GLOBAL BANKING & FINANCE REVIEW

Miles Dean, Founder of Milestone International Tax Partners

The Times' recent tax investigation has brought tax avoidance to the forefront of the public's mind. Jimmy Carr, Gary Barlow, doctors, dentists, Conservative donors, film finance schemes – they've all been under the spotlight in recent weeks. Miles Dean, Founder of Milestone International Tax Partners LLP, helps us bring some sense to this latest media frenzy in the following Q&A report:

1. **Let us start from the beginning. Comedian Jimmy Carr's K2 tax scheme: how did it work?**
From what I have seen in the media and in The Times, the K2 scheme appears to work as follows: Jimmy Carr enters into an employment contract with a Jersey company that he neither controls nor manages. K2 would then, presumably, enter into a contract with various counterparties (perhaps Channel 4) for the provision of his services. The counterparties pay K2 the agreed contractual fee, K2 pays Carr his salary entitlement, which is subject to tax and NIC. The balance, less K2's profit margin / spread (which would likely be a percentage of the gross turnover), is seemingly made available to Carr in the form of a loan. The company assigns this receivable to an offshore pension scheme that it has established for Jimmy Carr (and perhaps other employees) such that interest and capital payments are essentially made by the employee to a vehicle established for his own benefit. Assuming the loan is repayable and is not simply a sham arrangement the loan will not constitute taxable income (because it is a loan not income).

2. **Given it was a legal loophole, as are all tax avoidance schemes, what is your stance on Carr's embarrassing public climb-down after David Cameron labelled the scheme "morally wrong"?**
I'm not sure who should be more embarrassed – the Prime Minister or Jimmy Carr. David Cameron was wrong in my opinion to wade into what is essentially a private matter between Carr, his advisers and HM Revenue & Customs. Morality and taxation are not natural

bedfellows and the current trend, that tax avoidance is morally repugnant, wrong etc., fails to take account of why individuals and companies seek out tax avoidance strategies. Not to consider why the United Kingdom has a thriving tax avoidance industry is to fail to get to the heart of the matter. As to Jimmy Carr's climb-down:

- He was probably advised by his management that he had to for the benefit of his career!
- He was badly advised in the first place to enter into the K2 arrangement.
- He will likely be very careful in the future.

3. **Please explain how 1,300 doctors and dentists, as reported by The Times, have also not been paying the full amount of tax. They're guilty of evasion, not avoidance, which is illegal, isn't it?**

No. Tax evasion and tax avoidance are not the same and are, in fact, miles apart from one another. If a dentist knowingly fails to declare his income on his tax return then he is committing tax evasion which is a crime. If, on the other hand, he makes an investment in a "financial product" that relies on a particular provision of the tax code to provide tax relief, he cannot be said to be committing evasion. His income from practice and the relief he obtains as a result of the investment will be declared on his tax return thus allowing HMRC to scrutinise his affairs. The fact that HMRC don't believe the relief is available (for whatever reason) and subsequently deny relief, is in no way tax evasion.

4. **Film finance schemes have been around for a while, and are quite well known. How do they work?**

An Investor makes an investment into a partnership, with such an investment being funded by, say, 20 of the Investor's own cash and 80 of bank debt). The partnership in turn acquires assets that entitle the investor to claim an immediate tax deduction of 100 (for example, on the basis that the government of the day has decided that it is a good idea to encourage investment into a particular sector such as the British film industry or alternatively on the basis that interest costs on bank debt are paid upfront in the first year).

So, the Investor generates a tax deduction of, say, the full 100 in Year 1. Assuming that the Investor pays income tax at 50% then that tax deduction of 100 generates a tax saving worth 50 in Year 1 (which is not bad considering the Investor has only put in 20 of his own cash). In subsequent years, as income is earned by the structure, the Investor generates taxable income on which he will be taxed (assuming he remains UK resident). So over time, the tax saving achieved in Year 1 may be reversed (assuming the Investor remains a UK resident person liable to income tax at the 50% rate).

Early incarnations of film finance schemes operated in a way such that, regardless of the performance of the film, the Investor's return was of an amount equal to the initial contribution (plus a small margin). The Investor could be said not to have been genuinely exposed to the risks and returns associated with the underlying film investment. As HMRC have tightened the rules, the film scheme providers have adapted their schemes to introduce somewhat greater degrees of participation by the Investor in the underlying film investment.

5. **We are particularly interested in the Icebreaker scheme that Gary Barlow and other members of Take That have allegedly used. How does this differ from the K2 scheme Jimmy Carr used?**

On the one hand K2 is simply a non-UK structure through which Jimmy Carr has provided his services as an entertainer (or writer, or both). His primary source of income is that which he receives from K2. Gary Barlow, on the other hand, used the Icebreaker scheme to reduce

his tax liability in respect of his primary source of income, i.e. record royalties.
Barlow could have chosen to structure his tax affairs using K2 and JC could have chosen an Icebreaker scheme to reduce his entertainment income. The two schemes achieve a similar result, they just do this in different ways.

6. **How is this scheme implemented by its consumers without the relevant tax authorities becoming aware?**
The tax authorities are aware assuming the individuals concerned complete their self-assessment tax returns correctly – hence enquiries being opened by HM Revenue & Customs. HMRC might not know in advance that Gary Barlow/Jimmy Carr are using their respective schemes because the schemes might not fall within the ambit of DOTAS (Disclosure of Tax Avoidance Schemes).

7. **Apart from the obvious, how does the Icebreaker scheme benefit the consumer?**
Icebreaker operates in a similar way to the film schemes (except that the underlying investment is music). So essentially the Investor gets an upfront tax deduction in Year 1, but taxable income arising in subsequent years.

8. **Surely we should be less worried about single people's tax affairs and more worried about multinational corporations who hardly pay any tax?**
I think you have been listening to too many politicians. Multinational Corporations employ many thousands of people, as a result of which they pay NICs, PAYE and indirect taxes (GST/VAT etc.). They also pay tax on their profits: FTSE 100 companies pay an average ETR of 26%.
While some high-profile MNCs pay very little UK tax (well-known examples being Google and Amazon) this is due to the fact that they are web-based businesses. Their profit centres are low-tax jurisdictions whilst their UK operations tend to be cost centres. We live in a global economy and MNCs are free to trade and invest where they want and how they want.

9. **Do you think it is the relevant tax authorities, such as HM Revenue and Customs, not doing enough to prevent tax avoidance and evasion, or an inherent problem with Government policy that is allowing people to not pay their full allocation of tax?**
No. To suggest that the tax system in the UK offers an easy ride is simply not true. The UK tax system is easily one of the most complex in the developed world, on a par with the United States. HMRC and the Government are constantly tackling tax abuse and closing loopholes that come to their attention on a regular basis (even prior to Budget Day). We have seen retrospective legislation in some cases, where the loss to the Exchequer is deemed significant enough – of itself this is a statement of intent.

In addition to this DOTAS was introduced in 2004 and has evolved and been extended since then to be more effective. A GAAR (General Anti Avoidance Rule) is also being introduced and this will undoubtedly have an effect on the way in which the tax avoidance industry positions itself. That said, it might be several years until any GAAR case is taken (cf. Canada and Ireland).

We should ask: What more could be done? We must take a close look at the tax system and question why tax avoidance is so prevalent in the UK. It might be something to do with the fact that entrepreneurs and the wealthy don't believe they are getting good value for the tax that they pay, or that tax rates are 50% or more, or that personal allowances are eroded for the moderately wealthy and so on. On the whole there is a belief among taxpayers that the tax system is simply not fair (or, perhaps, morally acceptable).

In my view, we should reduce the number of volumes that make up the tax code and simplify it - by anyone's standards UK tax legislation is now impenetrable. Tax schemes are often "missold" to tax payers, especially individuals and small companies (who have no idea of the inherent risks or the extent HMRC will go to recover tax they consider should be paid). In many instances tax schemes are sold by IFA's and accountants (reselling the scheme providers products for a "clip"). The FSA and ICAEW should perhaps consider their members' role in the industry?

Miles Dean
Miles is a founder of Milestone International Tax Partners, having started his career in international tax in 1994. He is the co-author of International Tax Systems and Planning Techniques (Sweet & Maxwell) and The Principles of International Tax Planning (Corpus), as well as numerous academic articles. Miles has a varied client base ranging from owner-managed businesses to international investment funds and real estate businesses. Miles has recently advised on a number of high-profile cross-border infrastructure and real estate transactions. Miles specialises in finding bespoke, commercially workable solutions that create significant tax benefits for individual and corporate clients.

Milestone
Milestone is a boutique international tax practice established in Mayfair, London. The team comprises young, dynamic lawyers who have specialised in international tax throughout their careers. They specialise in International Corporate Transactions, International Investment Funds, Structure Finance, International Real Estate and Private Clients.

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