion from one of those guys whose names I will continue to say because they make me so cross—I have lost them now.

**Austin Mitchell:** You are drumming up business for them! **Chair:** I am. Here they are: Jonathan Peacock—whose name appears everywhere—Rex Bretten, Andrew Thornhill and Giles Goodfellow are the four that I came across. Once companies get an opinion, they are then covered for any payment of tax, aren't they? Should you find the scheme to be avoidance—that is, not legit—they are covered for any payment of retrospective taxation. Explain that to me.

***Lin Homer:*** It is not quite that simple. There is a defence of reasonable excuse.

**Chair:** That's right.

***Lin Homer:*** But the "Lifting the Lid" consultation, which you are aware of—

**Q294 Chair:** Talk about now, Lin, not the future.

***Lin Homer:*** Within the consultation—this is something that is out now for consideration—we have picked up the fact that we believe that the "reasonable excuse" application is being used more widely by the industry, if you like, than we think is appropriate. So we are considering whether there is a case for raising the hurdle for reasonable excuse as an extinguishing prima facie breach of the rules. Paragraph 4.13 is very clear about that, and we share your concern that the industry at least believes that all it potentially needs is that piece of paper from the lawyer. Therefore, we are looking at that in this consultation.

**Q295 Chair:** I do not understand what the hurdle is—I do not understand any of that. It just seems that this is a real abuse. You get a lawyer to sign—we have all been there. You get a legal opinion to give you what you want, and that becomes a way in which you avoid having to pay the retrospective tax.

***Jim Harra:*** May I clarify that for the record, because it is important that I do? If we succeed in defeating a scheme, the fact that the taxpayer had legal advice that it should have worked in no way enables them to escape the tax or the interest included from the past.

**Q296 Chair:** Or the retrospective tax?

***Jim Harra:*** Including for the past. The only thing it can do is, if we then try to apply a penalty for sending us an incorrect return, it can sometimes enable someone to claim that they had a reasonable excuse because they took legal advice that their return was correct. But there is no way that that enables them to escape taxation or interest on the tax.

**Chair:** Okay, I get that.

**Q297 Ian Swales:** I would like to explore two areas. The first is the issue of publicity. When you have successful cases, what is your strategy for making sure that public outrage is brought to bear? Secondly, you could be naming and shaming intermediaries, and so on, without exposing taxpayer confidentiality. Do you have any strategy in that regard?

***Lin Homer:*** Last time we discussed this issue I mentioned the publicity we give through the *Spotlight* publication. This is an area to which Mr Harra has been giving additional thought. It might be useful if he updated you.

***Jim Harra:*** Certainly in terms of publicising victories in tribunals and in courts, we issue press statements. I issued one in July when we won three cases. I think it was called, "Triple whammy for the tax man". We do get quite a bit of coverage on those. We also publish a magazine called *Spotlight*. It is an online magazine, which is aimed at tax advisers and users of schemes, telling them about our successes in challenging them. We write individually to taxpayers as well. That is an area that we are currently developing to improve the one-on-one communication that we have with people who are tempted to use the schemes.

**Q298 Ian Swales:** What about where you decide a scheme is not lawful? Do you then expose the designer of that scheme?

***Jim Harra:*** We have not done so. We communicate with people to warn them about schemes that we believe do not work. We need to put as much information as we can into that communication, so that people can identify what we are talking about and steer clear of them. But we have not disclosed names of the designers.

**Q299 Ian Swales:** One of the things that the Starbucks case shows us is that a lot of organisations worry about their reputations—the respectable, big accountancy firms that will be out looking for local government audits quite soon, for example. If you are naming the companies that are doing this kind of thing, it might reduce their appetite for doing it. Is that something you have considered?

***Jim Harra:*** That is something that we have looked at and can look at again. If we believed that it would help us to communicate effectively with people who might be tempted to use those schemes, that is something that we need to do. There are obviously the designers who design the schemes, and then there are a range of intermediaries who sell them either directly or through more intermediaries. You have heard three witnesses today who are quite open about what they do.

**Q300 Chair:** Two out of three are open.

***Jim Harra:*** Possibly, yes. So I am not sure that naming them will have a significant impact on how they behave. But if it means that we can be clearer to taxpayers about what to watch out for and steer clear of, then we would.

**Q301 Ian Swales:** Right. The other area I wanted to highlight was paragraph 2.6 in the Report. There is a strong argument that the real villains are sat on this side of the table, rather than where you are and the previous witnesses were, because we have designed a tax code that is so incredibly complicated that it has led to a whole industry in how to get around it. I was impressed by the comment that, as a result of your advice, Parliament have already initiated 93 changes to the tax law since 2004 to cope with avoidance. However, it does go on to say that might open up other avoidance possibilities. Can you say more about your strategy for that? How fast can we as legislators get on top of schemes? Do you get a good reception from politicians? How does it work?

***Jim Harra:*** First, as we are on this paragraph, I would like to clarify something that Mr James was puzzled about, which is the proportion of schemes that get closed by legislation. There have been 93 legislative measures since 2004, but each measure can close a multiplicity of schemes. That is how you can reconcile what he experiences with what the Report shows.

It is my experience that when we identify a need to legislate, either because we cannot challenge a scheme or because we believe we can but we need to send a signal to taxpayers straight away to say, "Stay away from this," we can get very rapid action. Indeed, figure 8 shows that within two weeks of a disclosure, that is what we achieved. Getting the reader's eye on the changes fast can kill these schemes. It can stop them in their tracks.

**Q302 Ian Swales:** A final question. We heard from the previous witnesses that complexity is part of the problem. To what extent are you involved with the so-called Office of Tax Simplification, specifically about not just simplification for its own end, but using simplification as an extra means to tackle avoidance?

***Edward Troup:*** May I come in on that? I'm not sure they would appreciate being called the so-called Office of Tax Simplification.

**Ian Swales:** Sorry. We haven't seen very much of them so far.

**Q303 Chair:** There are only six of them, Ian.

***Edward Troup:*** First of all, they are very interested in all of this. They are trying to find ways to simplify. What their work has shown is that it is actually a long haul. You raised the question of simplification and how much of the source of avoidance was complexity. Yesterday we announced the closure of four specific loopholes. Three of those were not simplifying measures. They are having to close off some complicated loopholes that have arisen. One of them, interestingly, abolished a relief that is now outmoded. It was something introduced many years ago, which was deduction for patent royalty payments by individuals who weren't carrying on a trade. That we found was being used just for avoidance now. For once, the Government have introduced an anti-avoidance measure that is simplifying.

But if you look at the cases that we have litigated, and if you look at the example of film schemes that you were talking about with the previous witnesses, it was not so much the complexity of the tax system, it was abuse of a genuine purpose that Government had in making a change to the tax system. So, while simplification is part of where we should tackle this, I think to believe that somehow a simpler tax system would cure all these problems is not going to work.

**Q304 Chair:** Have you stopped the avoidance of tax in the film business?

***Jim Harra:*** Our experience has been that the 2007 changes that have now been operating for five years look as if they are very resilient against avoidance. We have not encountered the same problems as we did with the previous scheme. Partnership losses are still a problem and films can be part of partnership losses as well as everything else, but the specific relief now appears to be much more resilient.

**Q305 Ian Swales:** I think Mr Troup makes a good point. If the Government decide to give relief to encourage, for example, investment in films, then don't be surprised if people get creative. It was the Government's intention to get more money into film production and get tax relief on it. That was part of the design. Obviously people then got more creative about it.

My last question is on simplification. Are we putting enough resources in? Do you feel that we can do more to get the linkage between what you see on a day-to-day basis and Parliament? Can it be made stronger so that there is much more of a dynamic relationship? A few of us, including me, sat on the last Finance Bill a few months ago, and it certainly was not evident that the Office of Tax Simplification had been behind one bit of it. It was piling another pile of legislation on top of what we already had. Is there something that we can learn from this?

***Lin Homer:*** Chair, I think I have said on a number of my outings before you this year, that it is vital that we have a strong input into both the planning of future legislation and the evaluation of existing. Part of the benefit for me of bringing Edward into the HMRC side of the business is that he transferred from HMT. We have always had a tax policy partnership. Both Jennie and Jim and my other DGs have people who are thinking about tax policy all of the time, but we are trying to ensure that we are involved at the earliest possible point. I think that we feel that that opportunity for influence is there.

**Q306 Ian Swales:** For example, would it now be a matter of routine that when we are coming up to a new Budget or Finance Bill, there will be a discussion about what next to do on avoidance or what new avoidance measures might be opening up? Is avoidance something that is actively discussed and managed at that time?

***Lin Homer:*** Yes. I think you saw with the announcements that the Chief Secretary and the Chancellor made earlier this week that they are taken very seriously.

***Amyas Morse:*** It struck me that one thing we learned was that many thunder through the gap in a short period of time. It must be a pretty impressive sight when you think of one of these big marketed schemes that they have to tell you about it within five days, and during the short time before you might make a reaction they get hundreds, maybe more, into the scheme.

Given that you were able to make announcements, with retrospection from the announcement, is there some magic reason why you could not take that deeming clause back to an earlier point, either when they launched a scheme or certainly when they should have notified it to you? They are still playing this game of dodging through and then saying, "It is more difficult for you to come at us."

***Jim Harra:*** I think it is part of the strategy in the market that they try to occupy territory, which we then, over a period of time, have to push them off. It is better if you can keep them off the territory altogether. Retrospective legislation is something that the Government has said it will exceptionally do if there is a case for doing it, but obviously it is not something that is done routinely, and Parliament would expect that you look very carefully at the case for doing it. In the last few years, there have been instances, including in 2012, of retrospective anti-avoidance legislation, which Parliament has passed.

***Amyas Morse:*** I was only thinking of something much more modest, which is what I will call retrospective announcement—in other words, that if you were going to announce an intent, you cannot announce the intent until after you have been notified of the scheme. During the time that all that is going on, there is a frantic race going on. Therefore you are in a position where you can say, "Given we don't have a chance to make this announcement at the beginning, we are going to deem that our announcement is made at the first instance." Whatever announcement you make is deemed to occur when you actually start marketing the scheme.

***Jim Harra:*** I understand that.

***Edward Troup:*** It is still technically retrospective. We know that. We have to be very careful, for all sorts of reasons, with that.

**Q307 Stephen Barclay:** Why have you not evaluated your own anti-avoidance strategy?

***Lin Homer:*** One of the challenges for us is how you chunk up the business. Chair, I know I have introduced Jennie Granger to you, but I am not sure the rest of the Committee has met Jennie yet. Jennie is our new director general for enforcement and compliance, so, in oldspeak, my new Mike Eland. The reality of our business is that things move between tax evasion, tax avoidance and tax planning. We tend not to absolutely pin down every activity to a piece.

It might be worth inviting Jennie to illustrate the kind of work that her team might get involved in, which could move almost through the whole of that spectrum as an investigation goes under way. We would not necessarily be able to say the whole of that piece of work was tax avoidance, because sometimes it will turn into tax evasion and people would end up in the criminal courts.

***Jennie Granger:*** Thank you, Lin. One simple example would be—

**Chair:** I am really sorry, you will have to speak up.

***Jennie Granger:*** An example can be where we are investigating whether a tax planning arrangement is in fact a scheme, and on the way through we may discover that some of the documentation has been manufactured, so it moves quickly across from one to the other and into the criminal space. We have prosecuted some people for that, and we have a number of promoters of schemes under investigation for those very issues.

**Q308 Mr Bacon:** Can you explain what you mean by some of the documentation is manufactured? Surely all documentation is produced. What is the difference between producing a document and manufacturing it? Do you mean created after the event to try and create an impression that was not there at the beginning?

***Jennie Granger:*** I mean fraudulent. I mean they have made up what is in it, as opposed to whether the substance is a transaction, which can have you in the avoidance space.

**Q309 Stephen Barclay:** With respect, my question was not about fraud.

***Jennie Granger:*** No, but something that we start investigating, thinking it is tax avoidance, becomes tax evasion. Recently we have taken a case where one promoter was put in prison for four years and his partner for 18 months. When we started that programme, we thought it was four square in this space, but these were not artificial; these were criminal; so there will have been activity that was on the tax evasion side of the line. That is one of the things that makes it hard to say what we are doing in the tax avoidance space and what we are doing in the tax evasion space. So we tend to try and evaluate the work of the business in its entirety, rather than box it artificially in that way.

***Amyas Morse:*** I am sorry, but I have to challenge you on that. The problem is that you do not have the systems to let you know what people are doing by subdividing their time. If you had slightly better management information you would know these things, and you could make rules as to when you move from one space to another. You would still get a more usable measure than what you have got now. We are sympathetic to lots of things, but not to that.

***Jennie Granger:*** I am perfectly happy to accept that our management information could be better. I am not going to argue with that.

**Q310 Chair:** It is shocking. You cannot measure success. You have no performance indicators. You do not know how much tax is at risk. You do not know how many resources you have deployed. You do not know the trend in the number of open avoidance cases—para 1.22, page 18. It looks chaos.

***Lin Homer:*** I do not think I would accept all of that.

**Q311 Chair:** You accepted the Report, Lin. You accepted the Report.

***Lin Homer:*** I do not think I accepted that it was chaos, Chair. One of the things I would accept is that we can and should over time improve management information. I absolutely accept that there is more to do.

**Q312 Chair:** You agreed para 1.22. I do not know how you would describe it. How do you describe that?

***Lin Homer:*** I opened by saying that there was more to do, and I am very happy to accept that. The narrower point about whether we will try always to define our work as some things being tax avoidance and some things being evasion is the simpler point that I was trying to make. A particular investigation will move from one space to another. I think Amyas's point that if we had a more accurate time recording system, we could then make better judgments is a fair one, and I would accept that.

**Q313 Stephen Barclay:** Of course there is a degree of fluidity and blurring of the lines. There is in every major business, and most businesses measure what it is their staff do. If we had had this hearing 18 months ago, we would have had, "We have got a strategy in place." At the hearing today we get, "We have written the strategy but we are not evaluating whether it is working." What I am trying to drive at is: how much would it cost to introduce a time recording system in HMRC?

***Lin Homer:*** We have recording systems. I think what you are really asking is, "How granular should it become?" We could take, and I think we have done—

**Q314 Stephen Barclay:** This is a £5 billion element of the business, isn't it? So I am not asking for it to be too granular; I am saying that you should be able to record something covering £5 billion-worth—

***Lin Homer:*** But I think on my last outing with Mike Eland we did give you, within areas of the business, fairly accurate views on what rates of return we were getting for investment. We will have had inputs into a particular area and outcomes. We do have PIs about yield and investigations. What we do not have is the situation where I think we can gather that to the level of evaluative help that Amyas is encouraging us to. I do not think it is nothing and you have got to spend; it is a set of systems you have got to continue improving.

**Q315 Stephen Barclay:** There is a recommendation here from the NAO, and I think a bugbear of the Committee is that it repeatedly makes recommendations that Whitehall ignores. It is our fault that we do not go to the Treasury minutes, in my view, sufficiently often to review why recommendations are made and not implemented. This paper makes a recommendation from the NAO at paragraph (e) of section 9. Are you going to implement that?

***Lin Homer:*** As I have said, I think we would accept that that is good advice, and I am very happy to suggest that we will work very closely with the NAO. I doubt that every single step of how I would want to change my MI would necessarily be to the NAO's liking, but I would be very happy to take that forward as a joint project. Just to say, Chair, we do monitor the recommendations you give us. I share those with my audit and risk committee, and we do try to keep track of what we have agreed and what we have not.

**Q316 Chair:** Do you show them to your non-execs?

***Lin Homer:*** Yes, we do. Our audit and risk committee is chaired by non-execs, and we use it to try and hold ourselves to account. Obviously, the NAO sits on that body as well. I would prefer my team to reject a recommendation if they do not agree with it, rather than accept it and not implement it.

**Q317 Stephen Barclay:** They are public records, so people can look for themselves at Treasury minutes and see how often recommendations are not accepted. They are in the public domain.

May I come back to the crux of the hearing, which was around the disclosure of promoters? The Report says that you do not know how many schemes should have been disclosed, and that there are also some promoters who are not willing to engage with HMRC. And yet we are actually talking about a pretty small market of 50 to 100 boutique promoters. Have you taken legal advice on the Australia and New Zealand example of penalties for promoters who push a scheme that is subsequently invalid?

***Lin Homer:*** We have been looking at other countries.

***Jim Harra:*** I am not aware that we have taken legal advice, but we certainly are aware of those schemes, and we have been in discussion with them and with other countries about sharing our models for how this works. In Australia, they have penalties for promoters who promote a scheme that turns out not to work and which it was unreasonable to have expected to work. I believe that they have not yet charged anyone a penalty, although they do have some cases going through the courts. That is one element of their anti-avoidance strategy, which in a number of ways is different from ours. Our approach is to require disclosure, and we have penalties of up to £1 million that we can charge for non-disclosure—

**Q318 Stephen Barclay:** But you would never use the £1 million penalty.

***Jim Harra:*** It has only just been introduced. The previous limit was £5,000, and in the 11 cases that we got the full penalty was charged.

**Q319 Mr Bacon:** What's wrong with the Australian approach? It sounds rather reasonable. To have the criterion that it was unreasonable to have expected that a scheme would work is a pretty good benchmark that can be determined by a court, and it gives you a basis for litigation.

***Jim Harra:*** I haven't said that there is anything wrong with it, but it is one element of a wider strategy that is quite different from ours. For example, a previous witness, Mr Levy, referred to the fact that he would like to see, in effect, product rulings given by Revenue and Customs, and that is a feature of the Australian system that is allied to the penalty regime, so I don't think that you can just cherry-pick one part of it.

***Lin Homer:*** Part of the benefit of bringing Jennie in is to give us an in-built opportunity to ask ourselves a question about what we do that is different from Australia.

**Q320 Mr Bacon:** Mr Troup made a point earlier about the 93 legislative changes, and he referred to the fact that this film tax credit had been brought in with the intention of encouraging the making of more British films, which seems a perfectly reasonable thing for a Government to wish to do. It does not seem to be beyond the wit of man to design a scheme that will achieve that end.

If it is so easy to avoid it or to corrupt the scheme so that it doesn't achieve its intentions, that suggests that it can't have been very well designed. So there is a design issue there, but the second thing is: why not have a system in which you can go and get a ruling in advance, in the way that Mr Levy asked for, so that you can be clear about the consequences of your actions before you take them? That is the great benefit of a rules-based system.

***Lin Homer:*** I think Mr Harra was making the point that you have to think about the impact on the whole of your system.

**Q321 Chair:** What does that mean?

***Lin Homer:*** If you move to a system that is wholly based on rules, you have to work out what the rules are and where they would stop, and I thought that you got some illustration of that in the evidence that was presented to you today. You saw one of your witnesses, in effect, say, "We presented something. We thought we'd shared it and we'd gotten a positive thumbs up, but HMRC keep looking and they've got more and more worried about this scheme." The problem is how much you know before you declare.

**Q322 Mr Bacon:** Sorry, I didn't hear what you said. The problem is how much you know before—?

***Lin Homer:*** What one of your witnesses this morning was really saying was, "I thought I'd got a yes out of HMRC and it turned out not to be a yes." I think Amyas pushed him quite hard on, "Was it really a yes, or was it a 'We're still looking'?" The thing about a rules-based system is that you could have a situation in which the decision about whether something was going to be adequate, which is currently made in legislation, is being made in rule. You would actually move from the film system being considered by Parliament and not being good enough to, potentially, things like that being considered on a rules basis, in a sense. It is a big change. We are not saying it's necessarily something that doesn't work elsewhere, but it's a whole-system change.

**Q323 Chair:** What is your experience, Jennie, from Australia? You come from there. Richard's just raised it, so what lessons do you bring us? Two or three things, very quickly.

***Jennie Granger:*** Yes, I will be very quick. It is important to distinguish between two types of schemes. HMRC, like us in Australia, have struggled with both. There are mass-marketed schemes, for example the employee benefit trusts—that is where you are seeing some of the big numbers. In that respect the Australian system, which requires everyone to file both product rulings and the promoter penalty legislation, has worked well. Basically, the ATO has been put in the position in which if you don't come in and get a product ruling, which is legislated, and have a reference number, and if you promote it in a way that is artificial in relation to that scheme, both of those things can lead to significant penalties for the promoter.

Interestingly enough, very few cases have come forward. In fact, even though that was introduced in 2006, the first two are before the court now. That is because the effective part has been enforceable undertakings, where, after a visit from the ATO and a discussion, the promoter agrees that a scheme is artificial. Then they have to unwind that and commit not to do it in future. That can be taken to court, which has influenced opinion.

The Australian system has been less successful in the other part that we are talking about: boutique schemes. The ATO does a range of things, similar to here, where visits to promoters, risk-assessing and intelligence from the market—particularly with offshore promotion—are still a struggle. Earlier we talked a little about things going underground and being difficult to flush out. Interestingly enough, in Australia, one thing that has been happening is use of social networks. In those circumstances, the more traditional investigative techniques have not worked as well, so there has been a need to rethink how to flush out what is going on there. There are important differences between the systems, as I said, but interestingly, they are struggling with the same behaviour.

On a point made earlier about communication, it is important to start to think about the timing of when you communicate. For example, in Australia, we had a struggle in the mining industry where a lot of, particularly young, males got into rather dodgy investments, so it was important to market right before tax-filing time, because that is when people would be tempted to sign up for things.

There are some points there that might be useful, but also some of the same hard lessons about how difficult it is to litigate, the tactical battles, and so on. You have got to be very persistent in relation to that.

**Chair:** Okay. Sorry, I interrupted Steve—go on.

**Q324 Stephen Barclay:** With those boutiques that are not engaging, why are you not targeting them in other ways?

***Lin Homer:*** I think that we are trying to target in other ways. The reason I mentioned "Lifting the Lid" is because it is designed to think about what the next steps are to add to your armoury. One of the conversations that you had with your earlier witnesses was on financial mis-selling. Again, in the consultation, one of the questions asked is: should we be looking more at that model of financial services mis-selling?

**Q325 Chair:** Lin, may I just stop you? What you are really good at is always saying what you will do in the future. I think that there is an armoury, and there is the DOTAS—

**Q326 Stephen Barclay:** If it is 50 to 100 firms, how many are not engaging—are we talking 20, or 30?

***Jim Harra:*** It is a smaller number than that. These promoters range from people who interact with us in a professional and co-operative manner—we may not like what they are selling, but they are very up-front about it and they fully co-operate with us—through to a very small number of promoters who, as part of their strategy, throw every obstacle in the way of HMRC finding out what they are doing. In those cases, we have to use our information powers, for example, to get information from them, and we may have to pursue them for penalties if they try not to disclose things to us in the first place. It is a very small number and, clearly, HMRC has statutory powers that we can apply to get the information that we need.

**Q327 Stephen Barclay:** You have loads of other powers. You could say that, because you think that they are not engaging with you on one thing, they may be higher-risk for other things, and then go to have a look at a load of other things. Then they may say, "That is a bit of a nuisance, so we'll start co-operating on this."

***Jim Harra:*** We certainly do stay on top of people who are unco-operative with us, and who feel that that is an effective way of dealing with us, because that is not the case.

**Q328 Stephen Barclay:** With respect, that is not the evidence that is given in the Report but if, perhaps, that resulted from this session, that would be a good outcome. Reading the Report, my sense is that, moving forward, a huge amount of reliance is being placed on the forthcoming general anti-avoidance rule as a catch-all principle. For a start, I am unsure on who will be on the panel to interpret that rule. Is HMRC to be on the panel, and will practitioners be on the panel? Can you talk us through that?

***Lin Homer:*** I think I would say we see this as part of the armoury. We continue to see the disclosure rules and what we can do with those as a very significant part as well, so I would not say that we think the GAAR is the be-all and end-all. Edward is leading the implementation of that.

**Stephen Barclay:** We hear a lot about the GAAR.

***Edward Troup:*** First of all, this is a general anti-abuse rule, not a general anti-avoidance rule. Graham Aaronson, who provided the Report, drew some distinctions with the way GAARs have been applied elsewhere. As Lin says, this is very much a deterrent. We do not see that it will mean that we no longer have to have anti-avoidance legislation, because applying the GAAR inevitably will require time through the courts. If we find out about an avoidance scheme, we may want either prospectively or retrospectively to stop it with specific legislation, and we do not expect that to stop happening.

As far as the panel is concerned, we will be publishing the draft guidance, which is quite an enhanced part of the GAAR, next Tuesday alongside the Finance Bill. That has to be approved by the panel. Graham Aaronson is taking on the role of interim chair of the advisory panel. We have advertised for the full-time, permanent chair of the panel, and we hope to get that person in place for the implementation of the legislation, which will come forward with the Finance Bill.

**Q329 Stephen Barclay:** What does the acting chair do for his current job?

***Edward Troup:*** He is a QC, as you know. He was appointed by the Exchequer Secretary to do the Report on the general anti-abuse rule.

**Q330 Stephen Barclay:** So we have got a practising tax barrister as the acting chair. Will HMRC be on the panel? Is it your intention to be on the panel?

***Edward Troup:*** The recommendation is that the panel should consist of a representative group of individuals, who would give advice on the guidance. We will not be represented on the panel. It will be a panel appointed by the commissioners of HMRC but it will be a panel on which we do not sit, to ensure its independence. Although Graham Aaronson is going to come to us with recommendations for the constitution of the interim panel, it will have a range of representatives on it from representative parts of business and, we hope, representatives of the ordinary taxpayer as well as of the professions. We expect it to have a good broad constituency to make sure that the guidance actually does what the anti-abuse rule was supposed to.

**Q331 Stephen Barclay:** How soon do you expect it to bring its first litigation case?

***Edward Troup:*** The panel does not litigate; the litigation is always for HMRC. On any particular case—which will be, inevitably, some time down the line, because the GAAR will not come into force until the Finance Bill has become law and the GAAR's implementation date has been set by the Finance Bill—HMRC may at some point in the future find an avoidance scheme to which it wishes to apply the GAAR. The full-time panel, which will be appointed by the permanent chairman after the Finance Bill has become law, will give advice or a recommendation on whether they think we should apply the GAAR in that particular case. That is the safeguard within the GAAR. They are not litigating; they are recommending, and it is not going to be Graham Aaronson because he is only there for a short time.

**Q332 Stephen Barclay:** What I was driving at is that Ireland, as I understand it, has a GAAR. It introduced it in 1989, but it was first tested in the Irish Supreme Court—the first decision was in 2011. There may be a risk that you are reluctant to test it and lose. We heard from one of the witnesses earlier who had had two cases that had been litigated all the way through, and on both cases the firm had won. Given the record of the Committee having a degree of "jam tomorrow" in our sessions, what I am trying to understand is how effective the GAAR will be; how quickly it is going to be implemented; what conflicts of interest there might be with the panel; and, therefore, how you could reassure us that this general provision will be effective.

***Jim Harra:*** First of all, it will have a deterrent effect. Indeed, the prospect of legislating for it is already having a deterrent effect. One mid-sized firm of agents has already gone on the record publicly to say—

**Q333 Chair:** You hope it will have a deterrent effect. You hoped that about this one.

***Jim Harra:*** They have said that they are moving out of the advisory market in anticipation of it becoming law. It will also create an additional level of uncertainty for the promoters and users of schemes. I believe that that will be a deterrent, and promoters will have to tell people that there is this level of uncertainty. For the persistent people who avoid and for whom we do have to invoke it, that will be some time down the line because, as the NAO Report acknowledges, it takes some considerable time to investigate a case thoroughly and get it into tribunal even without the GAAR, never mind with it.

**Q334 Austin Mitchell:** I am interested in the elephant in the room, which is to say the big four accountancy houses. They have high-powered departments developing schemes for tax avoidance that they sell to their audit clients. Those are barely mentioned in the Report, and have not been mentioned much by HMRC either, but it is the same kind of business. The Report is concerned with small businesses and rich individuals, but the impact of schemes developed by the big four must be greater, since they audit the accounts of 95% of plcs—big companies and multinationals. Can you tell us how many schemes developed by the big four have been submitted to DOTAS and how many have been struck down?

***Lin Homer:*** I can certainly tell you the proportion. In 2004, about 25% of the schemes that were disclosed to us were coming from the big four and the magic circle type firms. That is now fewer than 10%. Our view is that the work that has been done through disclosure has driven the top end of the market out, but, as we discussed earlier, it is still being populated by the boutiques.

**Q335 Austin Mitchell:** But how do you take the top end of the market out? The schemes must still be being developed.

***Lin Homer:*** No. We do not believe that they are entertaining these kinds of schemes for individuals. We have talked with you on other occasions about advice within big firms, and you know that our view is that, with multinationals, we need to keep tax discussions in the boardroom, we need to keep the whole of the top of the firm engaged in what their tax strategy is, but we do not believe that the mass marketing of these kind of schemes is being undertaken in anything like the quantity it was by that top end of the market now, not by our statistics.

**Q336 Chair:** Just arising out of this, it is the banks, as well, which rather shocked me. I was given a list of banks—HSBC, RBS. Many of the schemes are based on loans: somewhere along the line, however artificial the scheme is, there probably has to be a bank loan. HSBC, Bank of Ireland and Barclays all make 1% or 2% on each of the loans.

***Jim Harra:*** I think, historically, you are right: banks have been heavily involved in avoidance. Sometimes they have been designers of it; sometimes they have been facilitators of it through the provision of financing. Since 2009, we have had the voluntary code of practice for banks, and in there they undertake not only not to engage in avoidance themselves but not to engage in the promotion or facilitation of avoidance by others.

**Q337 Chair:** May I just ask you this? We own RBS, so I was shocked to see them on our list. Is it true—can you give us an assurance that RBS is not involved in designing schemes, advising individuals, or whatever they are, or lending money that enables tax avoidance?

***Jim Harra:*** I can give you an assurance that 236 banks, including the 15 largest—I would think RBS is still in that group—have signed up to the code of practice and thereby undertaken not to engage in that.

**Q338 Chair:** Are you monitoring that?

***Jim Harra:*** We do monitor that and we have regular conversations—indeed, I personally have regular conversations—with the boards of some of the largest banks about their compliance with the code of practice.

**Q339 Chair:** I then have to ask you the follow-up question: if all these banks are complying, who is lending the money?

***Jim Harra:*** Although banks have undertaken not to get actively involved in these schemes, if they are approached in the normal course of their business for financing, I think one of the things we want to monitor is to what extent they are asking questions about what the financing is for.

**Q340 Chair:** So they are still financing?

***Jim Harra:*** That is something I think we have to monitor very carefully.

**Q341 Chair:** Okay. That is what I asked. RBS could still be financing tax avoidance schemes?

***Jim Harra:*** I am not going to comment on RBS specifically, but that is something that we monitor.

**Chair:** Outrageous.

**Q342 Austin Mitchell:** Let's go back to the big four—our obsessive preoccupation. They have been very harshly and firmly—and, I think, justly—dealt with in the States: there have been massive fines for two of them and, in some cases, partners have been sent to prison for calculating the cost of any fines against the profits made from the schemes before they were struck down. I won't name names, but that is what happened. Fines are now pending against PwC. Here are big multinationals operating on an international basis. I assume that what has been done there is being done here—that similar schemes are being sold and developed here. Yet, here, nothing: no fines, no punishment, nowt. Why?

***Lin Homer:*** We believe that we apply the system consistently across big and small. You know—we endlessly come and—we think that we do.

**Q343 Chair:** Nobody out there thinks you do, Lin.

***Lin Homer:*** Well, I think that is something that we must continue working on. We remain in very direct conversation with both the big firms and the big providers.

**Q344 Austin Mitchell:** Conversations are no use if the buggers are fiddling. Sorry.

***Lin Homer:*** One of the things you heard today, and it is our belief, is that there is a reputational element to this. Some of the big associations that represent tax specialists are also very clearly saying that there is a reputational risk in being involved in egregious tax avoidance, as well as a professional risk. I do think we have to continue making the risks of being involved in these schemes more overt and visible to people, both to the users of the schemes and the advisers. We share some common ground with you on that.

**Chair:** I think our Committee will want to call the advisers, I'm afraid. I think that is the next stage.

**Q345 Austin Mitchell:** I wonder, in passing, what liaison you maintain with the regulators for accountants and auditors. These schemes often obfuscate and obscure the clarity of company annual reports. The job of the annual report is to give clear information to investors, to shareholders and potential investors. They might be faulty in some respects but that is their objective as audit controller of the company.

I notice that the prosecution that you brought against Iliffe Media produced a letter from Yattendon, the holding company controlling Iliffe. The chief executive wrote to the auditor saying he wanted the accounts made less clear. Because if the true rate of profit was made clear, it would produce wage claims from journalists: nasty people working for the newspaper would want more money because the company was making a lot of money. That is an indication of the way that the accounts get obfuscated and made less clear. That is surely a matter that you should be taking up with the regulator, the Institute of Chartered Accountants in England and Wales. Do you have any liaison with them?

***Lin Homer:*** Yes, we spend a lot of time working with ICAEW. As part of my preparation for today, I read one of its helpsheets that was issued in July 2012. That is very clear that people giving advice have to ensure that they remember the code of conduct of the profession as well as the law. I do think there is a role for the regulatory profession. We can send you a copy of this helpsheet; I think it is very explicit.

One of the challenges is that this is not a sector where there is a single regulatory body, because there is a fairly significant number of regulating bodies for both accountancy and tax experts. But my experience with all of them is that they are trying to ensure that the standards are high because it goes to the reputation of the professional.

**Q346 Austin Mitchell:** I must say that I have never known an institute be anything but kind when it is regulating auditors; their job is to help lame accountants over stiles. Mr Levy told us in the earlier session that there has been a change of policy, that HMRC is now being tougher and is striking down more, and that is producing uncertainty that is diminishing the amount of investment in these schemes. Are you being tougher and when did that toughness start?

***Lin Homer:*** Yes. I believe that HMRC has been ramping up in this area for a number of years. I get accused of jam tomorrow and I apologise for that, but I do think there is jam today and it is built on the work that started in 2004, with the disclosure rules.

The point I was trying to make is that we do not think it is finished work. We can envisage it will need further change. I perceive, from the discussions I have had with the industry in this first year, that we are having an impact on behaviour, and that is flowing through, in a sense, to our increasing the risk—reputationally and in terms of outcomes—for people being involved in this area. The professional bodies have a part to play in that, and we will continue working with them to try and get the right balance between what we do and what they do.

**Q347 Austin Mitchell:** The interesting question is why were you not tougher before? I have had long experience—

***Lin Homer:*** How long does one go back to?

**Q348 Austin Mitchell:** I have taken a series of delegations to Ministers and to HMRC consisting of people such as Professor Prem Sikka and Richard Murphy, particularly around the publication of pamphlets, like the black-coated mafia pamphlet. It has always seemed to me that when we met HMRC officials, they were always interested. I thought that it should not be up to us to tell them what fiddles were going on, but they were interested to learn about them. I thought they should have known.

Officials were interested to learn, but Ministers were just not interested, and nothing much happened as a consequence of meetings with Ministers. That indicates to me that there was a policy of being welcoming to incoming wealth and individuals of net worth. It was "come to Britain". The Government could boast that people had confidence in Britain and were bringing money here. Was there such a policy?

***Lin Homer:*** No. My view is, if you look at our position on tax avoidance, that there has been support from this Government and the previous one for beefing up our work in this area. I think any Government has to manage a position, because quite a lot of our Departments—DCMS, BIS and many others—do want to encourage entrepreneurship and economic growth. My view is that we get very good support from Ministers, and, as I said earlier, increased resources this week—

**Q349 Chair:** I think our pressure helped you.

***Lin Homer:*** I don't mind, as long as I get it.

**Q350 Guto Bebb:** Just two short questions to clarify some issues. I think I am not alone in being in receipt of an e-mail from HMRC, which stated that you will be working to ensure that all taxpayers work within the letter and the spirit of the law. So my question is in relation to the evidence we heard this morning. I think I am right in saying that one of the witnesses said that they had 255 schemes, of which 113 had been subject to investigation and 13 are still in dispute. Two went to court and they won both cases. Would it be fair to assume that the vast majority of the schemes that they had were therefore within both the letter and the spirit of the law?

***Lin Homer:*** I think you heard quite a lot of evidence this morning that a lot of schemes get closed down. We do not come here and talk about individual cases, but the NAO Report gives us a green RAG rating on our litigation success. Out of the 60 cases looked at, 51 were won, so my personal view is that we do very well when we litigate.

**Chair:** You should litigate more.

***Lin Homer:*** The question of whether we litigate enough is a point you have made to us, and I have committed to our seeing if we can build up. Clearly, that is both a capability and a capacity issue, but I think we are very good at winning our cases.

**Q351 Guto Bebb:** On a specific point, if 113 schemes were investigated and only 13 are still in dispute, would that imply that the other 100 were therefore deemed to be acceptable?

***Lin Homer:*** Not necessarily, because sometimes what will happen is as in the Australian example. You talk people out of doing things; they will decide for themselves. You will investigate and discover what you thought was there was not, so it is not that a scheme is agreed; it is that what you expected was not there. There can be a whole range of reasons.

It sometimes takes a long while before we uncover what is really going on in schemes. We have to dig quite hard to get to the underlying issue that might be causing avoidance. We go at cases more than once sometimes before we root out the challenge.

**Q352 Guto Bebb:** I am sorry to press you on this, but it still seems odd, in my view, that 113 were subject to investigation and only 13 are still in dispute. That is the point I am getting at. It appears that 100 cases were obviously looked at and then not taken any further.

***Jim Harra:*** It certainly is our approach that we encourage all taxpayers to stay within the spirit as well as the letter of the law, and also all the advisers and everyone else who deals with them. We spend a lot of our time trying to change people's behaviour and move their behaviour so that they stay in that space. Ultimately, if someone does not agree with us about the spirit of the law or does not care, all that we can enforce is the law. If we can challenge any of these schemes that are not within the spirit of the law, we do.

**Q353 Guto Bebb:** I have a point of clarity in relation to the part of the Report that says that there "is no evidence that the use of"—tax avoidance—"schemes is reducing." Yet we have heard evidence this morning from the witnesses that indicated that they felt that people were moving away from these schemes, possibly because your intervention was possibly more effective than we give you credit for. The tax practitioners and experts who were consulted say that changes to tax law and the actions had actually reduced the opportunities for tax avoidance. What is your overview of the situation? Do you think things are actually improving?

***Lin Homer:*** We believe that we are having an impact on the market, but we have not got as far as we want yet. You need—this goes back to MI—to know the number of schemes and the number of users. You pushed quite hard today and did not get many hard facts about the numbers of users, so you could have an increase in the number of schemes, but an overall reduction in the number of people using.

However, we are confident that we have challenged the high end of the market that was producing things that needed legislative change. We are seeing less and less legislative change—in other words, there is less finding of loopholes. We are seeing more behaviour, which we challenge by investigation, and that is at the boutique end.

One of the issues about ensuring that people understand the risks is that what may well be happening in many of these schemes is that they are not working at all and tax is not being saved, but fees are being paid. Promoters are going to stay in selling schemes that do not work until people stop buying them.

**Chair:** People are anxious to leave. There are three members who want to speak, and I need to raise two or three issues at the end.

**Q354 Ian Swales:** Briefly, when we had the Google, Starbucks and Amazon hearing a few weeks ago, I must have googled the phrase "tax avoidance" at some point, and, sure enough, the Google advert that came up was for a scheme about tax avoidance. It was one of these schemes where you get paid mainly in loans. I noticed from figure 3 that there are two such schemes—one onshore and one offshore. I have been a bit troubled by the vagueness of some of what we have heard today. Can you just say in one word whether such a scheme, where an employee is paid only a small salary and the rest in loans that are never repaid, is, prima facie, a scheme that you would close down?

***Lin Homer:*** It would lead to investigation.

***Jim Harra:*** One word would be "yes." There has been legislation to close schemes down that disguise remuneration. We are also challenging these schemes, including those that were entered into before that legislation was put in place.

**Ian Swales:** Google the words "tax avoidance" would be my advice.

**Q355 Stephen Barclay:** The Department says that the DOTAS regime has closed off £12.5 billion. How did you come to that figure?

***Jim Harra:*** I think some care needs to be used with that figure. If you look at all the legislative measures that have been made in response to it and you look at the revenue protected by those and total that, it will come to £12.5 billion. There is quite a strong argument for saying that, to some extent, you are chasing the same money all the time, because if it is the same avoiders moving from scheme to scheme and you are blocking them, you cannot add all of that up and say that that is all additional money. It is the totality of the revenue protected from all those measures.

**Q356 Stephen Barclay:** Over what period of time?

***Jim Harra:*** Since 2004.

**Q357 Stephen Barclay:** Is that up to today? Is it forward-looking?

***Jim Harra:*** I think that was up until the Finance Act 2010–12.

**Q358 Stephen Barclay:** So it is 2004 to 2010. Could you give the Committee a note with a breakdown of the various components and a figure for each component for each year?

***Jim Harra:*** Yes.

**Q359 Stephen Barclay:** Presumably, for each component you will have a year-by-year estimate to come to your figure.

***Jim Harra:*** Yes.

***Amyas Morse:*** If you are finished, I only wanted to ask a slightly different point. You have Jennie here and she has just outlined what happened in Australia, which is effectively that the marketed schemes were put out of business. That is true, is it not? Does the fact that you have her working with you mean that you have an appetite to look in that direction?

***Lin Homer:*** Certainly part of the attraction was having my in-built benchmark. As you know, I am quite keen that we stay in close touch with other organisations elsewhere in the world, so we are doing some work with France and Germany. I would like us to learn from other people's experiences, yes.

**Q360 Austin Mitchell:** Why does HMRC seem like a pussy cat compared to the IRS—nice, tame and polite? Why haven't you issued a penalty to any taxpayer for failing to disclose a scheme?

***Lin Homer:*** We have. I don't think we are a pussy cat. I have spoken to a number of people in the world on tax since I got this job. Outside this country, our tax administration is held in very high regard. That does not mean we should not learn from others, but there may be an element of our own interest in doing better that sometimes hides the quality of what we do already. I think we do much that is very good, but I think there is a great deal more we can do. I don't believe we are a pussy cat.

**Austin Mitchell:** Are you properly and adequately staffed to do the job? I know that the number of schemes is increasing.

**Q361 Chair:** I was just going to ask a question on that. Is it £70 million a year, or £70 million over two years?

***Lin Homer:*** It is £77 million—

**Chair:** Over two years or a year?

***Lin Homer:*** Over the next two years, on tax avoidance and evasion issues.

**Q362 Chair:** The figure was unclear in the public domain whether it was each year or over the two years. It is over the two years?

***Lin Homer:*** Yes. A similar amount is also being invested in some other areas of HMRC. There is some investment in areas like digital, which no doubt we will be talking to you about after your next Report, because that is customer service.

**Chair:** I think the public need to be clear on that, because it wasn't. There was a muddle regarding the investment.

***Lin Homer:*** It is £150 million from two different—

**Q363 Chair:** All right. To be honest with you, you have had the easy time today; you must be really lucky. On this Report, I want to raise three minor issues. There is a lot of work to do, whatever you look at—open cases, your strategy, and whether the resources are providing value. There is too much out there being lost to the taxpayer. I hope you accept that. I want to raise a number of issues that have come up since you were last here, regarding HMRC directors—

your non-executive directors. It was alleged by a Channel 4 "Dispatches" programme that Phil Hodkinson, who chairs the HMRC's ethics committee, earns more than £100,000 a year from a FTSE 100 firm, Resolution Ltd, incorporated in Guernsey. Is that true?

***Lin Homer:*** I watched the "Dispatches" programme. I am not prepared to discuss the full affairs of my NEDs in an open Committee. What I am prepared to say is whenever we appoint a NED, we put them through a rigorous check. I am, in future, going to use the same approach that we use with our tax big cases, whereby Edward, as our tax assurance commissioner, will assure me about appointments before we make them.

**Q364 Chair:** Let me put to you our view—probably shared by others here—that it would be completely inappropriate for any non-executive director sitting on HMRC to be involved in any of this aggressive tax avoidance—completely, utterly and totally. If any of them are at present, they should be sacked.

***Lin Homer:*** I accept that we need to have NEDs who obey the rules, and I will make sure that we check people carefully.

**Q365 Chair:** That's the future. I am saying: if you have anyone there now who is doing it, they should be sacked.

***Lin Homer:*** I don't think I have anyone in that category.

**Q366 Chair:** Okay. Can I ask you the other question? I am afraid you are very much the centre of the world at the moment. There was an article in *The Sunday Times* about Accenture, which is providing your IT; they are doing the Aspire contract. The allegation in the article is that on the profits they made in the UK—£82 million—they only paid £2.8 million in tax. A similar point arises. If you are our guardian of good behaviour, you should not be employing companies that are not paying their fair share of tax in the UK.

***Lin Homer:*** We have an approach where we will not use people who have committed any acts that we believe would put them in the tax evasion area.

**Q367 Chair:** I understand evasion. This is avoidance, isn't it? Legal, but not moral.

***Lin Homer:*** We have to abide by the rules that the Government and Europe set in terms of running big competitions. There are some limitations as to when we can pick and choose who is in, but we are interested in ensuring that we can run as tight a ship as possible.

**Q368 Chair:** Let me come back on that: you can write your contracts within the European rules such that you put as a part of those contracts that you will not do business with people who in any way aggressively avoid tax. I have know that for ever and ever, and it has always irritated me to see it—

***Lin Homer:*** We are supportive of that. Again, there was a change in the autumn statement that will be helpful in that respect.

***Edward Troup:*** The Chancellor announced yesterday that we will be consulting on the use of the procurement process to deter tax avoidance and evasion, with a view to new arrangements coming into effect from 1 April 2013. There will be a consultation process to see what more we can do to make sure that, consistent with procurement rules, we can go further.

**Q369 Chair:** Accenture, where the allegation is—I accept it is an allegation—are on what sort of contract with you?

***Lin Homer:*** They are one of our contractors.

**Q370 Chair:** Can you close the contract?

***Lin Homer:*** You know we will not discuss the individual tax affairs of companies. I can assure you that if those changes happen—

**Q371 Chair:** I am anxious to—I understand about changes. What I am saying is that there should be breaks in the contract. That is our view.

The very final thing is that we raised with you the issue of personal service companies. I have had raised with me—I think it has probably been past you—Reed employment agency, who actively encourage their agency workers to set up limited companies.

***Lin Homer:*** I am very happy to take that one away; I don't have information at hand. We have talked to you before about our approach to personal service companies and, again, I think I made a commitment here to ensure that we undertook more work around personal service companies.

**Q372 Chair:** I hope it is much, much more work, because there has been hardly any work.

***Lin Homer:*** I think I said 10 times, didn't I?

***Edward Troup:*** Again, without detaining you longer, there are two paragraphs in the autumn statement, paragraphs 2.103 and 2.104, which—

**Chair:** We never read all that.

***Edward Troup:*** I can read them out if you like. I commend them to you.

**Q373 Chair:** What do they say?

***Edward Troup:*** They announce some minor changes on controlling personal service companies, but also talk about a review on employment intermediaries as well.

**Chair:** So Reed may cease to do this? This is a letter I have had. Okay. I think you have had an easy day today.

***Lin Homer:*** Dare I wish you a merry Christmas, on the basis that we will not see you before then?

**Chair:** Merry Christmas to you, too.

# Written evidence

## Written evidence from Ingenious

INGENIOUS

Ingenious is an investment and advisory firm employing some 200 people with a sector focus on media, sport, leisure and clean energy. I believe that we are the largest independent investors in media and creative content in the UK having raised more than £8 billion since 1998. We recently extended the scope of our investment activities into leisure, sport and clean energy. In the year ending April 2012, Ingenious posted £35 million profits on which we paid £8 million in corporation tax.

We are focused primarily on commercial ventures in the high-risk creative industries, a sector of such crucial importance in the UK.

Everything we do has a commercial engine attached to it and is designed to deliver trading profits.

In particular, our partnerships have financed or co-financed to date 103 feature films, including such successful commercial movies as Avatar, 127 Hours, Hotel Rwanda, The Best Exotic Marigold Hotel, The Descendants, Die Hard 4, Shaun of the Dead and The Golden Compass (see appendix 1). Our latest film is Life of Pi which has just opened in the US to excellent reviews and is based on the award-winning novel by Yann Martel, a work that defied several previous efforts to get on to the screen.

Film is, however, only part of what we do. In television we have worked with all the major broadcasters and produced more than 600 hours of prime-time TV drama, including Foyle's War, Rev, Doc Martin, The Suspicions of Mr Whicher and Primeval. Our experience of producing children's animation includes

Fleabag Monkeyface and Pajanimals. Through Ingenious Games we have funded both console based video games (Colin McCrae: DiRT and Fuel) and mobile games. In the past we have also funded recorded music, including albums by Peter Gabriel and The Prodigy; we now focus on music festivals and other live events, such as the "Taste" and "Rewind" festivals.

We carefully choose projects, be it a film production or a live music event, to invest in and then provide those projects with the appropriate support to bring them to market. Through our approach, we have achieved a highly successful track record which has meant that we have been able to secure further investment and expand our range of activities as set out above.

Our investments embrace a wide range of business models and risk profiles. We occupy a unique position at the high risk end of the risk spectrum acting as a bridge between the worlds of finance and creativity, bringing together individuals and businesses to produce various forms of content, for a wide variety of media and entertainment platforms. The activities of all content-creating businesses are based on a complex and unpredictable, "hit-driven" relationship to the market. This is explained more fully in our written evidence to the Commons Culture Committee's current inquiry into Support for the Creative Industries. This is published by Parliament here:

http://www.publications.parliament.uk/pa/cm201213/cmselect/cmcumeds/writev/suppcrec/sce03.htm

Film is generally acknowledged to be a risky form of investment. There is substantial evidence of market failure on the film financing side of the industry. That is why successive British governments have taken measures to encourage private investment. We have always worked with the grain of public policy, respecting the spirit as well as the letter of the law, engaging with HMRC at crucial moments in the roll-out of policy and acting as a sounding board for the Revenue's Film Tax Unit.

Moreover, through our work we have:

1. helped produce a great number and variety of creative works;
2. helped create a large number of jobs in the creative industries in the UK; and
3. produced taxable income for the UK Exchequer of £600 million from our film slate with a further taxable income of at least £1 billion expected .

HMRC

We have always sought to have a clear and constructive relationship with HMRC. We have disclosed full details of all our film partnerships to HMRC and cooperated fully with them to build their understanding of the associated commercial arrangements. Unfortunately, we have found that HMRC have responded with repeated inefficiency and, by its own admission, mismanagement.

HMRC's current stance suggests an unwillingness and/or an inability to differentiate our partnerships' proven commercial investment strategies from other companies' arrangements. It also points to a policy of making "tough" pronouncements against investors whilst ceding actual decision-making responsibility to the Tribunal—a policy which is unsustainable in practice, a drain on the public purse and, we believe, more to do with politics than just or effective governance.

THE COMMITTEE'S CONCERNS

I understand that the current interest of your Committee arises from the recent report of the National Audit Office (NAO) on Tax Avoidance: tackling marketed avoidance schemes (HC 730). This report refers to amongst other things, partnership loss schemes and their relationship to film financing.

The most important point to register with the Committee in this regard is that we do not market "tax avoidance schemes". The report cites the HMRC "working definition" for tax avoidance of "using the tax law to get a tax advantage that Parliament never intended". Everything Ingenious does has a commercial profit motive attached to it and is designed to deliver trading profits. It is true that our investors were able set off early stage losses in our partnerships against other income but that is not unique to film and is in precisely the way in which Parliament intended, through sideways loss relief, to encourage investment and enterprise. And more often than not, the losses incurred in the early years are more than offset by the profits (which are taxable) which arise in later years. That after all is the purpose of our investment partnerships.

For these reasons, we are at a loss to understand why it may be considered that we market tax avoidance schemes.

*Patrick McKenna*
Ingenious Media

*4 December 2012*

**APPENDIX 1**

INGENIOUS FILMS TITLE

127 Hours

A Good Year Alien Vs. Predator Amazing Grace A-Team, The

Australia

Avatar

Baggage Claim Bel Ami

Best Exotic Marigold Hotel, The

Big Nothing, The Big Year, The Blackball

Book Thief, The Brick Lane

Bride & Prejudice Bronson

Rise of the Planet of the Apes

Children of Men

Children, The (fka The Day)

Churchill: The Hollywood Years

Closer

Counselor, The

Country of My Skull (released as "In My Country") Dawn of the Planet of the Apes

Decameron, The (released as "Virgin Territory") Descendants, The

Diary of a Wimpy Kid

Die Hard 4

Die Hard 5

Double, The

Dragonball: Evolution

Enduring Love Eragon

Fantastic Four 2 Fantastic Voyage Far North (fka "True North")

Flyboys

Foster

Four Last Songs

Garfield: A Tail of Two Kitties

Girl with a Pearl Earring

Golden Compass: The Northern Lights

Trance

Tucker & Dale vs Evil

Unstoppable

Untitled Nicole Holofecener Project Vanity Fair

Vera Drake Walker, The Watch, The

Water for Elephants

Waz

Wimbledon Wolverine, The

X-Men 3: The Last Stand

X-Men: First Class

X-Men: First Class 2

X-Men Origins: Wolverine

Young Hannibal

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**Written evidence from HM Revenue & Customs**

HMRC UPDATE TO PUBLIC ACCOUNTS COMMITTEE: LETTERS TO TAX AVOIDANCE SCHEME USERS

4 December 2012

In paragraphs 3.15 and 3.16 of "Tax avoidance: tackling marketed avoidance schemes", the National Audit Office (NAO) reported that HMRC has established a pilot project to evaluate the use of behaviour change techniques to "nudge" users by writing to them to encourage withdrawal from avoidance schemes.

We have taken forward this work since the NAO's review was undertaken in the following ways.

Three schemes are being used as pilots:

1. The first is a scheme using an Offshore Services Company to avoid PAYE and NIC We have sent letters to 1,200 of those users, split into four groups and will assess which one creates the greatest impact in terms of changing behaviour. There were approximately 1,500 users of this scheme in the year 2011–12, and the remaining population will act as a control group. Tax (PAYE, primary and secondary NICs) at risk is approximately £50 million.

2. The second is a scheme to avoid Stamp Duty Land Tax on the purchase of property. We have developed draft letters to send to 2,500 scheme users in December to explain that that a First Tier Tribunal in the summer found that this particular type of scheme did not work. The remaining users will receive bespoke letters. There are approximately 2,600 users of this scheme with Stamp Duty Land Tax at risk of approximately £186 million.

3. The third relates to schemes involving property business loss relief. The Government announced on 13 March 2012 that it had acted to close down Property Business Loss Relief schemes. There are approximately 200 people who we have identified have joined the partnership involved in the scheme, and we intend to send letters to all these users.

Please find attached an example of the type of letters being sent. They have been designed using behavioural insight techniques to encourage users to withdraw from avoidance schemes.

Dear

You need to contact us now on XXXXX XXXXXX about your tax affairs

We are targeting users of aggressive Tax Avoidance schemes. We have identified you as a user of a **Disclosed Tax Avoidance Scheme**

Our Specialist Investigations Unit will be carrying out a full investigation into this scheme and they will open an enquiry into your tax affairs. If we find that the scheme does not work as intended, then you may have to pay the full amount of any additional tax and National Insurance contributions due, plus interest for any tax that is late.

**Paying your taxes in full is the right thing to do. Not paying tax reduces our public finances. We all lose out on essential public services such as roads, the NHS and schools.**

**HMRC has to make sure that everyone pays the right amount of tax. We do not want people who pay the right amount to lose out because of those who do not.**

What you can do

Please call us now on XXXXX XXXXXX to discuss your involvement in this scheme. We can deal more quickly with our enquiry into your tax affairs if you call us.

To stop us from charging you interest on amounts you may have to pay later, you can make a payment on account or purchase a certificate of tax deposit. More details are at **www.hmrc.gov.uk/payinghmrc**

You should be aware that in certain circumstances we may charge scheme users a penalty. If you do not contact us then we may view this as a lack of cooperation, which would affect the size of any penalty.

If you have any other questions, call us on XXXXX XXXXXX**.** Or you can write to the above address. Please quote your unique Avoidance Reference Number in all correspondence.

You may wish to discuss this letter with your advisor.

Yours sincerely

Investigator

*Lin Homer*
Chief Executive & Permanent Secretary

*4 December 2012*

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## Supplementary written evidence from Ingenious

### 1. Introductory Statement

The Committee's Oral Evidence session was prompted by the publication of the NAO's report on *Tax avoidance: tackling marketed avoidance schemes* (HC 730). We reject the contextual premise that lies behind the invitation to us to give oral evidence: we do not market "tax avoidance schemes".

The report cites the HMRC "working definition" for tax avoidance of "using the tax law to get a tax advantage that Parliament never intended". Everything Ingenious does has a commercial profit motive attached to it and is designed to deliver trading profits.

It is true that our investors have been able set off early stage losses in our production partnerships against other income but this is not unique to film and is done *in precisely the way Parliament intended*—that is to say through sideways loss relief ("SLR") in general accounting principles, to encourage investment and enterprise (these provisions were effective in law between 1960 and 2007). More often than not, the losses incurred in the early years are offset by the profits arising in later years, which are taxable.

Unfortunately, the Committee's discussion of these issues was at key moments confused. The Chair appears to mix up two different legal bases (see especially Q 223). It is therefore useful to provide a short overview of the relevant statutory framework. It is not possible to understand film financing during the period in question, or to understand the role played by tax incentives within the film industry, without fully comprehending this legislative framework.

This supplementary memorandum therefore comprises: (a) a short account of the relevant legislative framework; (b) an account of Aries Film Partners, which, with respect to the Chair, is not "an exit scheme"; and (c) detailed comments on specific numbered Questions.

### 2. The Legislative Framework

Under section 48 of the Finance Act (No. 2) 1997, the Labour government introduced a provision allowing acquirers of British qualifying films to claim a 100% deduction for the cost of those films in the year of acquisition. This legislation manifested itself in a mechanism called " sale and leaseback" which provided private investors with the ability to reduce their income tax liabilities by joining UK partnerships set up to undertake the sale and leaseback trade. This was fully supported by HMRC through a statement of practice, SP1/98. A similar piece of legislation (section 42 of the Finance Act (No. 2) 1992) was already on the statute book but the deduction could only be claimed on a straight line basis over three years. The new section 48 allowed the deduction to be claimed in year one (but only on films below £15 million).

This stimulated a wave of private investment into the UK film business, but was ultimately unsatisfactory in its consequences. Notwithstanding the considerable benefit to the film services sector from increased levels of production, the sale and leaseback mechanism was open to abuse.

Moreover, investors did not take performance risk on the films. Commercial success or failure was irrelevant because investors simply received a tax deferral, to be paid back over the life of the film lease irrespective of film performance, while the producer used his benefit from the transaction to help defray the cost of production.

It was a purely financial arrangement which largely failed to achieve the original policy aim of creating sustainable film production businesses.

However it did set the scene for investors to move further up the risk curve. The next generation of film partnerships did take performance risk, while using SLR for any losses realised to protect the downside. This was done under general accounting principles: SLR was available to individual investors in partnerships from 1960 onwards and was not confined to the film industry.

The *quid pro quo* was that partnerships' income from film exploitation was taxable in the UK, so that in the event of commercial success HMRC would be better off because the tax paid on income would exceed the initial tax relief.

Unfortunately these arrangements were similarly open to abuse. As a result, and notwithstanding our attempts during Standing Committee proceedings on the Finance Bill 2007 to persuade Parliament to preserve SLR by introducing a purpose test and a pre-clearance procedure *so as to eliminate abuse*, SLR was eventually restricted to "active" investors.

Finally, in 2007, the film tax credit (FPTC) was introduced by the Labour government in place of s.42 and s48. Ingenious advised the Film Tax Unit at HMRC during consultations on this new credit.

### 3. Aries Film Partners ("Aries")

Aries is not an "exit scheme", as repeatedly claimed by the Chair in the oral evidence proceedings.

Aries was established in 2003 under the sale and leaseback provisions referred to above. Investors received tax relief on the cost of the acquisition of a film and were then subject to tax on the income arising from the subsequent lease of the film, creating a tax deferral.

Partners in Aries have recently been presented with an opportunity for the partnership to acquire a new film for leasing exploitation, in continuation of its existing trade. We, Ingenious, propose to provide around 82% of the additional capital required with the remainder coming from the other partners. The proposed profit share allocation for any income generated by this further trading activity would be 95% to our client and 5% to the other partners. This is a necessary adjustment to reflect the fact that the capital allowances arising on the new acquisition are effectively allocated by law to the partners who contributed capital towards the acquisition of the partnership's films and accordingly receive a proportionate share of any annual income from those films. Income arising from the original films and the new film is effectively pooled in the partnership and the capital allowances available by reason of the acquisition of the new film are, as a matter of law, set against the totality of the income.

Because the new films do not, initially, generate income, the allowances are claimed only in respect of the original income and are as a consequence of capital allowance legislation allocated to the partners who have an income share in the original films. Therefore, as Ingenious does not receive a share of original film income, in order to balance out the benefits received by the other partners from the availability of capital allowances, we seek to receive more of the income generated by the new film. This is simply an equitable arrangement to reflect the fact that we do not benefit from the capital allowances.

When the new film begins to generate income, the partners will be taxed at their usual rate of income tax and we will pay corporation tax at 24%. With the addition of dividend tax of 36.1% on the balance the effective rate of tax on us is 52%. Accordingly, all of the income generated by the new film acquired by Aries will be taxed at a significant rate: *there is no income which escapes taxation in the UK.* The same partners in the same partnership are carrying on the same trade, with all income still subject to UK tax.

If a partner chooses not to make a further investment he will continue to be allocated the same net taxable profits as always envisaged and will continue to pay tax on those profits. All income arising from the new film is fully subject to UK tax. If the film fails commercially, the partners will have lost some or all of their further capital contributions but will also have received tax relief from the capital allowances. Again, this is precisely the intention of the overall scheme of capital allowance legislation and is applied on a purely mechanical basis.

It is thus demonstrably clear that Aries is not an "exit" scheme as erroneously stated by the Chair.

### 4. Detailed Comments on Numbered Questions

**Q 199**: *insert* after "we have not bought films" the words "through our production partnerships".

**Q200**: *insert* after "The only buying of a film…" "occurs in relation to sale and leaseback. In recent years we have acquired some American films. We acquire them to invest in their future commercial performance."

**Q202/3**: The Chair is mistaken. Sale and leaseback provisions were not "closed down": on the contrary, they were extended by the government in 2005. They subsequently expired in 2007.

**Q216**: "*there* are film partnerships"…

**Q218:** the "film tax credit" was introduced in 2007.

**Q223**: this exchange is very confusing. The Chair talks about amending "the film tax" but the only provisions amended in 2007 were the SLR provisions of general finance legislation: this took place, or so we were advised by HMRC at the time, for reasons that had nothing to do with film.

**Q245**: *Insert* after "Yes", the words "we produced a detailed written account of our conversations with HMRC".

**Q246**: *Avatar* is just one of the films financed through our production partnerships. All of our films have been financed "properly".

**Q248:** the Chair makes repeated reference to "my note". If this is a note supplied by HMRC and the note denies the commerciality of our production financing arrangements we categorically reject what is said in the "note".

**Q255:** *insert* after "I agree, totally" the words "as a matter of law".

**Q258 *et seq*:** the references to Jersey here amount to a red herring. These companies were trading in the UK and subject to full UK tax.

*13 December 2012*

## Written evidence from Future Capital Partners

Tax Avoidance Schemes

I would like to thank the Chair of the Public Accounts Committee (the "**Committee**"), as well all Committee Members, for inviting me to give evidence before them on 6 December 2012 on tax avoidance schemes. I have received a copy of the transcript from the hearing, which I have reviewed, and I would like to provide the Committee with some further information which I hope will clarify some questions and answers and ultimately be of assistance to the Committee in preparing its report.

Generally throughout this letter I will refer to specific questions asked, and answers given, at the hearing. However, it is important to first set out the background, which I believe requires clarification, and I therefore do so below.

### 1. Film Tax Relief

A common theme throughout the hearing was the film tax reliefs introduced by Government to encourage growth of the British film industry and the mechanisms by which such reliefs were given and such growth was achieved. In particular the Committee focused on sale and leaseback structures and the acquisition of completed films. There seemed to be some confusion concerning film tax reliefs, especially in relation to the acquisition of a completed film. During the hearing, owing to time constraints, I did not have the opportunity to explain film tax reliefs fully and so would like to take the opportunity to do so now.

Section 42 Finance Act 1992 ("**section 42**") introduced tax relief which was spread over 36 months for expenditure on the production and/or acquisition of British Qualifying Films. Section 48 Finance Act 1997 ("**section 48**") accelerated that tax relief to 100% in the period that the production and/or acquisition expenditure was incurred where the film had a cost of production of less than £15 million. The accelerated relief was introduced to encourage investment in and the growth of the British film industry. It is worth noting here that the tax reliefs introduced by both section 42 and section 48, and the mechanisms used to realise that relief, achieved their intended aim of substantially growing investment into the British film industry.

Between 1992 and 1997 banks used finance leases (sale and leaseback) to acquire completed British films and lease them back to the producer—effectively shifting the reliefs from the producer (who was unable to extract any value from the relief) to the acquirer (who was able to use the relief). The producer received the benefit of relatively cheap finance which it could use to make it easier to finance films and consequently grow its business by retaining more rights. These transactions were forerunners to partnership transactions with individuals. When the accelerated tax relief was introduced in 1997 a new market opened up of individuals looking to invest in film structures and access the tax relief—and with a higher marginal rate than corporates, the net economic benefit to the producer (ie cash benefit) selling to a partnership was higher than that from a bank.

When section 48 was introduced in 1997 HMRC, in an effort to clarify their practice, issued guidance notes known initially as Statements of Practice and later as Business Income Manuals. These prescriptively laid out, over a number of pages, in great detail, HMRC's understanding of how leasing transactions (ie the sale and leaseback of completed British films) involving individual investors would qualify for the statutory tax relief assuming they were structured in the manner described. They also set out other stipulations regarding the use and availability of these reliefs. Future, other promoters, investors and our respective advisers paid great attention to these guidance notes.

The growth in the popularity of partnerships, initially acquiring and then producing British qualifying films was astonishing. Our estimates were that by 2002, the total size of the market had grown to over £2 billion per annum in expenditure that qualified for either section 48 or section 42 relief (including bank transactions). These individually funded transactions generally followed very closely the form that was prescribed by HMRC in their Business Income Manuals; partners borrowed about 80% of their capital contributed to a partnership on full recourse terms, over a 15 year period; partnerships acquired from film producers completed films and leased them back to the same producer (or a related entity) with lease rentals fixed sufficient to allow the partnership to distribute income to partners that would discharge their loans and interest; the producer would place an amount very similar to that borrowed by partners on deposit with another bank (not the lending bank) that would issue a letter of credit in favour of the partnership, assigned as security to the lending bank. Typically the difference between the purchase price of the film and the amount placed on deposit was called the Net Benefit—and whilst in the early days of bank dominated film leases, this was probably about 2%—4% of the film's production cost—by the time the relief came to an end, this was up at 17%—20% of the production cost from individually funded partnerships. It was through the Net Benefit that film producers benefited, very substantially, from individually funded partnerships, as was intended. The reliefs thus had a material impact on the ability of producers to finance British qualifying films and thus achieved their intended purpose of growing investment into the British film industry. The sale and leaseback structure described above to access the film tax reliefs is explicitly set out in HMRC's Business Income Manual 56455 (attached).

Partners would benefit from the transaction as they would derive tax relief on almost 100% of their capital contributed to the trade; lease rental income would pay off the loan and interest; income that repaid principal would be taxed—but income used to pay interest would be offset by a deduction available on the interest paid. Cash on cash, over their lifetime, these transactions would be cashflow negative for investors—and absent other changes to commercial circumstances, would require the initial tax relief to generate a return (called a Hurdle Rate) to allow an investor to meet the deferred tax liability. These transactions simply deferred tax. Again, all of this was intended by the film tax relief legislation and recognised by HMRC in their Business Income Manuals.

The above is not intended to be a comprehensive commentary on statutory film reliefs. However, I hope that it assists the Committee in an area that I perceived there could have been some confusion.

2. Specific Questions

*Question 118 and 122*

The Chair asked that I talk the Committee through a sale and leaseback model (as described above) and referred to a partnership named Terra Nova. Terra Nova is not a sale and leaseback partnership and did not utilise the statutory film tax reliefs referred to above. Terra Nova provided film production services to a major US studio.

The Chair stated (question 122), and I will paraphrase, that Terra Nova exploited an important Government initiative to encourage more films to be created in the UK to get a tax advantage that Parliament never intended. That is not correct as Terra Nova did not utilise the statutory film reliefs introduced by Parliament. If the Chair was inferring that sale and leaseback transactions exploited the statutory film relief legislation in a way that Parliament never intended that is equally incorrect, and i refer to my fuller explanation above of these reliefs.

*Question 118 and 119*

The Chair asked whether Terra Nova had been "closed down" by HMRC. Terra Nova was not specifically "closed down" in the sense that that phrase might be taken to mean. Legislation was introduced in March 2007 that limited sideways loss relief for non-active partners ie partners who do not spend a significant amount of time carrying out activities for the purpose of the partnerships trade. The amendment to the legislation was not specifically directed at Terra Nova and was applicable to all partnerships which had non-active partners. Terra Nova itself was not affected by that legislation as it was a transaction that had been implemented in the previous year. However, the transaction could not have operated in the same way were it implemented after March 2007.

If the Chair was referring to the fact that HMRC have closed their enquiry, we made an application to the Special Commissioners (now the First-tier Tribunal) to direct HMRC to close their enquiry and issue a closure notice, because it was our view that HMRC were unnecessarily delaying the progress of the enquiry. The case is now being litigated with a hearing expected in the second half of 2013.

*Question 129, 130, 131, 132, 133*

This set of questions related to the acquisition of completed films. Specifically at question 132, Mr Bacon states "If the purpose of the legislation was to encourage the making of British films, as I understand it to have been, it sounds like within it there was the capacity to use the scheme to do things other than finance the making of British films." Please refer to my background comments regarding the statutory film reliefs above (ie section 1.). As stated, accessing statutory film reliefs through the acquisition of completed films via sale and leaseback transactions was a very important source of finance for British film production companies. Ultimately this enabled investment in the British film industry and allowed the production of many British films as was the intention of the legislation.

*Question 140, 141, 142, 143*

These were questions that all related to Jersey general partnerships. Specifically the Committee wanted to know why Jersey general partnerships were used. The Committee were concerned that in using a Jersey general partnership partners were not declaring all information to HMRC. This is not the case. The partnership tax returns that were submitted to HMRC contain the name, address, UTR and NI number for each partner. Furthermore, as I said at the hearing, the partners income tax returns would contain all of the details of their participation in the transaction. No information was disguised or withheld from HMRC. We provide HMRC, as a matter of course, with all the transaction documents in any transaction we promote. In the course of any HMRC enquiry we will also provide HMRC with thousands of e-mails and other correspondence. We are very open with HMRC and provide them with all the information they might need (often before there is any legal requirement for us to do so).

If the partnership is registered at Companies House, the partner's name and address would be available to the public and it is for this reason that partners want to preserve confidentiality.

*Question 175*

At question 175 the Chair mentioned what she termed "exit schemes" in reference to sale and leaseback transactions. During the hearing I tried to explain the commercial reasons that partners may want to leave partnerships such as their credit exposure to financial institutions such as Bank of Ireland. Other reasons include:

- films have performed badly in some cases and generated insufficient income to repay loans, for which investors are fully at risk;
- tax rates have increased from 40% to 52% (including NI);
- investment returns have plummeted making it a struggle to generate the Hurdle Rate;
- HMRC has taken a revisionist approach to these old transactions, **even structures based entirely and solely on their own Business Income Manuals**;
- laws have been changed retrospectively that affect, in some cases, these businesses or their partners; and
- a growing number of partners have left the UK, introducing risk to the non payment of tax by non UK resident partners—and HMRC's stated attempts to pursue the remaining members for that tax.

A number of these considerations can influence partners' behaviour and result in them wanting to take appropriate commercial steps to manage their risks.

*Question 238*

At question 238 the Chair says that the sole purpose of Eclipse Film Partners No.35 LLP ("**Eclipse 35**") was to avoid tax. With respect the Chair's statement is completely incorrect. The First-tier Tribunal found at paragraph 412 of its decision that Eclipse 35's paramount objective was not to procure a tax advantage; rather Eclipse 35's paramount objective was to obtain the returns inherent in the Distribution Agreement and what Eclipse 35 did is not to be characterised as a mere device to secure a tax advantage. As this case is subject to ongoing litigation, it is not appropriate to comment further.

*Question 241*

We currently have 255 investment vehicles (ie partnerships and companies) that we have promoted or are responsible for. These 255 investment vehicles fall within 12 types of structure including film sale and leaseback partnerships and enterprise investment schemes, etc.

I trust that this letter will be of assistance to the Committee when it writes its report. I also hope that it clarifies some issues where I perceived there could have been confusion.

*Tim Levy*
Director

*13 December 2012*

## Written evidence from Tax Trade Advisors Limited

I would like to thank the Committee for inviting me to give oral evidence on the subject of Tax avoidance: tackling marketed avoidance schemes, particularly our response to the recent report by the National Audit Office on "Tax Avoidance: tackling marketed avoidance schemes".

I was grateful for the recognition of my honesty in giving evidence to the Committee. I cannot emphasise enough that the structures we have promoted have always operated strictly within the law both in terms of specifically how they are implemented and also how they have been promoted.

Tax Trade Advisors' (TTA) role is the independent review of income tax structures in the market. Our aim is to provide clear and transparent explanations of the promoted product, the risks and timeframes clients can expect as well as the expected tax relief. We also aim to provide comprehensive support during the application process and for any subsequent HMRC correspondence until the scheme is concluded. TTA has never developed its own structures.

We consistently advise our clients to pay their taxes irrespective of the deduction they are claiming via their tax return. With the majority of our clients suffering tax at source via PAYE most clients will not see the benefits of a successful tax avoidance strategy until such time as that structure is either successful in the courts or whether an agreement is reached with HMRC. By adopting this approach, if a structure is successful the Treasury will be required to repay the taxes paid plus interest.

As I made clear in my evidence we accept that the legislation being relied upon is being used in a way that was not intended by Parliament, best summarised by Justice Henderson in 2007.

> *"In short, this is in my view one of those cases, which will inevitably occur from time to time in a tax system as complicated as ours, where a well-advised taxpayer has been able to take advantage of an unintended gap left by the interaction between two different sets of statutory provisions."*
>
> Justice Henderson, High Court—D'Arcy 2007

We should point out that whilst we have only been comfortable in promoting "pure" avoidance strategies disclosed under DOTAS, there is an active market of those who are happy to work in areas where there is already a Targeted Anti-Avoidance Rule (TAAR), for example share loss schemes and partnership sideways loss schemes. These promoters and their non-disclosed schemes will therefore arguably continue beyond the widely anticipated General Anti-Abuse Rule (GAAR). Such firms argue that the strategies they promote are commercial and provide investors with real upside opportunity where the downside is often protected by tax relief. Often the economic risk of those structures is limited to the costs/fees invested in them.

It may also be worth noting that, only this week a senior QC who specialises in tax avoidance has passed his own judgement on the draft GAAR published as part of the Finance Bill 2013, describing it as "good for business". He refers of course to the business of tax avoidance and my own view is that his comments reflect the complexity of the drafting of that GAAR and the inevitable "gaps" that are left behind.

This theme of complexity aiding tax avoidance is one which was touched on at the PAC meeting and also in the NAO report. There is little doubt in my mind that a simplification of the GAAR and generally as simplification of tax legislation as a whole, would reduce the ability of developers of tax schemes to "run rings" around HMRC as you described it.

The NAO report confirms that tax avoidance is legal, it often involves contrived transactions that serve little purpose other than to produce a tax advantage. However, it is often referred to by HMRC alongside (or interchangeably with) so called "acceptable tax planning", which again is not overly helpful if the idea is to brand one thing as acceptable and the other as unacceptable.

There is also the perception, which is well founded in my view, that HMRC do regarded all tax planning as unacceptable and have a tendency to go after anyone who makes any attempt to reduce their liability. For instance, in 2007 a couple who had set out on a new business venture (Arctic Systems) together and organised their business affairs so they were able to maximise their combined lower rate tax bands, resulting in a tax saving of £7,000. HMRC challenged them aggressively, and Mr & Mrs Jones were forced to take their argument all the way through the courts to the House of Lords before it was eventually accepted that they had done nothing wrong. HMRC branded their activity as tax avoidance, although interestingly the NAO report suggests this is now acceptable tax planning. All too often, the distinction between acceptable tax planning and tax avoidance is deliberately blurred by HMRC.

In summary, I believe the distinction between acceptable tax planning and tax avoidance is an extremely subjective area. On the one hand there is a DoTAS procedure that might suggest where the line should be drawn, yet on the other hand there are some firms taking a different view of whether a scheme is disclosable at all, whilst others take the opposite view and disclose everything in order to ensure that they are protected.

Clearly the space Tax Trade Advisors occupies is the promotion of tax avoidance strategies and we therefore know exactly what is required to comply with the regulations but those who argue their schemes/strategies are not tax avoidance may well be falling foul of their requirements not least the requirement to comply with DOTAS.

Finally, to clarify a point raised by Nick Smith MP, I would like to make it clear that it is not illegal to promote, or to participate in, a tax avoidance scheme provided that HMRC's DOTAS regulations are met (a responsibility we and those we work with take very seriously—we never have and never will promote a structure which seeks to stay out of the scope of DOTAS). The amendments in legislation which subsequently block disclosed tax avoidance schemes do not render the transactions illegal, but they do remove the tax benefit, which is the reason that a particular scheme would then cease to be promoted. There is nothing illegal about entering into the same transactions that were entered into prior to that change in the law; the only certainty is that the particular tax relief at the heart of the arrangement will no longer be available. We therefore wish to categorically state that our clients never have and never will be promoted any "illegal scheme" via Tax Trade.

Answers to Questions

I was specifically asked by the Committee for the name of the arrangement we promoted whose promotion was governed by the FSA rules on promotion. Having now checked the terms of the Non-Disclosure Agreement that binds my firm, I am able to confirm that the structure was called "The First De Sales Limited Partnership", an exempt Limited Partnership registered in the Cayman Islands.

With reference to the "Working Wheels" structure, Nick Smith MP asked how many clients used it and what we made from it. As an introducer, and not the developer, I can only advise how many of our clients used the structure which was 60. The structure was implemented between March 2007 and December 2007, our accounts are prepared to 31 July each year and filed on Companies House. Our net profit for those two years was £59,000 and £305,000 respectively.

*Aidan James*
Managing Director

*14 December 2012*

## Supplementary written evidence from HM Revenue and Customs

Q358 Stephen Barclay MP to Jim Harra:

*In relation to the DOTAS regime, could you provide a breakdown of the various components and a figure for each component for each year between 2004–2010?*

1. £12.5 billion represents the aggregate amount of additional forecast tax yield as a result of blocking off avoidance loopholes in legislation from Finance Act 2005 to Finance Act 2010 inclusive.

2. The forecast yield from particular measures is set out at the Budget or other fiscal events, such as the Autumn Statement, that introduces each measure.

3. Full details of the anti-avoidance measure forecasts are attached at Appendix A.

4. Jim Harra explained in his evidence to the Committee on 6 December that the figure needs to be used with care (answer to question 355—copied below):

> ***Jim Harra:*** *I think some care needs to be used with that figure. If you look at all the legislative measures that have been made in response to it and you look at the revenue protected by those and total that, it will come to £12.5 billion. There is quite a strong argument for saying that, to some extent, you are chasing the same money all the time, because if it is the same avoiders moving from scheme to scheme and you are blocking them, you cannot add all of that up and say that that is all additional money. It is the totality of the revenue protected from all those measures.*

## APPENDIX A

SUMMARY OF FORECAST YIELD FOR ANTI AVOIDANCE MEASURES BY FINANCE ACT

FA 2005

| *Finance Act* | *Brief Description of Measure* | *£ Million 2005–06 indexed* | *£ Million 2006–07 indexed* | *£ Million 2007–08 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|
| 2005 | Remuneration | 500 | 500 | 500 | 1,500 |
| 2005 | Controlled Foreign Companies regime | 30 | 50 | 80 | 160 |
| 2005 | Double tax relief | 145 | 200 | 200 | 545 |
| 2005 | Loans and financial instruments | 115 | 150 | 150 | 415 |
| 2005 | Capital gains | 0 | 70 | 105 | 175 |
| 2005 | Financial products | 280 | 430 | 430 | 1,140 |
| 2005 | Double tax relief | 130 | 200 | 200 | 530 |
| 2005 | Arbitrage | 130 | 200 | 200 | 530 |

| *Finance Act* | *Brief Description of Measure* | *£ Million 2005–06 indexed* | *£ Million 2006–07 indexed* | *£ Million 2007–08 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|
| 2005 | Intangible assets | 15 | 25 | 25 | 65 |
| 2005 | Total | 1345 | 1825 | 1890 | 5,060 |

FA 2006

| *Finance Act* | *Brief Description of Measure* | *£ Million 2006–07 indexed* | *£ Million 2007–08 indexed* | *£ Million 2008–09 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|
| 2006 | Financial: stock lending arrangements | 30 | 30 | 30 | 90 |
| 2006 | Capital gains: capital redemption policies | 35 | 100 | 75 | 210 |
| 2006 | Financial products avoidance | 125 | 135 | 100 | 360 |
| 2006 | CGT | 0 | 40 | 35 | 75 |
| 2006 | Employment related securities | 70 | 65 | 45 | 180 |
| 2006 | Life assurance companies | 115 | 85 | 85 | 285 |
| 2006 | Total | 375 | 455 | 370 | 1,200 |

FA 2007

| *Finance Act* | *Brief Description of Measure* | *£ Million 2007–08 indexed* | *£ Million 2008–09 indexed* | *£ Million 2009–10 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|
| 2007 | Controlled Foreign Companies Rules: Repeal of Public Quotation Exemption | 125 | 160 | 160 | 445 |
| 2007 | Countering corporation tax avoidance | 180 | 195 | 195 | 570 |
| 2007 | Tackling avoidance using structured finance arrangements | 15 | 15 | 15 | 45 |
| 2007 | Double taxation relief—amendment | 0 | 0 | 0 | — |
| 2007 | Stamp Duty Land Tax anti-avoidance | 75 | 70 | 70 | 215 |
| 2007 | Countering CGT avoidance | 70 | 130 | 120 | 320 |
| 2007 | Loss buying | 30 | 45 | 50 | 125 |
| 2007 | Lloyd's corporate members: restriction of group relief | 0 | 0 | 0 | — |
| 2007 | Life insurance companies: financing arrangements | 120 | 165 | 165 | 450 |
| 2007 | Employee benefit trusts (EBTs)—closure of an avoidance scheme | 0 | 0 | 0 | - |
| 2007 | Tackling Managed Service Companies | 350 | 450 | 250 | 1,050 |
| 2007 | Countering avoidance by financial traders | 30 | 45 | 50 | 125 |
| 2007 | Avoidance by partnerships using sideways loss relief | 400 | 300 | 60 | 760 |
| 2007 | Sale of lessor companies anti-avoidance | 0 | 0 | 0 | — |
| 2007 | Total | 1395 | 1575 | 1135 | 4,105 |

FA 2008

| *Finance Act* | *Brief Description of Measure* | *£ Million 2008–09 indexed* | *£ Million 2009–10 indexed* | *£ Million 2010–11 indexed* | *£ Million 2011–12 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|---|
| 2008 | Individuals paying interest in advance: Restriction of loss relief | 25 | 10 | 0 | 0 | 35 |
| 2008 | Leased plant & machinery | 0 | 0 | 0 | 0 | — |
| 2008 | Corporation Tax—Disguised interest | 0 | 0 | 0 | 0 | — |
| 2008 | Life insurance Companies: Expenses relating to reinsurance arrangements‡ | 0 | 20 | 30 | 30 | 80 |
| 2008 | Industrial and Agricultural Buildings Allowance | 0 | 0 | 0 | 0 | — |
| 2008 | Leased plant & machinery | 0 | 0 | 0 | 0 | — |
| 2008 | Disguising interest | 0 | 55 | 120 | 105 | 280 |
| 2008 | Controlled foreign companies | 0 | 150 | 150 | 100 | 400 |
| 2008 | Stamp duty land tax: group relief | 0 | 10 | 10 | 10 | 30 |
| 2008 | Stamp duty land tax: alternative finance | 0 | 5 | * | * | 5 |

| *Finance Act* | *Brief Description of Measure* | *£ Million 2008–09 indexed* | *£ Million 2009–10 indexed* | *£ Million 2010–11 indexed* | *£ Million 2011–12 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|---|
| 2008 | Sideways loss relief | 0 | 25 | 40 | 15 | 80 |
| 2008 | Manufactured payments | 0 | 0 | 0 | 0 | — |
| 2008 | Double taxation treaties—treaty abuse | 0 | 200 | 40 | 30 | 270 |
| 2008 | Residence & domicile: changes for employment-related securities | 0 | 0 | 0 | 0 | - |
| 2008 | Total | 25 | 475 | 390 | 290 | 1,180 |

FA 2009

| *Finance Act* | *Brief Description of Measure* | *£ Million 2009–10 indexed* | *£ Million 2010–11 indexed* | *£ Million 2011–12 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|
| 2009 | Loan relationships—principles based measure | 0 | 0 | 0 | — |
| 2009 | Interest relief exploitation | 50 | 0 | 0 | 50 |
| 2009 | FOREX matching targeted anti-avoidance | 20 | 20 | 20 | 60 |
| 2009 | Plant & Machinery leasing avoidance | 0 | 0 | 0 | — |
| 2009 | Double taxation relief (DTR) avoidance involving repayment of foreign tax | 100 | 100 | 200 | 400 |
| 2009 | Terminal loss relief | | | | — |
| 2009 | Enhance tax avoidance disclosure regime | 10 | 15 | 10 | 35 |
| 2009 | Sub-total | 180 | 135 | 230 | 545 |

FA 2010

| *Finance Act* | *Brief Description of Measure* | *£ Million 2010–11 indexed* | *£ Million 2011–12 indexed* | *£ Million 2012–13 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|
| 2010 | Financial Products Avoidance—Unauthorised unit trusts | 100 | 100 | 50 | 250 |
| 2010 | Financial Products Avoidance—DTR using MODs | 0 | 75 | 80 | 155 |
| 2010 | Financial Products avoidance—manufactured interest [not Fin Bill] | 0 | 0 | 0 | — |
| 2010 | Financial Products avoidance—index-linked gilts | 40 | 65 | 40 | 145 |
| 2010 | Release of loans to participators | 15 | 15 | 15 | 45 |
| 2010 | Plant and machinery—anti-avoidance [a Rev Prot measure] | 0 | 0 | 0 | — |
| 2010 | Sale of Lessor Companies—Consortium Arrangements | 0 | 0 | 0 | — |
| 2010 | Share Incentive Plans | 20 | 20 | 20 | 60 |
| 2010 | Avoidance based on use of sideways loss relief | 0 | 0 | 0 | — |
| 2010 | Terminal loss relief (costings only) | 0 | 0 | 0 | — |
| 2010 | Gifts of qualifying investments to charities | 15 | 15 | 15 | 45 |
| 2010 | Reduce opportunities for undesirable SDLT tax planning involving partnerships. | 0 | 0 | 0 | — |
| 2010 | Total | 190 | 290 | 220 | 700 |
| F(2)A 10 | Derecognition of income flows (loan relationships) | 0 | 0 | 0 | — |
| F(2)A 10 | Avoidance using Authorised Investment Funds (AIFs) | 0 | 0 | 0 | — |
| F(2)A 10 | Total | 0 | 0 | 0 | — |
| F(3)A 10 | Life insurance companies (amendment to F(No 2)B 2010) | 0 | 0 | 0 | — |

| | | | | | |
|---|---|---|---|---|---|
| F(3)A 10 | Consortium relief | 0 | 0 | 0 | — |
| F(3)A 10 | Total | 0 | 0 | 0 | — |

FA 2011

| *Finance Act* | *Brief Description of Measure* | *£ Million 2011–12 indexed* | *£ Million 2012–13 indexed* | *£ Million 2013–14 indexed* | *£ Million 2014–15 indexed* | *£ Million 2015–16 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|---|---|
| 2011 | Group mismatch—interim & generic measures. | 0 | 0 | 0 | 0 | 0 | — |
| 2011 | Disguised remuneration generic & anti forestalling | 750 | 760 | 730 | 770 | 760 | 3,770 |
| 2011 | Derecognition | 0 | 0 | 0 | 0 | 0 | — |
| 2011 | Functional currency (countering avoidance by investment companies) | 60 | 60 | 60 | 60 | 60 | 300 |
| 2011 | Sale of lessor companies—preventing avoidance | 25 | 20 | 20 | 15 | 15 | 95 |
| 2011 | SDLT anti-avoidance | 30 | 30 | 40 | 40 | 50 | 190 |
| 2011 | Plant & Machinery leasing: anti-avoidance | 80 | 130 | 130 | 120 | 120 | 580 |
| 2011 | Substantial donors to charities | -10 | -10 | -10 | -10 | -10 | 50 |
| 2011 | Total | 935 | 990 | 970 | 995 | 995 | 4,885 |

FA 2012

| *Finance Act* | *Brief Description of Measure* | *£ Million 2012–13 indexed* | *£ Million 2013–14 indexed* | *£ Million 2014–15 indexed* | *£ Million 2015–16 indexed* | *£ Million 2016–17 indexed* | *Sub total (£m)* |
|---|---|---|---|---|---|---|---|
| 2012 | Life Insurance—earlier gains avoidance | 0 | 0 | 0 | 0 | 0 | — |
| 2012 | Changes to the Disregard Regulations | 0 | 0 | 0 | 0 | 0 | — |
| 2012 | SDLT Sub-sales avoidance | neg | neg | neg | neg | neg | — |
| 2012 | EU Reasoned Opinion—Section 13 | | | | | | — |
| 2012 | IHT Avoidance: Interests in Offshore Trusts | neg | 0 | 0 | 0 | 0 | — |
| 2012 | Inheritance tax & spouse relief | 0 | neg | -5 | -5 | -5 | —15 |
| 2012 | IHT avoidance: settlor interested trusts | 0 | 15 | 10 | 10 | 10 | 45 |
| 2012 | Tax avoidance: Manufactured Overseas Dividends | 30 | 40 | 40 | 40 | 40 | 190 |
| 2012 | Plant and machinery leasing | 25 | 40 | 40 | 35 | 35 | 175 |
| 2012 | Sale of lessor companies—protecting revenue | 0 | 0 | 0 | 0 | 0 | — |
| 2012 | Debt buybacks | 395 | 210 | 55 | 0 | 0 | 660 |
| 2012 | Property Income Sideways Loss relief | 0 | 0 | 0 | 0 | 0 | — |
| 2012 | Higher rate for corp bodies purchasing residential | neg | 65 | 65 | 65 | 75 | 270 |
| 2012 | Retrospective SDLT anti-avoidance | statement | | | | | — |
| 2012 | Review of high risk areas of the tax code: taxation | Consultation | | | | | — |
| 2012 | Review of high risk areas of the tax code | Consultation | | | | | — |
| 2012 | SDLT non-legislative anti-avoidance measures | Operational response | | | | | — |
| 2012 | Anti-avoidance—corporate investors in Authorised | 0 | 0 | 0 | 0 | 0 | — |
| 2012 | SDLT avoidance sub-sale scheme consultation | Consultation | | | | | — |
| 2012 | CGT Change to anti-avoidance rules | 0 | neg | neg | neg | -5 | —5 |
| 2012 | Total | 450 | 370 | 205 | 145 | 150 | 1,320 |

Yearly Totals

| *Finance Act* | | *£ Million 2005–06 indexed* | *£ Million 2006–07 indexed* | *£ Million 2007–08 indexed* | *£ Million 2008–09 indexed* | *£ Million 2009–10 indexed* | *£ Million 2010–11 indexed* | *£ Million 2011–12 indexed* | *£ Million 2012–13 indexed* | *£ Million 2013–14 indexed* | *£ Million 2014–15 indexed* | *£ Million 2015–16 indexed* | *£ Million 2016–17 indexed* | *Total (£m)* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2005 | Sub-total | 1345 | 1825 | 1890 | | | | | | | | | | 5,060 |
| 2006 | Sub-total | | 375 | 455 | 370 | | | | | | | | | 1,200 |
| 2007 | Sub-total | | | 1395 | 1575 | 1135 | | | | | | | | 4,105 |
| 2008 | Sub-total | | | | 25 | 475 | 390 | 290 | | | | | | 1,180 |
| 2009 | Sub-total | | | | | 180 | 135 | 230 | | | | | | 545 |
| 2010 | Sub-total | | | | | | 190 | 290 | 220 | | | | | 700 |
| F(2)A 10 | Sub-total | | | | | | 0 | 0 | 0 | 0 | 0 | | | — |
| F(3)A 10 | Sub-total | | | | | | 0 | 0 | 0 | 0 | 0 | | | — |
| Cumulative Total 2005—2010 = | | | | | | | | | | | | | | 12,790 |
| 2011 | Sub-total | | | | | | | 935 | 990 | 970 | 995 | 995 | | 4,885 |
| 2012 | Sub-total | | | | | | | | 450 | 370 | 205 | 145 | 150 | 1,320 |

*Q371: Chair to Lin Homer: Personal Service Companies*

As previously discussed, HMRC has strengthened its specialist compliance teams to more effectively address the use of personal service companies to disguise what would otherwise be an employment relationship. These teams focus on the enforcement of the intermediaries legislation, commonly referred to as IR35, ensuring that there is no tax lost in these types of arrangements. The legislation does not outlaw the use of personal service companies as they are often legitimate commercial arrangements.

Separately, the department undertakes work with end user/clients of labour to encourage them to undertake due diligence tests to ensure the validity of the supply chain. HMRC makes sure that big businesses are aware of the potential financial and reputational risks that may arise if they have not ensured their supply chain and it is found that they are engaging a company that is involved in avoidance.

As many of these arrangements involve legitimate commercial arrangements, it is beyond the remit of HMRC to be able to tell businesses that they should not enter into them, or encourage their use if appropriate. HMRC will offer advice on the tax consequences for businesses of the decisions they make.

*Lin Homer*
Permanent Secretary

*17 December 2012*

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