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FOCUS

When tax dodging becomes dodgy

The humbling of Jimmy Carr has cast a keen light on the labyrinthine steps the rich take to order their finances

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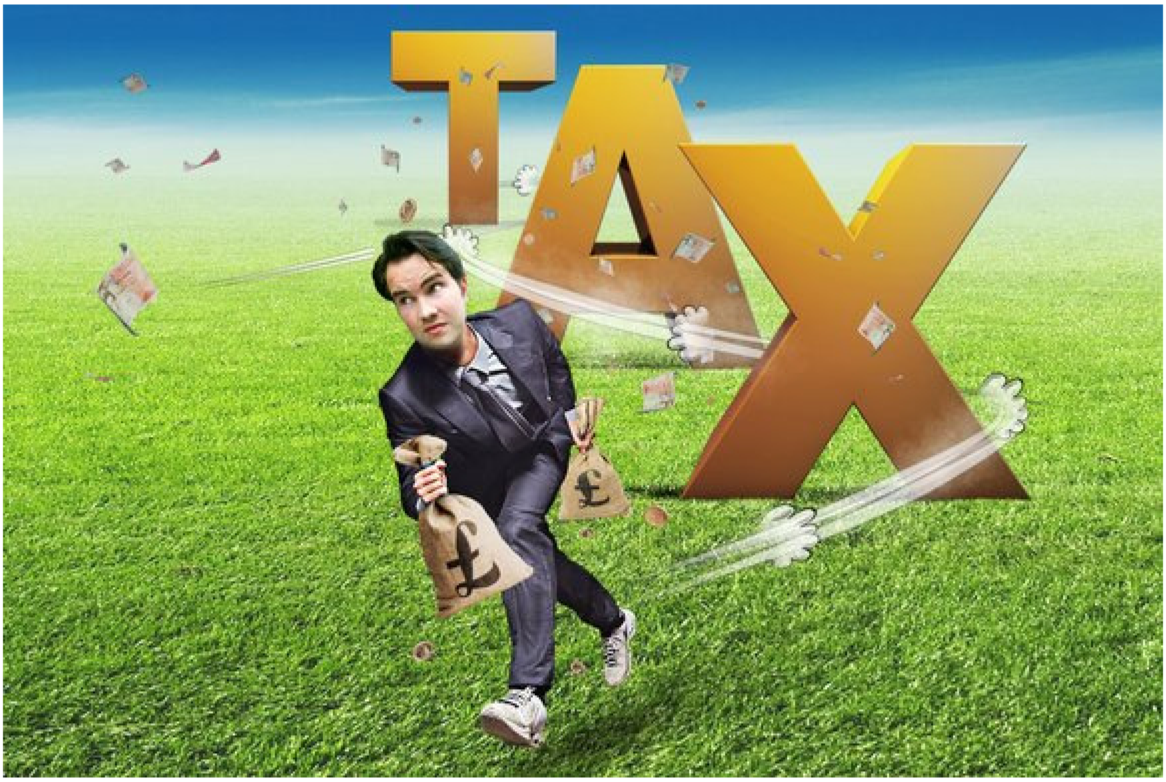

ON the face of it, it was an odd week to boast of selling tax-avoidance schemes, but the irony was apparently lost on UK Financial Solutions, a firm that claims to help homebuyers escape thousands of pounds in stamp duty.

As David Cameron branded comedian Jimmy Carr "morally wrong" for channelling his income through a dubious offshore tax scheme, an agent from the company was telling a homebuyer how he could help her to save just over half of the £14,250 stamp duty liable on her £475,000 property.

The claim would no doubt surprise George Osborne, who vowed to crack down on stamp duty avoidance in his March budget. Yet no sooner had the chancellor announced his measures than tax lawyers were busy looking at even more ingenious ways of getting around them in the latest stage of what HM Revenue & Customs (HMRC) openly admits is a "cat and mouse game".

Britain is turning into a nation of accountants, with some of the country's best brains engaged in trying to outwit HMRC. The number of qualified practitioners has more than doubled over the past 18 years to 240,000, and more than 10% of university graduates are making a career in the profession, according to a report from Dr Prem Sikka, professor of accounting at the University of Essex — meaning we have more accountants a head than any industrialised nation.

But then we also have one of the most complex tax systems in the world: our tax code runs to 686 pages, with hundreds of arcane reliefs and allowances that can be ruthlessly exploited by tax lawyers.

For every person who last week condemned Carr — who admitted to a "terrible error of judgment" over his involvement in a Jersey-based K2 tax-avoidance scheme — there seemed to be another who pointed out that tax avoidance was a legal and a rational response to the complexity of the system.

Nobody likes handing over more money to HMRC than they must, so is it any wonder some taxpayers are tempted to stray beyond tax "planning" — making use of legitimate reliefs on Isas or pension contributions — to outright avoidance schemes that aim to use a badly drawn-up system to their advantage?

CDP Corporate, the company behind the stamp duty schemes offered by UK Financial Solutions, is so confident of its loophole that its website claims the duty is, in effect, optional. "In the view of our barrister at Lincoln's Inn, there is no legal reason to pay stamp duty," it says.

As the stamp duty agent said in his sales patter last week: "I pay tax on my income and Vat on the goods I buy, I have a family of four and I need an extra bedroom, why should I have to pay £10,000 in stamp duty for the privilege of moving? I have a lot of friends who think tax avoidance is morally repugnant but I guarantee if they moved house and had the opportunity to save tax, they would take it."

With Britain back in recession, HMRC needs to raise its revenues, and higher-earning taxpayers will face increasing pressure to pay their fair share. Figures out this week are expected to show public borrowing in May rose to about £16 billion, up from £15 billion in the same month last year, largely because a slower economy means lower tax receipts.

The government gave the Revenue nearly £1 billion in the 2010 spending review to tackle avoidance, evasion and fraud, and HMRC wants accountants and taxpayers to be in no doubt it intends to use this firepower.

There have been some successes: in April the Revenue won an important battle in the war against tax avoidance when a tribunal ruled that Eclipse 35, an "aggressive" film scheme with a roster of high-profile investors, was not entitled to tax breaks.

The scheme, whose 289 investors include Sir Alex Ferguson, Sven-Goran Eriksson and a host of sports stars and City figures, borrowed money to buy two Disney films, which were immediately leased back to the studio over 20 years. The scheme then claimed tax relief on the debt interest on behalf of investors. However, the court ruled they were not entitled to this because the scheme was not a genuine trading business.

The investors may now be liable for huge tax bills and the Revenue is going after several other Eclipse schemes.

“These film schemes have been a thorn in the side of HMRC for several years now — their stance is unwavering: that the schemes are abusive. This should be a warning to any investor,” said Miles Dean, founder of Milestone International Tax Partners.

It could take many years for the Exchequer to unwind the schemes, however. There are 40 permutations and because they are legal and hinge on an interpretation of existing legislation, the taxman must target them individually through the lengthy tribunal system. The same is true of the stamp duty schemes.

The smart money and smart brains are forever sniffing out new loopholes: sometimes, however, politicians inadvertently make it too easy for them.

The Sunday Times has unearthed two new dodges being used by the rich and famous: both are simple, lucrative and have left accountants puzzled by politicians’ naivety. One, unwittingly created under Labour, has enabled Olympic architects, BBC and ITV presenters and England footballers to pay personal taxes of 2% on some of their income.

It is open to company directors who, under a 2007 law, can borrow large sums from their own firms. The loans are classed as a benefit in kind rather than income, which means the director pays just 2% tax on the sum — against 50% if they took it as salary or 36.1% as a cash dividend.

Zaha Hadid, the architect of the London Aquatics Centre,could have saved £1m in one year using this method. Her spokesman said the loan was not taken for any tax planning reasons and that she paid the full rate of tax on all her other earnings.

Anish Kapoor, designer of the “helter-skelter” Arcelor Mittal Orbit tower, was entitled to a similar saving under such a scheme but may not have used it. Gary Lineker, the BBC Match of the Day presenter, stood to save about £224,000, and Steven Gerrard, the England football captain, had arrangements saving a potential £169,000. The three declined to comment and it is possible that, despite taking the loans, they did not make use of the tax loophole.

The loophole, according to one accountant, was just sitting there to be exploited. “I would dearly love to know why the last government changed the law to allow this because it used to be unlawful,” he said.

HMRC said it would look at the details and would not hesitate to act where the rules were being abused, but internal Revenue guidance seen by this paper makes it clear how hard it would be to mount a challenge, provided the loans are made and repaid in compliance with basic rules.

The second dodge involves setting up bases in Ireland to take advantage of its rock-bottom corporation tax. Google, Amazon and Facebook have bases there, and The Sunday Times has established British pop stars including Cheryl Cole, JLS and Olly Murs have set up Irish subsidiaries.

Again, this gives a substantial saving — it allows international earnings to be channelled through the firms at a tax rate of 12.5% compared with 24% in Britain. It was made more lucrative by a change in the law enacted in 2009 under Labour.

And then there are schemes of the sort used by Carr, who, it was revealed last week, was investing about £3.3m a year in an offshore loan scheme that promised to reduce the taxman's cut to about 1.5%.

Although the comedian was by this weekend telling jokes in his shows about his discomfort, he suffered another embarrassment — via his estranged accountant father, Jim.

In a newspaper article, Carr Sr described how he supported his son financially into his thirties — but that Jimmy, 39, turned on him in 2003, the year after his career took off, when asked to contribute to his living costs. "Perhaps, after years of drawing pretty much full-time on the bank of Dad, he saw this as a hostile act, despite the fact he was earning well in the region of £750,000 a year," Jim Carr said.

The government's new general anti-abuse rule, or GAAR, which comes into force next year, should make it easier for the taxman to clamp down on artificial tax schemes before they are even marketed. An advisory panel will be able to "strike down" schemes whose sole purpose is avoiding tax.

Accountants fear it is drawn too widely and could catch innocent taxpayers involved in simple inheritance-tax planning. "It marks a seismic shift in the approach to tax planning," said Sophie Dworetzsky, partner in the wealth planning team at Withers, an international law firm. "Taxpayers and advisers need to be very alert to the risk of planning being unwound after the event."

For some, the solution is more money for enforcement and tougher fines for offenders, but many say the penalty regime is already unreasonable. Since April, individuals are automatically fined £100 if they fail to file their tax returns on time, even if they do not owe tax.

One alternative is greater transparency, with a Scandinavian-style system where personal tax returns are a matter of public interest, which, combined with a growing sense of moral disapproval of tax dodging, could nudge people into doing the right thing. It would not, however, tackle the use of corporate structures to minimise personal liabilities, which is at the heart of most aggressive avoidance schemes.

What Britain really needs is a simpler tax system, say accountants. As long ago as 2005, Osborne said Britain should investigate the merits of a flat tax — a single rate for all business and personal taxes that would preclude the need for reliefs and allowances.

The Institute of Directors (IOD) and the TaxPayers' Alliance have urged such a tax, set at 30%, of the sort adopted by some of the former communist countries of eastern Europe, with a personal allowance of £10,000 and no loopholes. Stamp duty and inheritance tax would be abolished.

"Fiddling with the system causes more complexity and has little benefit to growth — this proposal would put a rocket under economic confidence," said Graeme Leach, chief economist of the IOD. "This is a real opportunity to make life easier for people, get more money on the high street and give Britain a tax system which is right in principle and works in practice." But will the government heed the message?

The joke's on Jimmy

We all like to put a bit of money away for a rainy day, don't we? But I think you're more prepared than Noah — Sean Lock

It's okay to avoid tax, providing every time you do a joke about a town being shit, you add "partly down to me, I'm afraid" — Frankie Boyle

Apparently the offshore version of tonight's 8 out of 10 Cats had a lot more Jimmy Carr jokes in it — Ryan Taylor

World record for the fastest climbdown from K2 goes to Jimmy Carr — Victoria Derbyshire

We all want to pay less tax, but there is a difference between astute planning and aggressive avoidance

Booze cruises

How it works Thousands of us cross the Channel every year to take advantage of lower duties on alcohol. The UK duty on a bottle of wine is about £1.90, compared with only 2p in France. Does this put your average booze cruiser in the same boat as the celebrities paying 2% tax rates on company loans? Both are using anomalies in existing tax laws to their advantage.

Is it okay? Only if it is for personal consumption. You are likely to be quizzed if you have more than 90 litres of wine, 10 litres of spirits, or 3,200 cigarettes in your car boot and HM Revenue & Customs is convinced it is for commercial gain.

Tax relief on donations

How it works Gift Aid, which lets charities reclaim basic-rate tax on donations, is a classic case of the state using the tax system to influence behaviour — with varying success. The basic rate of income tax is 20%, so for every £100 given, a charity can reclaim £25. Higher-rate taxpayers can also reclaim £25 if they pay the 40% rate, or £37.50 if they pay 50%.

Is it okay? The government believes higher earners claim huge amounts of relief on donations to charities that may do little charitable work, or are linked to the person making the gift. It tried to introduce a cap on reliefs but backtracked after an outcry.

Film schemes

How they work Again, governments initially used the tax system to encourage investment in British films, but the perks have returned to haunt them. Labour introduced tax breaks in 1997, but closed them down when they were abused. The tax breaks now focus on producers rather than investors, but that has not stopped accountants marketing the schemes.

Is it okay? The Revenue dislikes any scheme created purely for tax purposes — by borrowing to buy film rights and then claiming relief on the debt, for example.

Paying yourself a loan

How it works Paying income tax on your earnings seems to be optional among Britain’s rich and famous. A common — and perfectly legal — wheeze is to set up a company that then pays your earnings out as a loan rather than salary or dividends, on which income tax would be payable. Tax is charged at only 2% on the loan interest. Jimmy Carr infamously used this tactic through an offshore company.

Is it okay? The Revenue regards taking a loan as “disguised remuneration” to be tax avoidance. It will come down hard if you continue to roll over the loan without paying tax.