



HM Revenue  
& Customs

# Tax Avoidance involving Profit Fragmentation

**Summary of Responses**  
6 July 2018

# Contents

1	Executive Summary	3
2	Introduction	4
3	Responses	5
4	Next steps	14
5	List of stakeholders consulted	15

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# 1. Executive Summary

- 1.1. Following announcement at Autumn Budget 2017, the government proposes to introduce new legislation to tackle tax avoidance involving fragmentation of business profits.
- 1.2. These changes will add to current rules, providing legislation that will specifically target this type of avoidance.
- 1.3. Draft legislation is published alongside this response document.
- 1.4. The government is grateful for the engagement of stakeholders in this consultation. Following publication of this response there will be a period of further technical consultation on the legislation. The changes will be finalised for Finance Bill 2018-19 and are planned to come into effect from April 2019.

## 2. Introduction

### Background

- 2.1. On 10 April 2018 the government published a consultation document seeking views on proposed rules to tackle tax avoidance involving fragmentation of business profits.
- 2.2. The arrangements typically involve some or all of the profits of a UK business being moved to an offshore entity where nil or very little tax is paid - this is often an offshore company owned by an offshore trust. Typically the UK trader is not a settlor or trustee of that trust, and in some cases is said to be excluded from benefitting from the trust assets. However, there will often be some means by which those amounts will, or may, accrue to persons who have links to the UK trader.
- 2.3. The proposed new rules work by applying a number of tests which consider whether profits have been fragmented and diverted outside a UK tax charge. The proposals also included rules requiring notification of arrangements that are potentially in scope, and for early payment of the tax involved.
- 2.4. The consultation document set out the proposed rules and asked a series of specific questions about the proposed rules and how they would work.

### Overview of responses received

- 2.5. The consultation had 16 responses, mainly from the advisory profession and representative bodies. Officials from HMRC also met with a number of stakeholders. Annex A contains a list of stakeholders who responded or who met with HMRC.
- 2.6. Respondents agreed that this type of arrangement is unacceptable and should be prevented and counteracted. However, respondents expressed some concerns about the specific design of the proposed legislation.
- 2.7. There were particular concerns about the proposals for notification and advance payment.
- 2.8. The responses to the consultation and the government's comments are presented in the following chapter.

## 3. Responses

3.1. This chapter gives details of the responses received to the proposals set out in the consultation document.

### General approach

3.2. The consultation set out conditions that characterise the avoidance, and which, if present, would trigger the application of the legislation:

- There are profits attributable to the professional or trading skills of an individual (A) resident in the UK, whether A is trading as an individual or a partner, or conducting business through a company;
- Some or all of those profits (“alienated profits”) end up in an entity Z which results in significantly less tax being paid on them than would have been paid had they arisen to A. An “entity” for these purposes would be interpreted widely, and would include a company, partnership or trust, whether or not having legal personality;
- A, or a connected person, or someone acting together with A or the connected person, is able to enjoy economic benefits from the alienated profits; and
- It must be reasonable to conclude that some or all of the profit of the offshore entity is excessive having regard to the profit-making functions that it performs (that is, the offshore entity has insufficient substance to earn the contended profits).

3.3. The consultation raised the following questions about the general approach.

**Question 1: The government would welcome any evidence and information about these and similar arrangements to assist it in designing legislation that is properly targeted and does not bear inappropriately on businesses that pay all the taxes due in the UK.**

**Question 2: The government would welcome comments on whether any additional conditions are required to ensure that the approach set out above is effective and robust.**

**Question 3: Will the proposed conditions allow most businesses to decide quickly and simply whether or not they are caught by the legislation?**

3.4. Respondents agreed that these arrangements are unacceptable and should be tackled. However, respondents questioned the need for further legislation, pointing to a range of existing anti-avoidance rules that could be deployed against these arrangements. In particular, respondents mentioned the Transfer

of Assets Abroad legislation, transfer pricing, Information and Inspection Powers, and the General Anti-Abuse Rule.

- 3.5. Respondents were concerned that the conditions appear to be widely drawn and argued that the proposals would add a further layer of complexity to the legislation. This would make it more difficult for taxpayers to satisfy themselves that they are fully compliant.
- 3.6. Respondents were concerned to ensure that legitimate businesses could satisfy themselves quickly and simply that they are not affected by the new rules – there was a suggestion of including a motive test.
- 3.7. Respondents were concerned about the terms used in the consultation such as “skills of an individual”, or the subjective proposals such as “reasonable to believe”. They commented that these could be difficult to interpret and apply with certainty.
- 3.8. Respondents recommended that HMRC provide guidance to offer clarity to compliant taxpayers – this needs to be published in a timely manner.

## Government response

- 3.9. The need for further legislation is based on HMRC experience in applying current legislation against this type of arrangement. Some rules (such as transfer pricing) do not apply to the businesses involved in these arrangements, and the arrangements are often formulated to make current legislation difficult to apply. Based on HMRC’s experience, the government considers that further legislation is necessary.
- 3.10. The government will ensure that the legislation is focussed on arrangements that seek to obtain a tax advantage. This will not reduce the application of the rules to avoidance arrangements but will enable compliant businesses to satisfy themselves that they are not affected more easily.
- 3.11. The government will look at alternatives to the “skills of an individual” test that will deliver the same outcome but in a more easily applicable manner.
- 3.12. The government will publish detailed guidance on gov.uk in advance of the changes coming into effect in April 2019.

## “Significantly less tax” condition

- 3.13. The consultation set out the proposals for the “significantly less tax” test condition. This would involve a comparison with real rates of tax suffered on the alienated profits, rather than headline rates. This means that if, for example, any special rules or individual rulings apply in the other jurisdiction they will be taken into account in the comparison.
- 3.14. The consultation set out the following questions.

**Question 4: Will this test of a lower rate of tax be effective?**

**Question 5: Are there any alternatives which should be considered?**

**Question 6: The government would welcome views on any genuine activities carried on in low tax territories which might require special consideration.**

- 3.15. Respondents were concerned that business activities are often carried on from low tax territories for non-tax reasons, for example financial regulation reasons. Further to this, some respondents were concerned that the indicative percentage (80%) included in the “significantly less tax” condition should be lowered to avoid the notification requirement applying to legitimate business operations. They argued that the structure of the proposal means that a business could potentially be caught even if it has allocated its profits between jurisdictions in a proper and accurate manner.
- 3.16. Respondents wanted to ensure that the test was “like for like”, and raised concerns about a comparison being made between, for example, the different rates charged on UK individuals and overseas companies. That is, if the UK trading entity is a company the respondents’ view is that the comparison should be with the rate of UK corporation tax that should be payable on the profits involved.
- 3.17. One alternative suggested was to use a list of territories such that only businesses located in a territory on the list would be within scope.

## Government response

- 3.18. The government will ensure that the legislation reflects that the measure of profits in the comparison is the profit after all applicable UK rules have been taken into account – for example, where transfer pricing has been properly applied.
- 3.19. The government confirms that “like for like” comparisons will be used. If the profits are correctly attributable to a UK company the additional profits brought into charge by this measure will be taxed at the UK corporation tax rate.
- 3.20. The government notes the comments regarding a list of excluded territories. The types of arrangement involved do not always involve territories with particular tax characteristics. Therefore, a list-based approach may not ensure that these arrangements are dealt with fully.

## Excessive profits and substance

- 3.21. This condition looks at whether the personal connection between the relevant individual and the offshore entity results in excess profits being attributed to the

latter in order to minimise tax. The following question was set out in the consultation.

**Question 7: Any comments on this excessive profits test would be welcome.**

3.22. Respondents welcomed the Government’s intention to recognise that genuine activities by offshore entities which are not abusive should not be caught by these proposals.

3.23. Respondents expressed concern about measuring “excess profit”. In particular, respondents were concerned to ensure that the excess profit should be the excess remaining after other applicable UK legislation has been applied.

**Government response**

3.24. The government agrees and will ensure that “excess profits” are measured in the manner suggested.

**Power to enjoy**

3.25. Another condition for the new legislation to apply will be that UK profits are moved to an entity to which the UK individual or company concerned has a form of connection. However, it may not always be clear that the form of connection is formally covered by existing tax legislation. The government therefore intends, for the purposes of the new legislation, to apply wider rules which will apply when UK profits are being alienated.

3.26. The following questions were set out in the consultation.

**Question 8: Is the use of “power to enjoy” as a test the best way of addressing these schemes?**

**Question 9: Will the “power to enjoy” rules catch all likely targets?**

**Question 10: Will they risk bringing in arrangements where no tax avoidance is involved?**

3.27. Some respondents were concerned that the proposed rules are drawn too widely. In particular they consider that the potential range of connected persons is too wide.

3.28. Respondents were also concerned that the term “may become entitled” is too wide in cases where a trust has wide discretion. This could extend the potential beneficiaries well beyond the intended scope of the legislation.

3.29. A suggestion was made that the application to connected persons should only be in cases where the situation arose intentionally.

3.30. Respondents requested that the government require that there is a clearly defined link between the UK individual and the offshore entity to avoid catching genuine third party transactions such as banking, insurance or leasing, which could be caught by the proposed rules. It was suggested that the genuine commercial activities of the offshore entity be excluded from being caught by the rules.

### Government response

3.31. The government notes the concerns regarding the “power to enjoy” conditions and will consider them further with a view to ensuring that they deliver the intended outcome. Clear guidance will be published in advance of the changes coming into effect.

### Acting together

3.32. The proposed legislation aims to address situations where individuals or companies effectively follow the instructions of another person, whether or not there is a strict legal arrangement providing that this is the case. It will involve looking at all the circumstances, and in particular whether the alienation of profits that occurs would happen in a genuine commercial arrangement.

### **Question 11: The government would welcome comments as to whether this connection test is appropriate.**

3.33. One response suggested that this test is too wide and should be limited only to cases where an individual does exercise effective control as opposed to situations where they could do so.

### Government response

3.34. The government will review this test in developing the legislation to ensure that it achieves the stated objective and does not go further and draw in arrangements and relationships that should not be affected.

### Procurer of arrangements

3.35. The consultation also proposed that the connection rules should apply to someone with a UK business, who has arranged or directed that payments should be made to the offshore entity involved in the arrangements, or in other words that they “procured” the arrangements or payments. In these circumstances, the UK person will be deemed to be connected with the entity receiving the payments.

### **Question 12: Will this connection rule bring in any arrangements where avoidance is not involved?**

### **Question 13: Do you have any other comments on this proposed rule?**

- 3.36. Respondents commented that the legislation should ensure that an independent offshore entity is not brought within scope of this rule simply by being part of commercial arrangements to supply services overseas.
- 3.37. One respondent suggested that taxpayers be given protection by the inclusion of an explanation of its purpose early within the proposed legislation, whereby a Tribunal can adjudicate if HMRC unfairly targets a taxpayer in a situation where no tax evasion or aggressive tax avoidance is involved.

## Government response

- 3.38. The government is grateful for these comments. The government proposes to model these rules on existing legislation that serves a similar function in other parts of the tax code.

## Preventing double taxation

- 3.39. Where the amounts potentially brought into charge under the new legislation are also subject to UK tax under other provisions, there will be provisions to prevent double taxation, whether to income tax or corporation tax.
- 3.40. Existing anti-avoidance legislation would generally take priority over this legislation. If any other anti-avoidance legislation, e.g. Transfer of Assets Abroad, applies in the same tax year or accounting period, then that will take priority.

### **Question 14: What potential double taxation should be taken into account in the legislation?**

### **Question 15: Any comments on interaction with other anti-avoidance legislation would be welcome**

- 3.41. Respondents were concerned to ensure that there are effective rules to prevent tax being charged twice on the same income, particularly where income may be charged in different periods in different territories.
- 3.42. Respondents were concerned to ensure that the rules prevented a penalty being charged where a penalty already arises in other anti-avoidance legislation.

## Government response

- 3.43. The government acknowledges these concerns and will ensure that the double taxation provisions ensure that income that is fully taxed in the UK is not brought into charge again.

## Notification and payment of tax

- 3.44. The consultation set out proposals to require a taxpayer who enters into arrangements of this sort to notify HMRC, and to require payment of any tax

shown on a relevant charging notice to remove the cash flow advantage that would otherwise arise from using those arrangements. The notification requirement would deliberately be set wider than the conditions required to bring sums into charge, to allow HMRC to examine cases where there is room for doubt over whether the new provisions apply or not.

**Question 16: The government would welcome comments on the features which should be included in the notification requirements.**

- 3.45. Respondents were concerned that the proposed notification rules were drawn too widely and would draw many compliant businesses into the requirement to notify, and would require many more to at least consider whether they should notify.
- 3.46. Respondents were particularly concerned in cases where the “substance” test would clearly indicate that profits had been allocated correctly.
- 3.47. A suggestion was made to include the option for taxpayers to obtain an advanced clearance for condition four, so to avoid the need for notification if clearance was given.
- 3.48. One response suggested that the DOTAS hallmarks should be expanded to encompass this type of arrangement.

### Government response

- 3.49. The government notes these concerns. The proposal was designed to remove as far as possible subjective judgements from the conditions for notification. The government will therefore consider additional objective conditions that might be put in place to remove as many compliant taxpayers from the potential requirement to notify as possible, but without affecting the scope of the legislation in its application to fragmented profits.
- 3.50. The consultation proposed excluding from the notification requirement any arrangements that have been notified under DOTAS. On reviewing this proposal the Government has concluded that this exclusion would not have any significant impact on compliance burdens and has therefore decided that notification will be required under these rules even if notification is also required under DOTAS.
- 3.51. The measure aims to tackle arrangements that vary considerably and are often designed specifically for the business. Therefore, the government considers that the most appropriate way to ensure compliance with the new rules is to place a targeted requirement on each taxpayer to notify potential liability under the new rules.

### Payment of tax

- 3.52. The consultation proposed that if HMRC has reason to believe that an amount is chargeable under the new rules, then HMRC will issue a preliminary notice

explaining the reasons for a proposed charge and the basis on which it has been computed. The taxpayer would then have a period of 30 days to make submissions that may result in HMRC changing its view. If HMRC considers that a charge is still due (which may differ from that set out in the preliminary notice) it may issue a charging notice, which will require payment of tax and be followed by a review period during which the charge may be adjusted.

**Question 17: The government would welcome comments on these proposals for payment of tax for users of these arrangements.**

**Question 18: Are there any conditions in particular which might impose onerous reporting burdens on companies not involved in avoidance?**

- 3.53. Respondents raised significant concerns about this proposal. These included the concern that there could be considerable uncertainty about the amount to be charged, which would in effect require almost a full enquiry process to establish the correct position.
- 3.54. Respondents were also concerned that given the breadth of the notification rules, compliant businesses could face an early payment requirement in cases where it would be unlikely that there would be additional tax to pay.
- 3.55. Respondents were also concerned that some taxpayers may not be able to pay if they do not have access or the right to the funds of the trust.
- 3.56. Another concern raised was that the 30-day period for taxpayers to make submissions against preliminary notices were fairly short. A suggestion was made to bring this in line with the 90-day period given under section 222 of the Finance Act 2014.

## Government response

- 3.57. The government acknowledges these concerns. The government has decided to postpone this part of the proposal. The government will monitor compliance with these rules and will keep the requirement for an early payment rule under review.

## Alternative approach

**Question 19: Views would be welcome on whether there are alternative approaches to preventing the avoidance without affecting genuine commercial arrangements.**

- 3.58. Respondents suggested that the government should consider using existing legislation to combat these arrangements, or alternatively should look to extend the scope of existing rules such as the Transfer of Assets Abroad rules.

## Government response

- 3.59. The need for further legislation is based on HMRC experience in applying current legislation against this type of arrangement.

## Other issues

### **Question 20: Are there any other considerations that the government should take into account when considering the design of this legislation?**

- 3.60. Respondents suggested that the government need to consider this legislation in line with the OECD Base Erosion and Profit Sharing reports.

## Government response

- 3.61. The government notes this concern and believes that the proposals are consistent with the reports on the basis that they seek to align taxation and genuine business substance.

## Impact assessment

### **Question 21: Do you have any comments on the assessment of equality and other impacts?**

- 3.62. One response commented that the estimated increased Exchequer revenue seemed relatively low and that given the complexity involved further thought should be given to the application of existing legislation.

## Government response

- 3.63. The government notes this comment. The government considers that these avoidance arrangements need to be tackled. In addition to the direct effect the government expects there to be an indirect effect of reducing potential avoidance behaviour.

## 4. Next steps

- 4.1. The government is grateful to all the respondents to the consultation who gave their time to provide their views and suggestions.
- 4.2. The government will consider the responses and suggestions put forward. Following publication of this response there will be a period of further technical consultation on the legislation. The changes will be finalised for Finance Bill 2018-19 and are planned to come into effect from April 2019.

## Annex A: List of stakeholders consulted

Association of Accounting Technicians  
Association of Taxation Technicians  
The British Private Equity & Venture Capital Association  
The Charity Law Association Standing Committee on Taxation  
The Chartered Institute of Taxation  
Deloitte LLP  
Ernst and Young LLP  
Grant Thornton UK LLP  
KPMG  
Institute of Chartered Accountants in England and Wales  
The Law Society of England and Wales  
Macfarlanes LLP  
Mazars LLP  
Moore Stephens LLP  
Pinsent Masons LLP  
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