A man at the golf club told me about this tax scheme …..

Many of us have been told at one time or another how easy it is to save tax. With all the publicity around the "Jimmy Carr" scenario and a lot of misinformation published in the national newspapers, let's consider this a little more..

Tax planning can fall into several categories, including:

a) Legitimate tax planning to avoid exposure to unnecessary taxes
b) Legitimate means of deferring tax liabilities but ultimately not avoiding tax
c) Complex tax schemes, often expensive to operate, and which are legal but seek to benefit from loopholes in tax legislation.
d) Illegal tax evasion schemes or fraudulent mis-declaration.

No one should consider d) at any time. This is illegal tax evasion. It is a criminal offence and the consequences are large fines and penalties and/or imprisonment.

Planning under a) should be available from all good tax advisers.

Planning under b) is valuable, but sometimes is made to sound better than it really is. Tax is validly deferred but ultimately it is still payable to HMRC.

The Jimmy Carr scheme fell into category c). It sought to avoid tax by using an offshore company to receive income which then advanced the money to the comedian in the form of a loan which the offshore company could require to be repaid (but no doubt the loan would never be repaid). It is argued that funds received in the form of these repayable loans are not UK taxable income hence minimal, if any, UK tax is payable.

So why shouldn't we all use schemes like this under category c) ? Let me suggest a few things you should consider before proceeding:

IS IT LEGAL ?

The Jimmy Carr scheme had been considered by tax counsel who view it as legal. This means it does not fall into category d) and hence is not deemed tax evasion, which is illegal and is a criminal offence. Note that the penalties for tax evasion are very heavy fines and the possibility of imprisonment so it is important to ensure the scheme is legal before even considering using it. However being "legal" is not enough to recommend the scheme …….

WILL IT ACTUALLY WORK ?

Although it is a legal scheme, there is still no guarantee it will be successful. Importantly, schemes such as these are often quite new and will be open to challenge by HMRC. The scheme may not ultimately succeed in reducing your tax bill if the HMRC challenge is successful. Wherever possible, HMRC will look to legislate to close unintended loopholes where they see “tax leakage”. Hence many of these schemes tend to be effective only for a short period.

It may be some two years before HMRC even start their challenge. Until you file your tax return (which may not be until 31 January following the end of the tax year), HMRC will not even be aware that you have used it. They have a further year to open an enquiry. Given the potentially large amounts of tax at risk, a long protracted challenge, court cases, appeals etc. can extend the period of uncertainty for years and years.

HOW MUCH WILL IT COST ME ?

The cost of participating in one of these schemes is usually quite expensive. The promoter wants to reap the benefits of his “good idea” quickly before the loophole is closed and will charge significant fees. Usually, there is also a need to establish a fighting fund to ensure the promoter is able to mount a defence against HMRC when inevitably they challenge the scheme. If this fighting fund subsequently proves insufficient, you may be asked to contribute more to defend what is by then your own tax position.

If you participate in one of these schemes you are more likely to be viewed as a “high-risk” taxpayer. As a high-risk tax-payer you are more likely to be selected by HMRC for a tax investigation into your personal affairs. This could take from several months to several years. You will need to employ a tax adviser to deal with such an investigation and lengthy enquiries clock up advisors fees very quickly indeed (even if you have nothing to hide). Most taxpayers are unwilling to accept this risk.

So with fees for defending the scheme and a higher risk of significant personal tax enquiry fees, it is clear that unless you have a significant amount to gain (ie. a lot of tax to save), the potential cost of participating in the scheme may be much more than the potential benefit.

HOW WILL HMRC KNOW I HAVE USED THE SCHEME ?

Every tax scheme now has to be declared to HMRC by the promoter and must be disclosed on the individual tax returns of everyone who makes use of it. There are penalties for failing to register or disclose you have used them. Note that if HMRC do successfully challenge a scheme, they will know exactly who has used it and exactly who to go after for tax. They also now know you are potentially a “high-risk” tax payer.

WHAT IF HMRC ARE SUCCESSFUL IN THEIR CHALLENGE ?

You will not have saved any tax, you will have paid a high level of fees, and in the future you will potentially expose yourself to penalties on the tax you didn’t pay when you should have done.

SHOULD I BOTHER ?

Anecdotal evidence suggests that when taxpayers are made aware of the real risks of entering into these schemes, less that 10% who could benefit from them actually choose to proceed. Sadly many of those who do go ahead, are blissfully unaware of the significant risks they are taking.

Of course it may be that the scheme you are considering does not get challenged (and instead is stopped by future legislation) and you may not be the subject of an HMRC enquiry, but remember it may well be years before you know this for sure.

So if you wouldn't buy meat from a man in a pub, think twice before you take tax advice from a golfer. And if he says "Don't worry , it is legal", be aware, there are many more questions to ask !

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