GAAR STUDY

A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system

REPORT BY GRAHAM AARONSON QC

11 NOVEMBER 2011

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SECTION 1

Summary of Conclusions

1.1 Subject to one reservation, the conclusions set out in this section, and developed in the rest of this Report, reflect the views of the Advisory Committee. The reservation is that the two members of the Advisory Committee who are serving judges in the United Kingdom (Sir Launcelot Henderson and Howard Nowlan) wish to maintain a position of strict public neutrality on the policy issues discussed in this Report, and therefore on the question whether or not a GAAR should be introduced. They do, however, agree with their colleagues on the Advisory Committee that, if a GAAR is to be introduced, a model of the type recommended in this Report appears to be the most suitable for adoption in the UK.

1.2 In broad terms the purpose of the study was to consider whether the introduction of some type of general anti-avoidance rule would be beneficial for the UK tax system.

1.3 Beneficial does not mean simply providing another weapon in the armoury to challenge unappealing tax avoidance schemes. The issue is more complex, and a number of important factors have to be taken into account to determine whether, looked at overall, introducing a GAAR today would be a positive step.

1.4 Most critical among these factors is whether such a step might erode the attractiveness of the UK's tax regime to business. The continuing turbulence in financial markets and the fragility of the UK economy has kept this issue in the forefront of the Study Group's discussions.

1.5 I have concluded that introducing a broad spectrum general anti-avoidance rule would *not* be beneficial for the UK tax system. This would carry a real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning. Such

tax planning is an entirely appropriate response to the complexities of a tax system such as the UK's.

1.6 To reduce the risk of this consequence a broad spectrum rule would have to be accompanied by a comprehensive system for obtaining advance clearance for tax planning transactions. But an effective clearance system would impose very substantial resource burdens on taxpayers and HMRC alike. It would also inevitably in practice give discretionary power to HMRC who would effectively become the arbiter of the limits of responsible tax planning.

1.7 However, introducing a moderate rule which does not apply to responsible tax planning, and is instead targeted at abusive arrangements, *would* be beneficial for the UK tax system. Such a rule could bring a number of significant benefits -

(i) First and foremost, it would deter (and, where deterrence fails, counteract) contrived and artificial schemes which are widely regarded as an intolerable attack on the integrity of the UK's tax regime. Such schemes make a mockery of the will of Parliament. In discussions with various representative bodies of the tax profession there has been unanimity of view that such schemes are wholly unacceptable.

(ii) Introducing such a targeted rule should contribute to providing a more level playing field for business: enterprises which conduct responsible tax planning would no longer have their competitiveness undermined by others which seek to reduce their tax burden by contrived and artificial schemes. Likewise tax professionals who are not willing to recommend or implement such schemes will not have their client base eroded by those who are prepared to do so.

(iii) At the moment, in the absence of any such anti-abuse rule, the task of judges in the Tax Tribunals and the Courts in dealing with abusive schemes is confined to deciding whether such schemes succeed or fail by applying the normal principles of statutory interpretation to the tax provisions concerned. Judges inevitably are faced with the temptation to stretch the interpretation, so far as possible, to achieve a sensible result; and this is widely regarded as producing considerable uncertainty in predicting the outcome of such disputes. In practice this uncertainty spreads from the highly abusive cases into the centre ground of responsible tax planning. A GAAR specifically targeted at abusive schemes would help reduce the risk of stretched interpretation and the uncertainty which this entails.

(iv) The UK's tax legislation is notoriously long and complex. In many places it is virtually impenetrable. A significant contributing factor to the length and complexity is the need for the drafting of any given set of rules to anticipate attempts by some taxpayers to avoid the application of those rules, or exploit their application, in a way that Parliament could not rationally have contemplated. Enacting an anti-abuse rule should make it possible, by eliminating the need for a battery of specific anti-avoidance sub-rules, to draft future tax rules more simply and clearly. Also, fewer schemes would be enacted and so there will be less call for specific remedial legislation.

(v) In time, once confidence is established in the effectiveness of the anti-abuse rule, it should be possible to initiate a programme to reduce and simplify the existing body of detailed anti-avoidance rules. The Office of Tax Simplification would be the obvious agency to do this. This would lead to a significant improvement in the certainty of operation of the existing body of tax rules.

(vi) An anti-abuse rule which is targeted at contrived and artificial schemes will not apply to the centre ground of responsible tax planning. Consequently there will be no need for a comprehensive system of clearances, with the resource burdens which such a system would require.

(vii) The centre ground will of course have its outer limit; and taxpayers who wish to test the location of that limit by their tax planning will remain free to do so. A mechanism such as an independent advisory panel would be a quick and cost-effective way of helping taxpayers and HMRC identify the location of this outer limit, without running the risk of giving greater discretionary powers to HMRC.

In this particular context it is important to note that at present the effectiveness of some tax planning is uncertain, given the willingness of HMRC to challenge such schemes and the unpredictability of the response of the Tax Tribunals and Courts to such cases. Accordingly, a specifically targeted anti-abuse rule should not significantly increase the area of uncertainty.

(viii) It should help and inform the public debate about tax avoidance and abusive practices; and it should help build trust between taxpayers and HMRC, as the boundaries between acceptable and unacceptable behaviours are clarified.

1.8 These benefits which a specifically targeted anti-abuse rule would bring are substantial and valuable. Accordingly, I strongly recommend that such a rule should be enacted. This also reflects the views of the Advisory Committee[1].

[1]Subject to the reservation, as regards the serving judges, noted in paragraph 1.1.

1.9 To make the introduction of such a GAAR manageable, for taxpayers and HMRC alike, it should initially apply to the main direct taxes – income tax, capital gains tax, corporation tax, and petroleum revenue tax. It should also cover national insurance contributions (which would require separate legislation). At a later stage, when the GAAR is seen to operate fairly and effectively, consideration should be given to including other taxes such as stamp duty land tax. However, it would not be sensible to include VAT, as this tax has its own anti-abuse rules derived from EU law, and applying a UK GAAR in parallel could raise issues of consistency with EU law.

1.10 The tax rules in many areas have become extremely complex and in practice can give rise to very anomalous results. A GAAR would not remove the need to improve the specific legislation where this is so. Indeed, it will highlight the need for this, as the GAAR will operate most effectively where the principles underlying the specific tax rules are clear. Accordingly, one of the advantages of a GAAR would be to encourage legislators, and drafters, to consider more carefully the principles behind proposed legislation. In some areas, for example trust taxation, specific guidance notes in relation to the application of the GAAR may, as an interim measure, need to be agreed between HMRC and representative bodies working in this area. This exercise should also be used to highlight the need for reform of the rules rather than simply providing a continuing form of guidance.

1.11 It should be possible to draft such a rule so that it would operate effectively and fairly. Appended to this Report (Appendix I) is an illustrative draft of a general anti-abuse rule and an accompanying Guidance Note (Appendix II) which must be read with it. These incorporate principles which should enable abusive schemes to be specifically targeted and appropriately counteracted. The draft GAAR includes a series of important safeguards to ensure that the centre ground of responsible tax planning is effectively protected. These safeguards are –

(i) an explicit protection for reasonable tax planning ("safeguard 1");

(ii) an explicit protection for arrangements which are entered into without any intent to reduce tax ("safeguard 2");

(iii) placing upon HMRC the burden of proving that an arrangement is not reasonable tax planning ("safeguard 3");

(iv) having an Advisory Panel, with relevant expertise and a majority of non-HMRC members, to advise whether HMRC would be justified in seeking counteraction under the GAAR ("safeguard 4"). This Advisory Panel should publish (appropriately anonymised) digests of its advice.

(v) giving taxpayers and HMRC the right to refer to material or information which was publicly available when the tax planning arrangement was carried out. This could provide valuable help in determining whether an arrangement should be regarded as reasonable tax planning: This material should be available as evidence even if it would not otherwise be admissible as a matter of law.

(vi) requiring that potential application of the GAAR has to be authorised by senior officials within HMRC. This is to ensure consistency and responsibility in its application by HMRC.

1.12 It must be emphasised that the general anti-abuse rule appended to this Report has been drafted as an illustration to demonstrate that it is possible to incorporate in the form of legislation the principles which I consider must govern a general anti-abuse rule if it is to be beneficial for the UK. The key principles are the safeguards summarised in the sub-paragraphs (i)-(vi) above. Those key safeguards, and the other

principles incorporated into the draft, are discussed in greater depth later in this Report.

1.13 While recommending the enactment of such a specifically targeted anti-abuse rule, I note two particular concerns which have been frequently expressed during discussions with representative bodies.

(i) The first is a fear of “mission creep”: that the essential safeguards to protect the centre ground of responsible tax planning may be eroded by subsequent amendment.

(ii) The second is that the prospect of reducing the volume and complexity of specific anti-avoidance rules, which an anti-abuse rule should facilitate, will not be fulfilled.

If the Government decides to introduce a GAAR of the sort recommended, then I trust that it will take these concerns into account. Provision for a regular, say five yearly, review of progress would instil confidence that the benefits which the GAAR should bring will be delivered.

SECTION 2

The Study – Establishment and working methods

Appointment and terms of reference

2.1 In December 2010 I was asked to lead a study programme to establish whether a GAAR could be framed so as to be effective in the UK tax system and, if so, how the provisions of the GAAR might be framed.

2.2 I was asked to consider in particular whether such a GAAR could –

(i) provide the Government with an effective means of deterring and countering tax avoidance;

(ii) ensure that the rules work fairly;

(iii) ensure that the rules would not erode the UK tax regime's attractiveness to business;

(iv) ensure that sufficient certainty about the tax treatment of transactions could be provided without undue compliance costs for businesses and individuals;

(v) keep any increase in resources for HMRC to an acceptable level and ensure that there would be a minimal need for resources to be diverted from other priorities.

2.3 The Government invited me to create an advisory committee to work with me on the study. I thought it appropriate to have a group which was small enough to work cohesively while having diverse backgrounds in the field of taxation. I considered that it would be very helpful if the advisory committee could include –

(i) judges with extensive experience in the field of taxation and, if possible, with particular experience in the operation of general anti-avoidance rules in other jurisdictions;

(ii) academic lawyers, again with extensive experience in the field of taxation and, if possible, with particular knowledge of the issues relating to GAARs; and

(iii) an experienced tax practitioner in the field of commerce and industry.

Such expertise, coupled with my own experience in the field of commercial taxation, would bring a rounded perspective to the study.

2.4 Accordingly I invited the following to be members of the Advisory Committee, and I am very grateful that they each immediately agreed to do so. I must add that this is dwarfed by my gratitude for the rigour and thoroughness of their analysis of every issue, however detailed, which arose for consideration during the entire course of the study. They are –

- John Bartlett (Group Head of Tax, BP Plc);

- Professor Judith Freedman (Professor of Taxation Law, Oxford University Law Faculty, and Director of Legal Research, Oxford University Centre for Business Taxation);

- Sir Launcelot Henderson (Judge of the Chancery Division of the High Court of Justice);

- The Rt. Hon. Lord Hoffmann (Formerly Lord of Appeal, and Non-Permanent Judge of the Court of Final Appeal of Hong Kong);

- Howard Nowlan (Formerly Tax Partner at Slaughter & May, and part time Judge of the First Tier Tax Tribunal); and

- Professor John Tiley CBE, QC (Hon), FBA, (Emeritus Professor of the Law of Taxation, founding Director of the Centre for Tax Law, Cambridge University, Emeritus Leverhulme Fellow).

2.5 A small secretariat was established to manage most of the practical aspects of the study, and also to carry out some research. The secretariat comprises –

- Jonathan Bremner (a barrister at Pump Court Tax Chambers); and

- Zoe Leung-Hubbard (seconded by HMRC)

2.6 We are all particularly grateful for their outstanding efficiency and effort, which have made a major contribution to the smooth running of the study.

Study group methodology

2.7 The field of study was divided into a number of topics, which were considered in sequence. Periodically the Advisory Committee convened to discuss these issues with me. There have been five full meetings of the Advisory Committee, each preceded by a briefing paper which I prepared to deal with the issues to be covered. Between meetings discussion continued by email correspondence. During this period, note was taken of extensive academic and practitioner material from many jurisdictions as well as the UK.

2.8 For the first five months the attention was focused on the question whether there was a need for some form of GAAR; and, if so, then what framework of principles should the GAAR embody.

2.9 To complete this first stage of the study I also held a round of discussions with a number of representative bodies –

- The Tax Committee of the Confederation of British Industries;
- The Tax Committee of the Institute of Chartered Accountants in England and Wales;
- The Tax Committee of the Institute of Chartered Accountants of Scotland;
- The Tax Committee of the Law Society;
- The Tax Committee of the City of London Law Society;
- The Chartered Institute of Taxation;
- The Tax Committee of the Trades Union Congress;
- The Tax Directorate of the Institute of Directors;
- The Revenue Bar Association.

2.10 The framework of principles set out in section 5 of this Report reflects the views expressed by members of the Advisory Committee[2] and takes account of the points raised by the representative bodies.

2.11 The next stage of the study focused on seeing whether it would be possible to embody the agreed framework of principles in the form of a draft of an illustrative GAAR. To inform this process I held a second round of discussions with the same representative bodies, together this time with the Law Society of Scotland.

2.12 The draft GAAR which is set out at Appendix I to this Report, and which is discussed in section 6, also reflects the views of the Advisory

[2]Subject to the reservation, as regards the serving judges, noted in paragraph 1.1.

Committee and takes account of comments and suggestions made during the second round of discussions with the representative bodies.

Drafting the Report

2.13 I have drafted the Report myself, and therefore any failings are solely my responsibility. In reaching the conclusions of principle set out in this Report, and also in adopting the approach which the draft GAAR takes to embodying those principles, I have endeavoured to reflect the views of the Advisory Committee[3], to whom I am greatly indebted for the comprehensiveness and quality of the advice which they offered throughout the period of the Study.

[3] Subject to the reservation, as regards the serving judges, noted in paragraph 1.1.

SECTION 3

Does the UK need a GAAR?

3.1 Some people hold the view that while Parliament might have expected tax legislation to apply to a particular transaction in such a way as would produce a predictable amount of tax, nonetheless every taxpayer is entitled to use his wiles and skill without limit in order to secure a lower tax charge. To those who hold this view the appropriate response is for Parliament to introduce specific rules to block such attempts. This is therefore a sort of fiscal chess game, but with an ever increasing number of moves and pieces.

3.2 This approach had more adherents in earlier days, when it was common to regard tax as a form of confiscation by the state, and which to be lawful had to be justified by the letter of the law. It went hand in hand with a very strict approach to the interpretation of tax statutes.

3.3 My approach to taxation, tax avoidance and the question of whether a GAAR would be beneficial for the UK is based on the premise that the levying of tax is the principal means by which the state pays for the services and facilities which it provides for its citizens. As Mummery LJ expressed it in a very recent Court of Appeal judgment, tax is a contribution "towards the costs of providing community and other benefits for the purposes of life in a civil society"[4].

3.4 On this approach it is reasonable to impose some limit on the ability of taxpayers to escape their share of the tax burden by looking for loopholes or weaknesses in the tax rules, and then constructing elaborate schemes designed to exploit them. To be consistent with the rule of law this limit should be imposed by legislation.

[4] R (Huitson) v HMRC [2011] EWCA Civ 893, paragraph 94.

3.5 That, then, is my approach. But it does not mean that we should move straight to the conclusion that the UK needs to introduce a GAAR to deal with the problem. Before approaching any such conclusion it is essential first to consider whether the problem can be dealt with adequately by the means available in the UK tax regime as it exists.

3.6 In discussing this I shall use the very broad expression "tax avoidance", but without intending to imply that every attempt to reduce a tax bill is something to be frowned upon, let alone treated as an affront to society. As is made clear throughout this Report, there is a large area of entirely legitimate tax planning.

3.7 At the moment tax avoidance is addressed in three main ways –

(i) purposive interpretation of tax statutes by the Courts;
(ii) specific anti-avoidance legislation; and
(iii) rules requiring the disclosure of tax avoidance schemes.

Purposive interpretation

3.8 Purposive interpretation of tax statutes is a relatively recent development. Until the ground-breaking speech of Lord Wilberforce in *Ramsay*[5] Courts tended to interpret tax statutes in a strict, literalist, manner. As Lord Loreburn LC put it[6] -

> "But still more important, in the present context, is the special constitutional convention which jealously safeguards the exclusive control exercised by Parliament over both the levying and expenditure of the public revenue. It is trite law that nothing less that clear, express and unambiguous language is effective to levy a tax."

3.9 Adding to the difficulty of confronting tax avoidance which this strict interpretation imposed was another principle which required Courts, in

[5] *Ramsay v IRC* [1982] AC 300 at 323.
[6] *Vickers Sons & Maxim Ltd v Evans* [1910] AC 444 at 445.

cases where the statutory language was ambiguous, to opt for the interpretation which favours the taxpayer –

> "It is quite clear that if in a taxing statute words are reasonably capable of two alternative meanings the Court will prefer the meaning more favourable to the subject".[7]

3.10 The turning point came (but was not immediately recognised as such) with the speech of Lord Wilberforce in *Ramsay*, where he stated –

> "A subject is only to be taxed on clear words, not on the "intendment" or on the "equity" of an act. Any taxing act of Parliament is to be construed in accordance with this principle. What are "clear words" is to be ascertained upon normal principles; these do not confine the Court to literal interpretation. They may, indeed should, be considered the context and scheme of the relevant act as a whole, and its purpose may, indeed should, be regarded….."

3.11 This has developed in subsequent cases, and the current approach to the interpretation and application of taxing statutes is succinctly summarised by Ribeiro PJ in the *Arrowtown* case in the Hong Kong Court of Final Appeal[8] in a passage which was explicitly endorsed by the House of Lords in *BMBF v Mawson*[9] -

> "The driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

3.12 By using purposive interpretation, and looking beyond the literal language of the particular provisions to seek the true meaning from their wider context, the Courts have frustrated many attempts to avoid tax which, pre *Ramsay*, would have succeeded.

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[7] Salmon LJ in *Fleming v Associated Newspapers* [1971] 44 TC 382 at 398.
[8] *Collector of Stamp Revenue v Arrowtown Assets Ltd* (2004) 6 ITLC 454.
[9] [2004] UKHL 51, [2005] IAC 684, paragraph 33.

3.13 As a general proposition I regard this as a very positive development. However I share the view of a large number of tax professionals that in some cases the Courts, under the guise of purposive interpretation, have been prepared to stretch[10] the interpretation of tax legislation in order to thwart tax avoidance schemes which they regard as abusive. I shall revert to this because the temptation to give stretched interpretations in such cases is particularly relevant to the major issue of uncertainty which I address later.

Specific anti-avoidance legislation

3.14 Specific anti-avoidance provisions have been part of the UK tax legislation landscape for more than fifty years. An early example of this was section 28 FA 1960, which was designed to counteract the use of dividend stripping and bond washing to create tax losses where no economic loss was suffered.

3.15 In the meantime the volume and complexity of anti-avoidance legislation has increased exponentially and now forms a substantial portion of the body of the UK's tax legislation. The most recent example, dealing with so called "disguised remuneration" takes up more than 68 pages of the statute book[11]; and it is estimated that there are now more than 300 targeted anti-avoidance rules (or "TAARs").

Disclosure Of Tax Avoidance Schemes ("DOTAS")

3.16 The DOTAS rules are relative newcomers, initially introduced for a limited class of cases and then extended to cover additional areas of tax. DOTAS requires the very early notification of tax avoidance

[10] "Stretching" statutory language in this context has been recognised in the recent Supreme Court judgment in *HMRC v DCC Holdings* [2010] UKSC 58. Lord Walker, delivering the judgment of the Court, at paragraph 25 noted – "argument has focused, in particular, on whether and how far the words in section 84(1) [FA 1996]….can be stretched (or need to be stretched) in order to avoid the absurd result of….".
[11] Schedule 2, FA 2011

schemes, so as to enable HMRC to evaluate them and, where it thinks appropriate, enact specific legislation to counter them.

3.17 It is still early days to determine the value of the DOTAS scheme as a whole. However, it is plainly a useful source of information for HMRC. That, of course, has to be weighed against the additional burden which DOTAS places on taxpayers, and the additional complexity which consequential anti-avoidance legislation adds to the already vast body of tax legislation. There will also inevitably be instances where counteracting legislation comes too late to deal with early users of particular schemes: by their nature these schemes are often complex, and HMRC have to apply a great deal of intellectual effort in determining whether the scheme would be effective under existing rules and, if not, precisely what changes to the rules are needed to deal with them.

3.18 There is no doubt that the combination of purposive interpretation, specific anti-avoidance rules and DOTAS substantially reduces the scope for tax avoidance. Accordingly, the UK context is very different from that which applied in other common law jurisdictions, such as Australia and Canada[12], when GAARs were first introduced there.

3.19 The critical question is whether it is effective enough in preventing the sort of tax avoidance schemes which many citizens and taxpayers regard as intolerable. If it is effective enough, then I would not consider there to be a sufficient case to recommend the introduction of a GAAR for the UK. This would be so even though it is possible that a well-designed GAAR could, in time, lead to simpler tax legislation and would reduce the temptation to stretch the interpretation of tax legislation.

[12] The Canadian GAAR was introduced in 1987 in response to the *Stubart* case, where the Supreme Court rejected the general application of a business purpose test (which some saw as emanating from *Ramsay*) . Likewise the Australian GAAR was introduced against a background of highly literalist interpretation of tax statutes.

3.20 Regrettably, however, it is clear that purposive interpretation, specific anti-avoidance rules and DOTAS are not capable of dealing with some of the most egregious tax avoidance schemes. Such schemes focus on prescriptive tax rules which are not susceptible to contextual interpretation. A recent example is the "SHIPS 2"[13] scheme, which gave UK taxpayers a seven step route to creating an artificial tax loss which could be used to set off against their other tax liabilities. In the High Court Proudman J sympathised "with the instinctive reaction that such an obvious scheme ought not to succeed"[14]. However given the prescriptive nature of the statutory rules in question she was unable to find a purposive interpretation sufficient to defeat it.

3.21 The Court of Appeal[15] reached the same conclusion. In the present context it is particularly pertinent to note the comments of Thomas LJ and Toulson LJ. Thomas LJ[16] said –

> "I agree with the judgment of Mummery LJ which sets out with great clarity why the appeal and cross appeal have to be dismissed. However, for the reasons given by Toulson LJ, my concurrence is reluctant. The higher-rate taxpayers with large earnings or significant investment income who have taken advantage of the scheme have received benefits that cannot possibly have been intended and which must be paid for by other taxpayers. It must be for Parliament to consider the wider implications of the decision as it relates to the way in which revenue legislation is structured and drafted."

3.22 Toulson LJ[17] said –

> "I also agree. On the corresponding deficiency issue I add a brief summary to explain the reason for my reluctant concurrence in a result which instinctively seems wrong, because it bears no relation to commercial reality and results in a windfall which Parliament cannot have foreseen or intended."

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[13] *Mayes v HMRC* [2011] EWCA Civ 407.
[14] [2010] EWHC 2443 (CH), [2010] STC 1, paragraph 45.
[15] The judgment of the Court of Appeal is final. Permission to appeal to the Supreme Court was refused on 1st November 2011.
[16] (at paragraph 100)
[17] (at paragraph 101)

3.23 I agree with Thomas LJ that it would be appropriate for Parliament to consider the implications of that decision. SHIPS 2 shows the inadequacy of the existing means of combating highly artificial tax avoidance schemes. It, and other schemes like it, provide the answer to the question "does the UK need a GAAR?". The answer is that it does.

3.24 That, however, is not a sufficient answer. To give a sufficient answer it is essential to determine the principles which should underlie any GAAR which might be introduced for the UK. Having done this it is then necessary to see that those principles can be embodied in legislation which would operate effectively. These considerations are addressed in the following sections of this Report.

SECTION 4

The views of representative bodies

4.1 As noted in paragraphs 2.9 – 2.11 above, I have discussed the study with ten representative bodies who have an interest in the proper administration of tax laws in the UK. These discussions were in two rounds. The first round was for the purpose of discussing the problems which were encountered in practice with, or as a result of, tax avoidance schemes. The second round was to discuss their reaction to specific proposals in the form of early drafts of an illustrative GAAR.

4.2 It is not only politeness which leads me to express my gratitude for the quality of the representations which they made. The articulation of their concerns and aspirations have played a very major role in shaping the principles which should form the basis for any potential GAAR. They also helped refine a great deal of the detailed provisions in the illustrative GAAR.

4.3 As a general observation I would note a remarkable uniformity of view as to the issues which need to be considered and the concerns which need to be addressed. There was also considerable uniformity of aspiration as to how the tax system could be improved and what role a GAAR might or should play in achieving those aspirations.

4.4 This is not to say that each representative body was equally enthusiastic or unenthusiastic about the prospect of a potential GAAR, or indeed that within each representative body there was uniformity of enthusiasm or lack of enthusiasm.

4.5 The degree of emphasis placed on different points varied between the representative bodies, and sometimes within the representative bodies. It is not necessary to set out a summary of each of the representations. Rather, I think it best to address their representations under four broad

headings: the attitude to tax avoidance, GAARs in general, the illustrative GAAR, and aspirations.

Attitude to tax avoidance

4.6 There was unanimous disapproval, indeed distaste, for egregious tax avoidance schemes: schemes such as SHIPS 2 (discussed in paragraphs 3.20-3.23 above) should be deterred or, if undeterred, defeated. There was consensus in the view that purposive interpretation, even coupled with DOTAS, would fail to deal with carefully contrived schemes that rely on the application of prescriptive rules where no underlying principle can be discerned in the rules as set out in the statute.

4.7 It was a widely, and strongly, held view that highly aggressive schemes of that type made for an un-level playing field. It put tax professionals, whether advisers or company tax managers, in the invidious position of having to decide whether they should try to reduce the tax bill by using such schemes, given that on the present law the schemes would almost certainly produce that result, even though they personally regarded the schemes with distaste. The obvious dilemma lies in the fact that their competitors might set aside such scruples and gain a commercial advantage by recommending or adopting the scheme.

4.8 There was substantial concern that the existence of such schemes tended to affect HMRC's attitude towards more conventional tax planning.

4.9 It was unanimously considered that the fear of aggressive tax planning led HMRC to require tax rules to be protected by a mass of provisions, some highly detailed and some very broad, which made the main rules difficult to discern. In some instances these rules create serious traps for taxpayers to fall into if they carry out transactions which the main

provisions were not intended to apply to. This was particularly stressed in the context of trust taxation.

4.10 There was also unanimous agreement that aggressive tax avoidance schemes encouraged judges to give a stretched interpretation to the relevant statutory provisions. The degree of willingness to do so varied from judge to judge, and also reflected the degree of disapproval with which the judge regarded the particular transaction. This produced considerable uncertainty.

GAARs in general

4.11 Without exception the representative bodies were concerned about the possibility that some HMRC officials would use a GAAR in cases for which it was not designed. In particular there was a fear that the use of the GAAR might in some cases be threatened as a means of applying pressure in tax disputes over non-abusive tax planning.

4.12 There was also unanimous concern that GAARs could give the revenue authorities a great deal of discretionary power. This could be either by enabling them to decide which type of transaction they would challenge; or it could be by publishing a volume of guidance which would inevitably affect taxpayers' willingness to carry out certain transactions even though such transactions seemed in principle to fall outside the scope of the GAAR.

4.13 It was widely thought that GAARs were conceptually paradoxical. Complex tax systems such as the UK's positively invite taxpayers to carry out certain transactions by according them special tax advantages; and yet experience with GAARs in other jurisdictions showed that these responses might nonetheless be susceptible to challenge under the terms of the GAAR because the transaction was unquestionably motivated, at least in part, by the desire to access the tax advantage.

4.14 A unanimous concern was that uncertainty might be created in the interaction of a GAAR with particular reliefs or other tax advantages which appeared to be available for certain transactions under the relevant tax rules.

4.15 Concern was expressed by some representative bodies that a GAAR would make it impossible to escape from the unintended traps which complex tax rules put in the way of ordinary commercial or personal transactions.

The illustrative GAAR

4.16 As noted above, during the second round of discussions the representative bodies were invited to consider an early draft of the illustrative GAAR. Their main areas of concern with this were as follows.

4.17 There was general recognition that the safeguards written into the illustrative draft would reduce the risk of giving HMRC undue discretionary power over tax planning transactions.

4.18 However, there was strong concern that the safeguards written into the illustrative GAAR may not survive in practice. This might happen at the stage prior to enactment (i.e. by significant changes in the version put before Parliament); or it might happen by subsequent amendment. To use the expression currently in vogue, there was a palpable fear of "mission creep" after the GAAR reached the statute book.

4.19 The main fear directed to the terms of the illustrative GAAR itself was uncertainty as to where any given transaction or arrangement would fall on the spectrum of tax avoidance. Although clearly intended to apply only to egregious, or very aggressive, tax avoidance schemes, it was thought likely that HMRC may seek to apply the GAAR more

widely. To restate views already noted above, while there was unanimous agreement that a GAAR would be beneficial if it eliminated egregious tax planning schemes, there was substantial concern that it may in fact be invoked by HMRC and applied by the Courts against a wider range of tax planning.

4.20 There was very strong support for the concept of an Advisory Panel, with an independent chairman and a non-HMRC member. This was seen as having a three-fold impact on reducing the area of uncertainty.

(i) First, on the assumption that one of the independent members has expertise in the area of the transaction in question, the Panel should reduce the risk of the GAAR being invoked by HMRC as a result of their failing to understand the nature or purpose of the transaction. This was not raised as a criticism of HMRC; rather that it is simply a fact of life that HMRC can not be expected to have up to date experience in many fields of commercial (and especially financial) activity.

(ii) Secondly, if the Advisory Panel published its decisions in anonymised form, this would build up a database which taxpayers and tax professionals could use to calibrate their own response to prospective tax planning exercises.

(iii) Thirdly, it was proposed that the Advisory Panel would be an effective instrument for updating and expanding guidelines for the operation of the GAAR. This would reduce uncertainty as to where an arrangement would fall on the spectrum of tax planning. It would also ensure that a growing body of guidance would be given by an independent body, and therefore guard against any increase in HMRC's discretionary powers.

Aspirations

4.21 Some representative bodies expressed very strongly their view that the protection against abusive tax schemes which the GAAR would bring should be used to ensure that future tax legislation is drafted more simply. While acknowledging that it would take some time before HMRC are confident that the GAAR works as an effective deterrent, they considered it essential that a programme should then be initiated to review and simplify the existing body of legislation. In their view the GAAR would provide an opportunity to gain this very substantial benefit, and that opportunity must not be wasted.

4.22 A number of representative bodies expressed the hope that, given the protection against unacceptable tax schemes which the GAAR would provide, the Courts should not seek to extend the application of the *Ramsay* principle beyond the stage already reached in the decided cases. This was, again, in order to reduce the uncertainty affecting the centre ground of tax planning.

SECTION 5

The framework of principles for a GAAR

Overarching principle

5.1 I have concluded that a GAAR which is appropriate for the UK must be driven by an overarching principle. This is that it should target those highly abusive contrived and artificial schemes which are widely regarded as intolerable, but that it should not affect the large centre ground of responsible tax planning.

5.2 Critically, I consider that this overarching principle must be supported by the simple proposition that where there can be reasonable doubt as to which side of the line any particular arrangement falls on, then that doubt is to be resolved in favour of the taxpayer so that the arrangement is treated as coming within the unaffected centre ground.

5.3 The other principles to be adopted are likewise designed to support and give effect to this overarching principle.

Not a rule of interpretation

5.4 Before turning to these supporting principles it should be made clear that the GAAR is not to be regarded as a rule of construction, or interpretation, of statutory language. Rather, it operates on the hypothesis that the particular tax rules engaged by the arrangement would, on conventional purposive interpretation, succeed in achieving the advantageous tax result which it set out to obtain. The GAAR then provides an overriding statutory principle to which other tax legislation is subject.

5.5 Recognising that the GAAR is a rule which overrides the consequences which would otherwise flow from tax legislation brings an advantage, but it also imposes heavy responsibilities.

5.6 The advantage is that the GAAR can use concepts which could not be developed by applying conventional interpretation to the tax rules. A significant example of this is to define "an arrangement" in the sensible terms which were rejected by the majority of the House of Lords in *Craven v White* [18] because in their opinion those terms went beyond the scope of permissible judicial interpretation.

5.7 The heavy responsibility is to ensure that the GAAR must be operated by HMRC in the public interest. This means that it is not to be wielded as a weapon to intimidate taxpayers in relation to arrangements to which it could not apply. Nor should it be allowed to become a means of increasing HMRC's discretionary powers.

5.8 I consider it appropriate to adopt two unconventional approaches in order to secure those objectives, bearing in mind that the GAAR itself would be an unconventional type of tax legislation.

5.9 The first of these is to provide for an authoritative source of guidance as to the sort of cases to which the GAAR should apply. This could be achieved by having guidance notes included as a schedule to the Finance Act which enacts the GAAR itself, so that it gains the authority attaching to legislation. Appended to this Report is an illustrative Guidance Note of the type envisaged.

5.10 To serve as an ongoing source of guidance, such guidance notes would need to be updated from time to time. To avoid the risk of increasing HMRC's discretionary powers it would be appropriate for the updating of the Guidance Note to be the responsibility of an

[18] [1989] AC 398. The majority held that a composite transaction could not include a step if there was a possibility that it might not take place, even though it was part of the plan and it did in fact take place. The minority preferred to regard a composite transaction as including any step which was planned to be included and which was in fact carried out. In the illustrative draft GAAR sub-section 15(3) adopts the minority approach.

independent body. The Advisory Panel referred to later is an example of the sort of body that could serve this purpose.

5.11 Secondly, in any potential dispute relating to the application of the GAAR there should be available all material which may help to determine whether a particular arrangement falls within the intended target area of the GAAR or, conversely, falls within the unaffected centre ground. This material should include available evidence, as at the time of the arrangement, in the form of official material or HMRC practice or widespread taxpayer practice, which is capable of throwing light on the inquiry; and this should be admissible even if it would not otherwise be admissible under the normal rules of evidence.

Differentiating between responsible tax planning and abusive schemes

5.12 Reverting now to the overarching principle, I have of course had many long and probing discussions with the Advisory Committee about how best to differentiate between the abusive tax schemes at which the GAAR is targeted and the centre ground of responsible tax planning which it is not to affect.

5.13 In many overseas GAARs, and indeed in many of the UK's specific anti-avoidance rules, the approach has been to target arrangements which have the sole or main purpose of achieving a tax advantage. There are many variants in the language, but the underlying concept is the same: if one of the objects of the arrangement is to achieve a tax advantage, then for that very reason the tax advantage should be denied.

5.14 I do not consider this to be the right approach for a GAAR that is suitable for the UK tax regime. The insuperable problem is that the UK tax rules offer, and indeed in many instances positively encourage, the opportunity for taxpayers to reduce their tax liability. Taking advantage of this can be described as a form of tax avoidance, but clearly it is not

something to be criticised and therefore it should not be counteracted by a GAAR. Obvious examples are arrangements designed to access capital allowances for investment in plant, or enhanced reliefs for scientific research expenditure, or tax incentives given for investment in enterprise zones. There are myriad other more subtle instances where there are different tax regimes for different, but not very distant, types of transactions (e.g. loan relationships, repos, derivatives etc.).

5.15 The conclusion reached is that to identify the sort of abusive scheme which the GAAR is intended to deter or counteract it is necessary to adopt a more pragmatic and objective initial approach. The starting point should be to see whether the arrangement is abnormal, in the sense of having abnormal features specifically designed to achieve a tax advantageous result. If an arrangement has such an abnormal feature or features then it becomes in effect "short listed" for consideration as a *potential* target for the GAAR. Conversely, if there is no such feature then it is immediately dismissed from consideration.

5.16 Placing an arrangement on this notional shortlist is a preliminary step. This leads to the critical stage of determining whether the arrangement does in fact fall within the GAAR's intended target area.

5.17 At first blush one might think this could be achieved by asking whether the arrangement is designed to achieve a tax result which Parliament, or the legislation, did not intend. The insuperable problem here, though, is the established principle of statutory interpretation in the UK which holds that the intention of Parliament can be discerned only from the language of the legislation itself. Ex hypothesi the GAAR is designed to deal with cases where the language of the legislation would, under normal principles of interpretation, indeed achieve a favourable tax result (e.g as in the SHIPS 2 scheme). So this question could never be answered in the affirmative.

5.18 Variants of this approach have been examined in an attempt to avoid the paradox created by that principle of statutory interpretation: for example, using criteria such as whether the tax result which the arrangement seeks to achieve is a result which is inconsistent with the "scheme of the legislation", or with the intention of the legislation "viewed as a whole", or "having regard to the wider context". The insuperable problem here is that the very essence of conventional purposive interpretation is to have regard to the context in which the particular provisions are set[19].

5.19 I have reached the conclusion that the better approach is to identify what it is that makes the centre ground of responsible tax planning unobjectionable; and to use this as the way to exclude from the shortlist of abnormal transactions those which come within that centre ground.

5.20 I consider that the reasoning developed by the Court of Final Appeal in Hong Kong, dealing with its GAAR[20], leads to the best approach for the UK. That approach is to recognise that tax rules may give taxpayers a number of reasonable choices as to the sort of transactions which they may carry out and, depending on the choice, the tax result which could be achieved. Ribeiro PJ expressed the principle in this way –

> "….the statutory purpose of section 61A is not to attack arrangements made to secure benefits which are legislatively intended to be available to the taxpayer."[21]

5.21 Because of the established principle of statutory interpretation in the UK, which requires the legislative "intention" to be established solely from the wording of the legislation, the language needs to be modified. Accordingly, I have modified it so as to refer to arrangements made to

[19] See the passage cited from Lord Wilberforce's speech in *Ramsay*, in paragraph 3.10 above.
[20] S.61A Inland Revenue Ordinance
[21] *Ngai Lik Electronics Company Ltd v Commissioner of Inland Revenue*, FACV No.29 of 2008, paragraph 101.

secure tax benefits which can be regarded as a reasonable response to choices afforded by the legislation.

5.22 This then is the approach which I consider most appropriate for a UK GAAR, and it is adopted in the illustrative draft GAAR appended to this Report.

Reducing uncertainty

5.23 There will, of course, be cases where it is arguable, but not clear, that an arrangement can be regarded as a reasonable exercise of choices made available by the tax rules. In such cases I consider that the appropriate principle is to give the taxpayer the benefit of the doubt. This would be achieved by placing on HMRC the burden of demonstrating that the arrangement *can not* reasonably be regarded as a reasonable exercise of choice.

5.24 Doing this should substantially reduce the scope for doubt as to whether an arrangement falls within the intended target area of the GAAR.

5.25 As previously noted, there is already considerable uncertainty in identifying the limit of effective tax avoidance; and no legislative or other framework will ever remove it entirely. However, it is important to reduce the scope of uncertainty as far as possible. To this end it would be desirable for there to be some mechanism to enable doubts to be addressed as quickly as possible. An effective mechanism for achieving this could be an advisory panel who would advise HMRC whether there are reasonable grounds for invoking the GAAR in the case of any particular arrangement. I envisage an advisory panel with a majority of non-HMRC members, which would receive written representations from the taxpayer as well as from HMRC. Establishing such a panel could have several advantages.

(i) First, it would provide an element of impartial supervision of the administration of the GAAR by HMRC.

(ii) Secondly, if the Advisory Panel's conclusions in each case are published (anonymised, so as to protect taxpayer confidentiality), then this would build up a body of guidance which could be used by taxpayers and HMRC to calibrate their understanding of where the dividing line falls between responsible tax planning and abusive tax schemes. This would be further helped if the Panel were to publish regular digests of its anonymised opinions.

(iii) Thirdly, the Advisory Panel could be used as an appropriate body to update the guidance notes referred to above.

5.26 Introducing these measures to give the taxpayer the benefit of the doubt and to reduce the scope for uncertainty would make it unnecessary to introduce a general system of clearances for the GAAR. Such a system would impose very considerable resource burdens on taxpayers and HMRC alike; and if a general clearance system were to be operated by HMRC themselves, then it would give them additional discretionary powers – which would be wrong as a matter of constitutional principle.

5.27 However, no such objection applies to extending existing clearance arrangements (such as for company reorganisations or de-mergers) so that the application, and the clearance if granted, would extend to confirmation that the GAAR would be inapplicable to the arrangement concerned. Accordingly I consider that it would be appropriate, and sensible, to include such a provision in the GAAR.

5.28 On the issue of uncertainty there are two further points which need to be made.

5.29 First, there will inevitably be cases where tax planning arrangements test the outer limits of the centre ground, giving rise to uncertainty as to whether the GAAR applies. However, in most if not all of these cases it is likely that there would in any event be uncertainty as to whether such tax planning would succeed in achieving its objective on the basis of the tax rules themselves, without any consideration of the GAAR. The comments of Lord Walker in the recent Supreme Court *Tower MCashback*[22] case are a powerful reminder of this fact of life.

> "The composite transactions in this case, like that in *Ensign* (and unlike that in *BMBF*) did not, on a realistic appraisal of the facts, meet the test laid down by the CAA, which requires real expenditure for the real purpose of acquiring plant for use in a trade. Any uncertainty that there may be will arise from the unremitting ingenuity of tax consultants and investment bankers determined to test the limits of the capital allowances legislation."

5.30 Secondly, there are some areas of taxation, such as trusts, where the present statutory rules are extremely complex and can give rise to many anomalous consequences. This is not a reason to recommend against a GAAR. Rather, it calls for rationalisation of these rules. As an interim measure specific guidance notes will need to be agreed between HMRC and representative bodies working in such cases.

Exclusion for arrangements with no tax intent

5.31 There is one further principle which I consider should be included in the UK GAAR. This is that there should be an automatic exclusion from the operation of the GAAR for any arrangement which is entered into entirely for non-tax reasons. It is, of course, unlikely that arrangements which have no tax intent at all would in fact give rise to a tax advantage. However, that is nonetheless possible[23].

[22] [2011] UKSC 19, paragraph 80.
[23] See, in the commercial context, *Five Oaks Properties Ltd v HMRC* [2006] STC (SCD) 769

5.32 I think it important that this reassurance is given, if only to avoid unwarranted fears by small business concerns or private individuals that arrangements such as providing financial assistance to suppliers or relatives, and without any intention of seeking tax reduction as a result, might come within the scope of the GAAR.

5.33 In such cases it is reasonable to require the taxpayer to prove that the arrangement was not entered into with any intention of reducing his tax liability. Accordingly this particular safeguard differs from the general rule adopted in the GAAR by imposing the burden of proof on the taxpayer.

Counteraction

5.34 One of the main objectives of the GAAR is to deter taxpayers from entering into the sort of abusive arrangements at which it is targeted. If that deterrence fails, and the taxpayers go ahead with arrangements which fall within the GAAR's target area, then consideration needs to be given to the form of counteraction which should be applied by HMRC.

5.35 The basic principle which I consider should be adopted is that counteraction should produce a result which is reasonable and just. The determination of a reasonable and just result is an issue which should be justiciable before the Tax Tribunal, and not left to HMRC's discretion.

5.36 There are two ways in which this can be achieved. The first is simply to leave it to the Tax Tribunal to determine what would be a reasonable and just result in all the circumstances. This would be the appropriate treatment for cases, like *Ramsay* itself, where the arrangement is effectively self-cancelling. In such cases it may be reasonable and just simply to treat the transaction as if it did not take place (so that any loss claim would be ignored); but there might be instances where such

arrangements do in fact change the economic position of the persons involved, in which case that change should be respected by the counteraction.

5.37 In other types of cases, where the arrangement is designed to achieve some real commercial or personal purpose in addition to the intended abusive tax result, I consider that the appropriate counteraction should, where possible, be to base the assessment and computations on a hypothetical equivalent transaction which would achieve the same commercial or personal result but without the abusive tax result.

5.38 In such cases there would inevitably be concern that HMRC might seek to identify or construct an equivalent arrangement producing the highest possible tax liability. To guard against this the counteraction provisions of the GAAR should place the onus on HMRC to establish that its designated equivalent arrangement is appropriate to the circumstances.

5.39 As a further protection I consider it important that, if the taxpayer does not agree with HMRC's proposed counteraction, then on appeal the Tax Tribunal should reach its own conclusion as to what would be the appropriate equivalent arrangement. Further, if the Tribunal forms the view that it is either impossible or excessively difficult to identify such an arrangement, then it should apply whatever counteraction appears to it to be reasonable and just.

5.40 It is also important that where counteraction is applied, then consideration must be given to the tax liability of the same taxpayer for other periods, or of other taxpayers for that period or other periods, so as to ensure so far as possible that the counteraction does not lead overall to excessive taxation.

Introduction of the GAAR

5.41 Counteraction under the GAAR would have the effect of overriding the result which would otherwise follow from the tax rules. There is a case, therefore, for arguing that the GAAR should not apply to arrangements which are entered into (even if they are not completed) by the time when the GAAR itself enters into force.

5.42 However, I consider that this would be inappropriate. Ex hypothesi the GAAR is designed to apply only to artificial and abusive tax schemes which, as previously discussed, are widely regarded as intolerable. It is also important to note that if the GAAR is enacted, then its enactment will have been preceded by a period of consultation, and that period will have been preceded in turn by the publication of this Report.

5.43 I therefore see no unfairness in applying the GAAR to an arrangement which is not yet completed before the date when it comes into force; and it would in my view be appropriate to do so.

Scope of the GAAR

5.44 I consider that if a GAAR is to be enacted, it should initially be confined to the main direct taxes, namely income tax, corporation tax, capital gains tax and petroleum revenue tax. It should also extend to national insurance contributions, although this would require separate enactment as NICs are not regarded as a tax for the purposes of Parliamentary procedure.

5.45 It is sensible to restrict the operation of the GAAR to these taxes in the first place, in order to allow experience to be gained before consideration is given to extending it to other taxes, such as SDLT.

5.46 However, it would not be appropriate for that consideration to extend to VAT, as this tax has its own (still developing) abuse of law doctrine: issues could therefore arise as to possible inconsistencies between terms of the GAAR and the EU doctrine of abuse of law.

Penalties or penal interest

5.47 In some jurisdictions[24] there are provisions applying special penalty or rates of interest regimes to tax recovered under a GAAR. Including similar measures in a UK GAAR would certainly increase its deterrent effect, and may be regarded by a significant proportion of taxpayers as no more than just retribution for schemes designed to avoid paying a fair share of tax.

5.48 However, I consider that including such provisions would be seen as presenting an irresistible temptation to HMRC to wield the GAAR as a weapon rather than to use it, as intended, as a shield. For this reason I do not consider that it would be appropriate to include any provisions for applying special rates of interest or penalties to tax recovered by use of the GAAR.

[24] For example Australia, New Zealand and South Africa, and see the USA economic substance codification.

SECTION 6

Embodying those principles in a GAAR

6.1 A substantial part of the period of the GAAR Study has been taken up with considering whether, and if so how, the principles discussed in section 5 above can be incorporated as legislation.

6.2 The conclusion reached is that it is possible to do so, and the illustrative GAAR in Appendix I is an indication of what might be appropriate legislation. The Guidance Note at Appendix II highlights particular points to note in the draft GAAR, and importantly gives guidance on the operation of the critical protection of responsible tax planning.

6.3 Rather than setting out here an extensive restatement of what is in the illustrative GAAR and the Guidance Note readers of this Report are invited to read the texts of Appendices I and II. For present purposes it is sufficient to note that the illustrative GAAR follows the route indicated in section 5 of this Report. In broad terms the GAAR imposes two main requirements -

(i) The first is that the GAAR applies only to abnormal arrangements: an abnormal feature has to be identified, its inclusion has to be for the purpose of achieving the intended tax result, and the intended tax result has to be achieved in one of a number of specified ways.

(ii) The second is that the GAAR will operate only if the arrangement cannot reasonably be regarded as a reasonable exercise of choices of conduct afforded by the legislation. This is the most important of the protections (termed “safeguards”) for responsible tax planning. As emphasised in the previous section of this Report, cases where there may be doubt as to whether the arrangement falls within that description are to be

resolved by giving the taxpayers the benefit of the doubt. This is achieved in the illustrative draft GAAR by using the expression –

"If it *can* reasonably be regarded as a reasonable exercise of choices of conduct…….".

The test is objective, and in practice it means that in the event of dispute the Tax Tribunal will decide in the taxpayer's favour not only if the judge himself regards the arrangement as a reasonable exercise of choices of conduct but also, where he does not himself take that view, he nonetheless considers that such a view may reasonably be held.

6.4 With the burden of establishing the point placed on HMRC this may be seen as a high hurdle which the GAAR needs to clear. Indeed, it is intended to be a high hurdle. However, I am satisfied that the GAAR will clear this hurdle when dealing with the highly artificial tax avoidance schemes, of which SHIPS 2 is a very visible example, which it is designed to deter or defeat.

6.5 The other protections referred to in section 5 of this Report are set out in the GAAR, whether under the caption "safeguards" or in section 10 of the illustrative draft which deals with the admissibility of relevant evidential material.

6.6 There is one particular point which it may be worthwhile highlighting here. This is the control and management regime set out in section 13 of the illustrative draft. This requires a senior HMRC official to authorise any prospective use of the GAAR. Its purpose is to ensure consistency and responsibility in the use of the GAAR by HMRC.

6.7 Section 13 goes on to provide that the taxpayer must be notified of the prospective use of the GAAR by HMRC, and must be given the opportunity to make representations as to why in his view the GAAR is

inapplicable. This particular provision addresses the concern that HMRC may otherwise invoke the GAAR in cases where they do not have a sufficient understanding of the nature of the arrangement or the context in which that arrangement was carried out. This would be particularly important for areas such as finance and derivatives where it is difficult to keep pace with the development of new types of instrument.

6.8 The next section of the illustrative draft, section 14, provides for the referral of disputed matters to the Advisory Panel. The draft envisages that this Panel will be established under regulations made by statutory instrument. I envisage that there would be an overall panel of members, comprising individuals with experience in a range of commercial activities, and also individuals experienced in what is known as private client taxation. The Panel would also have members appointed by HMRC. I envisage that in any given case a small sub-panel of three members would be appointed to consider the representations of HMRC and the taxpayer. On this sub-panel, two of the members would be independent, and at least one of them would have expertise relevant to the arrangement concerned.

6.9 The Panel would operate on an advisory basis only, and its conclusions would not be binding on either HMRC or the taxpayer. However, the opinions of the Panel would be available to be taken into account by the Tax Tribunal on any appeal against counteraction under the GAAR.

6.10 Finally, it should be emphasised that the illustrative draft is just that. All of its features could be incorporated in a draft which is more succinct or compressed. Conversely, some of its provisions could be expressed more extensively. It is also quite possible that some of its provisions may need to be adjusted to ensure that the GAAR does not itself have any gaps or loopholes which can be exploited by the ingenuity of the promoters of artificial tax schemes.

6.11 Accordingly, while I would be happy to see a suitably refined version of the illustrative GAAR enacted into legislation, my main concern is not pride of authorship, but rather that there should be enacted a GAAR which reflects the principles which I have set out and which can put a stop to the abusive schemes at which it is targeted.

APPENDIX I – ILLUSTRATIVE DRAFT GAAR

PART XY
GENERAL ANTI-ABUSE RULE

Scope of this Part

1. (1) This Part applies for the purposes of income tax, corporation tax, capital gains tax and petroleum revenue tax ("the taxes").

(2) The enactments which apply to the taxes, including -

(a) subordinate legislation, and

(b) relevant double taxation arrangements (see section 15) given effect under section 2 of the Taxation (International and Other Provisions) Act 2010

are in this Part referred to as "the Acts".

2. Section 8 applies to counteract abnormal arrangements (see sections 6 and 7) which, but for this Part, would achieve an abusive tax result from the application to the arrangements of the provisions of the Acts, and which are contrived to achieve such a result.

3. (1) For the purposes of this Part an "abusive tax result" is an advantageous tax result (see section 15) which would be achieved by an arrangement that is neither reasonable tax planning (see section 4) nor an arrangement without tax intent (see section 5).

(2) For the purposes of this Part an abnormal arrangement is contrived to achieve an abusive tax result if, and only if, the inclusion of any abnormal feature (see sections 6 and 7) can reasonably be considered to have as its sole purpose, or as one of its main purposes, the achievement of an abusive tax result by –

(a) avoiding the application of particular provisions of the Acts, or

(b) exploiting the application of particular provisions of the Acts, or

(c) exploiting inconsistencies in the application of provisions of the Acts, or

(d) exploiting perceived shortcomings in the provisions of the Acts.

Safeguard 1 - reasonable tax planning

4. (1) An arrangement does not achieve an abusive tax result if it can reasonably be regarded as a reasonable exercise of choices of conduct afforded by the provisions of the Acts.

(2) Accordingly, section 8 (counteraction) shall not apply to such arrangements.

(3) Such arrangements are in this Part referred to as “reasonable tax planning”.

Safeguard 2 - arrangements without tax intent

5. (1) An arrangement does not achieve an abusive tax result where the advantaged party shows, to the civil standard of proof, that it was neither designed nor carried out with the intention of achieving an

advantageous tax result, and that no step or feature was included in or omitted from it with that intention.

(2) Accordingly, section 8 (counteraction) shall not apply to such arrangements.

(3) Such arrangements are in this Part referred to as “arrangements without tax intent”.

Abnormal arrangements and abnormal features

6. (1) For the purposes of this Part an “abnormal arrangement” is an arrangement which, considered objectively –

(a) viewed as a whole, and having regard to all the circumstances, has no significant purpose apart from achieving an abusive tax result (so that in the context of such an arrangement all of its features shall be regarded as abnormal); or

(b) has features which would not be in the arrangement if it did not also have as its sole purpose, or as one of its main purposes, achieving an abusive tax result.

(2) The provisions of section 7 apply for the purposes of sub-section (1)(b).

(3) For the purposes of this Part “abnormal features” are the features referred to in sub-section (1)(b) read together with section 7.

Abnormal arrangements: features which may be taken into account

7. (1) Sub-section (3) sets out features which in the context of the particular arrangement may be regarded as abnormal features, and

which accordingly may be taken into account in determining whether that arrangement is an abnormal arrangement.

(2) Features other than those set out in sub-section (3) may be so regarded and taken into account; but the fact that the arrangement has one or more of the features set out in that sub-section shall not necessarily lead to the conclusion that the arrangement is an abnormal arrangement.

(3) The features are -

(a) that the arrangement would, apart from the operation of this Part, result in receipts being taken into account for tax purposes which are significantly less than the true economic income, profit or gain;

(b) that the arrangement would, apart from the operation of this Part, result in deductions being taken into account for tax purposes which are significantly greater than the true economic cost or loss;

(c) that the arrangement includes a transaction at a value significantly different from market value, or otherwise on non-commercial terms;

(d) that the arrangement, or any element of it, is inconsistent with the legal duties of the parties to it;

(e) that the arrangement includes a person, a transaction, a document or significant terms in a document, which would not be included if the arrangement were not designed to achieve an abusive tax result;

(f) that the arrangement omits a person, a transaction, a document or significant terms in a document, which would not be omitted if the arrangement were not designed to achieve an abusive tax result; and

(g) that the arrangement includes the location of an asset or a transaction, or of the place of residence of a person, which would not be so located if the arrangement were not designed to achieve an abusive tax result.

Counteraction

8. (1) An abnormal arrangement which is contrived to achieve an abusive tax result shall be counteracted as follows.

(2) If the arrangement viewed as a whole is contrived to achieve an abusive tax result, and has no significant purpose apart from this, the receipts and deductions of an advantaged party (see section 15) shall be computed and assessed in such manner as is reasonable and just (including, if appropriate, by treating the arrangement as if it had not taken place).

(3) If the arrangement viewed as a whole has a significant purpose apart from being contrived to achieve an abusive tax result, the receipts and deductions of the advantaged party shall, subject to sub-section (5), be computed and assessed as if a corresponding non-abusive arrangement had been carried out instead of the actual arrangement.

(4) A “corresponding non-abusive arrangement” is an arrangement which would enable the achievement of a purpose which is the same as or similar to that which the actual arrangement was intended to achieve, but which does not achieve an abusive tax result.

(5) If, having regard to the particular arrangement, it is not possible to determine what would be a corresponding non-abusive arrangement, then the receipts and deductions of an advantaged party shall be computed and assessed in such manner as is reasonable and just.

Safeguard 3 – burden of proof on HMRC

9. It shall be for HMRC to show, to the civil standard of proof –

(a) that the arrangement is an abnormal arrangement;

(b) that the advantageous tax result of the arrangement would be an abusive tax result (and accordingly that the arrangement is not reasonable tax planning);

(c) that the counteracting computations and assessments are reasonable and just; and

(d) where relevant, what is to be taken as the corresponding non-abusive arrangement.

Guidance Note and admissibility of evidence

10. (1) In determining the matters set out in sub-section (2) -

(a) there shall be taken into account the Guidance Note in Schedule XY, and

(b) there also may be taken into account any material referred to in sub-section (3), whether or not such material would otherwise be admissible in evidence.

(2) The matters referred to in sub-section (1) are –

(a) whether the arrangement is an abnormal arrangement;
(b) whether any particular feature is an abnormal feature;
(c) whether the arrangement constitutes reasonable tax planning;
(d) whether the tax result is an abusive tax result; and
(e) what is to be taken as the corresponding non-abusive arrangement.

(3) The material which may also be taken into account is –

(a) any relevant Parliamentary, Ministerial or HMRC material which is in the public domain at the time of the arrangement;

(b) published guidance or determinations of the Advisory Panel;

(c) evidence of HMRC practice at the time of the arrangement; and

(d) evidence of practice commonly adopted at the time of the arrangement.

Corresponding adjustments to the computation and assessment of other periods or other persons

11. (1) Where the receipts or deductions of an advantaged party are counteracted under the provisions of section 8, such corresponding adjustments shall be made to the computation and assessment of receipts or deductions, whether for the same or for other periods and whether for that party or for other persons, as are reasonable and just having regard to the nature of the counteraction applied.

(2) Any person who is dissatisfied with a refusal to make a corresponding adjustment, or with the nature of the corresponding

adjustment made, shall have the right to appeal to the tribunal. On such appeal the tribunal shall reach such determination as it considers reasonable and just.

Clearances

12. Where the arrangement is, or involves, a transaction or a step which is within a provision of the Acts which provides for an application by any person for clearance, then that person may, subject to the same time limits and procedures, apply for confirmation that the provisions of section 8 (counteraction) shall not be applied to the arrangement.

Control and management

13. (1) There shall be no counteraction under section 8 in respect of any arrangement unless it is authorised, in accordance with the procedure set out in this section, by an officer of HMRC who is designated by the Board for this purpose.

(2) Where a designated officer considers that counteraction may be applicable in the case of any arrangement, he shall so notify the party whom he considers to be the advantaged party.

(3) Within six weeks of receipt of such notification that party shall be entitled to send to the designated officer written representations stating why in his opinion counteraction is not applicable to the arrangement.

(4) If no representations are sent within six weeks the designated officer shall be entitled to authorise counteraction under section 8.

Safeguard 4 – referral of potential counteraction to Advisory Panel

14. (1) If representations are sent within that period the designated officer shall consider them, and if having done so he considers that counteraction is applicable he shall within four weeks of receiving them send to the Advisory Panel:

(a) the notification referred to in sub-section 13(2),

(b) the representations referred to in sub-section 13(3), and

(c) any comments of his in respect of the representations.

(2) Within six weeks of receipt of the documents referred to in sub-section (1) the Advisory Panel shall advise the designated officer whether in its opinion it would be reasonable for him to authorise counteraction under section 8 in respect of the arrangement.

(3) The designated officer shall consider the opinion of the Advisory Panel, and shall within two weeks of its receipt send to the party concerned –

(a) a copy of the opinion, and

(b) his decision whether or not to authorise counteraction.

(4) On any appeal against counteraction under section 8 the opinion (or opinions, if not unanimous) of the Advisory Panel shall be admissible in evidence.

(5) The Advisory Panel shall be constituted in accordance with regulations made under this section *[NB the composition specified in the regulations should be - an independent chairman, an*

independent member (where possible with relevant expertise) and an HMRC member].

Other definitions

15. (1) An “advantaged party” is any party to an abnormal arrangement whose tax liability would be reduced, or entitlement to a tax relief, credit or payment would be increased, if the arrangement achieved the abusive tax result.

(2) An “advantageous tax result” is a result which –

(a) achieves a significant reduction in receipts or a significant increase in deductions taken into account for the purpose of computing or charging any of the taxes;

(b) achieves a significant deferral of the time when receipts are so taken into account, or a significant acceleration of the time when deductions are so taken into account; or

(c) achieves a significant reduction in the rate of tax chargeable.

(3) An “arrangement” -

(a) includes any plan or understanding, whether or not legally enforceable; and

(b) also includes any step or feature which is intended to be included, and which is in fact included, as an element of an arrangement, whether or not the inclusion of that element as part of the arrangement is legally enforceable or factually inevitable.

(4) “Deductions” includes expenses, charges, reliefs, losses and tax credits.

(5) “HMRC” means The Commissioners for Her Majesty’s Revenue and Customs.

(6) “Receipts” includes income, profits and chargeable gains.

(7) “Relevant double taxation arrangements” are those to which this Part can lawfully apply.

(8) “Tribunal” means the First-Tier Tribunal or, where determined by or under Tribunal Procedure Rules, the Upper Tribunal.

Commencement

16. (1) This Part applies to arrangements wholly or partially carried out after the commencement date.

(2) If an arrangement to which section 12 (clearances) applies is carried out partly before the commencement date, then the time for applying for confirmation under the provisions of that section shall be extended until sixty days after this Part comes into force.

APPENDIX II – ILLUSTRATIVE DRAFT GUIDANCE NOTE

SCHEDULE XY – GUIDANCE NOTE

OVERVIEW

Operation of the GAAR

1 Sections 1-16 in Chapter XY introduce the new general anti-abuse rule. This rule is designed to deter and counteract abnormal arrangements which go beyond reasonable tax planning and which are contrived to achieve an advantageous tax result. An advantageous tax result achieved by such an arrangement is referred to throughout the Chapter as an "abusive tax result".

2 Counteraction under the GAAR comes into effect only if the application to the arrangement of the particular relevant tax rules, given their normal purposive interpretation, would produce an abusive tax result. Accordingly, the GAAR is not an extension to the normal principles of purposive interpretation, but rather is a separate rule which comes into operation when the application of those normal rules would fail to prevent the achievement of the abusive tax result.

3 This does not mean that consideration of the potential operation of the GAAR needs to be postponed until the application of the particular relevant rules has been tested to the point where it is established that they would lead to the achievement of an abusive tax result. In the interests of minimising the delay and costs involved in resolving disputes relating to the arrangement the assumption, and intention, is that in normal cases the application and interpretation of the particular relevant

rules and the potential application of the GAAR should be dealt with in parallel.

4 In broad terms, whether there should be counteraction by the GAAR is determined by answering a sequence of questions:

(i) Is the arrangement an abnormal arrangement?

(ii) If so, what is the abnormal feature in the arrangement?

(iii) Is that abnormal feature included with the sole, or with a main, purpose of achieving an advantageous tax result?

If so, proceed to (iv).

(iv) Is the arrangement protected by safeguard 1, which covers reasonable tax planning?

If so, there is to be no counteraction. If not, proceed to (v).

(v) Is the arrangement protected by safeguard 2, which covers arrangements designed and carried out without any intention of achieving an advantageous tax result?

If so, there is to be no counteraction. If not, there will be counteraction.

5 An important additional safeguard (referred to as “safeguard 3”) is given by placing on HMRC the burden of proving that the arrangement is abnormal, that the abnormal feature has the sole or a main purpose of achieving an advantageous tax result, and that the arrangement does not constitute reasonable tax planning.

6 Where counteraction is applicable, then its form depends upon the particular nature of the arrangement. Depending on the circumstances it may take the form of –

(i) adjusting computations and assessments as is reasonable and just; or

(ii) adjusting computations and assessments by reference to a hypothetical arrangement which would achieve the same non-tax result as the actual arrangement, but without achieving the abusive tax result which the actual arrangement sought to achieve.

7 Where counteraction takes place, then provision is made for corresponding adjustments to be made to computations and assessments (whether for the same or other periods or for the same or other persons) so as to ensure as far as possible that the counteraction will not have the effect of imposing an element of double taxation on income or profits derived from the arrangement.

Evidence

8 So as to permit a fully informed consideration of whether the arrangement is abnormal, whether it constitutes reasonable tax planning, and what would be the appropriate form of counteraction, provision is made for the admissibility of all relevant material which was in the public domain at the time of the arrangement, including evidence of practice (both HMRC and non-HMRC) at the time of the arrangement.

Control and management within HMRC

9 To ensure uniformity of application, and to minimise the risk that the GAAR may be invoked inappropriately by HMRC case workers,

authorisation by designated HMRC officials is required before HMRC can seek to apply the GAAR to any arrangement.

10 The designated officials are required to follow a set procedure which is designed, inter alia, to ensure that taxpayers are given the opportunity of explaining why in their view counteraction is inapplicable.

Advisory Panel

11 An additional safeguard (referred to as "safeguard 4") against inappropriate use of the GAAR is given by requiring the designated HMRC officials to seek the opinion of an Advisory Panel as to whether HMRC have reasonable grounds for pursuing counteraction under the GAAR.

12 The constitution of the Advisory Panel will be laid down in a statutory instrument issued under the authority of this Part. In any given case this will comprise an independent chairperson, a person (who may be an HMRC official) nominated by HMRC, and an independent person who, where possible, will have relevant experience of the area of activities relevant to the arrangement.

13 Regulations will provide for the publication of a synopsis of each opinion (anonymised to preserve taxpayer confidentiality), and of regular digests of such opinions.

Clearances

14 The GAAR does not provide for a general system of clearances. This is because the elimination from the scope of counteraction of all arrangements which can reasonably be regarded as reasonable tax planning makes it unnecessary to commit the resources which a general system of clearances would involve (both for HMRC and taxpayers).

15 However, where the arrangement includes steps in respect of which existing legislation provides a clearance procedure, then the GAAR permits taxpayers to expand that clearance application so as to include an application for confirmation that there should be no counteraction under the GAAR. This will therefore maintain the certainty of treatment achieved by existing clearance procedures, without requiring significant additional resources (whether from taxpayers or HMRC).

SECTION 1

16 Sub-section 1(1) applies the new general anti-abuse rule to income tax, corporation tax, capital gains tax and petroleum revenue tax.

17 Sub-section 1(2) makes it clear that references to provisions in the relevant Acts which apply those taxes include provisions in statutory instruments and also double taxation arrangements. However, the expression "*relevant* double taxation arrangements" is used to make it clear (by reference to the definition provisions in section 15) that the GAAR does not operate in respect of double taxation arrangements (or articles in double taxation arrangements) in any case where the provisions of section 2 of the Taxation (International and Other Provisions) Act 2010 would prevent its application. This may depend upon the precise terms of the double taxation arrangement and of the relevant OECD commentaries applicable to the arrangement.

SECTION 2

18 Section 2 has two functions:

(i) First, the section makes it clear that the GAAR comes into operation *after* the normal purposive interpretation has been applied to the statutory provisions in question. In other words, the GAAR is not a part of, or an extension to, the normal process of statutory interpretation. It is instead a separate statutory rule

which has to be considered once the normal process of statutory interpretation shows that the arrangement would achieve an abusive tax result.

This does not mean that the possible application of the GAAR must be deferred until after the interpretation of the provisions, and their application to the arrangement, have been determined. Where the possible application of the GAAR is under consideration at any stage of a dispute, its potential application should be considered in parallel with consideration of the interpretation and application of the other statutory provisions.

Accordingly, it is important to note that the GAAR does not affect either the normal judicial interpretation of tax statutes, or HMRC's right to challenge in the normal way arrangements which it considers ineffective in achieving a tax avoidance purpose. Likewise, the taxpayer's right to contest such challenges is unaffected.

(ii) Secondly, the section introduces the key elements which need to be present before counteraction of tax advantageous arrangements is potentially engaged. The three elements are –

(a) that the arrangement in question is an abnormal arrangement;

(b) that the abnormal arrangement would, in the absence of the GAAR, achieve an abusive tax result; and

(c) that the abnormal arrangement is contrived to achieve the abusive tax result.

SECTION 3

19 Sub-section (1) defines the term “abusive tax result”. It covers advantageous tax results (as defined in section 15) which would arise from arrangements which do not fall within the pivotal safeguard 1 (in section 4) for reasonable tax planning, or within safeguard 2 (in section 5) for arrangements without tax intent.

20 Sub-section (2) explains that an abnormal arrangement is to be taken as being contrived to achieve an abusive result if the inclusion of any abnormal feature (as defined in sections 6 and 7) has as its sole purpose or one of its main purposes the achievement of an abusive tax result. There are two particular points to note –

(i) The expression “if the inclusion of any abnormal feature …..*can reasonably be considered* to have …..” shows that the test is an objective one. It is not necessary to demonstrate that the promoter of the arrangement or the parties to it subjectively intended the abnormal feature to have such a purpose (although this would be very likely if not inevitable). Rather, the test is whether it would be reasonable to consider the inclusion of the abnormal feature as having such a purpose.

(ii) Some abusive tax arrangements operate by including a feature which has a dual purpose – one designed to achieve a particular tax result and the other designed to achieve some non-tax purpose. The language of sub-section (2) makes it clear that it is sufficient for the arrangement to be regarded as “contrived to achieve an abusive tax result” if the abnormal feature has as one of its main purposes achieving that result, whether or not it also has some other purpose.

21 Sub-section (2) then goes on to list four methods by which arrangements seek to achieve abusive tax results, and requires that the abnormal feature is used in one of these methods. The methods are –

(a) avoiding the application of particular provisions;

(b) exploiting the application of particular provisions;

(c) exploiting inconsistencies in the application of provisions; or

(d) exploiting perceived shortcomings in provisions.

22 Experience has shown that it is these methods which in practice are adopted by promoters and devisers of abusive tax avoidance schemes.

SECTION 4

23 Safeguard 1 in section 4 is of fundamental importance to the operation of the GAAR.

24 Its purpose is to protect arrangements which can reasonably be regarded as a reasonable response to choices of conduct which are made available by the relevant tax legislation. Arrangements which fall into this category are described, by sub-section (3), as “reasonable tax planning”.

25 In some cases the legislation does not merely make an advantageous tax result available, but it provides an incentive to taxpayers to carry out transactions in order to achieve that advantageous tax result. Obvious examples of this are enhanced capital allowances for investment in machinery and plant, and specific tax reliefs for investing in enterprise zones or in research and development.

26 There are, though, many additional cases where legislation less obviously offers choices of conduct. For example, the choice between debt or share capital as a means of funding companies results in quite different tax treatments. Likewise investment as a capital transaction is treated quite differently from investment by way of a dealing activity.

27 As more complex activities and structures have developed, particularly in the field of finance, so tax legislation has responded by creating different rules or regimes for different types of transactions. Financial instruments, loan relationships, foreign exchange dealings and derivative transactions are all fairly recent examples of subjects covered by detailed legislation where the tax treatment accorded to transactions falling within the regime is different from that accorded to those falling outside.

28 Similarly, complex business models may be adopted by commercial enterprises (particularly multinational enterprises), where assets, activities and personnel may be located in different entities and in different countries in order to increase the enterprise's competitiveness; and sophisticated transactions may be required to meet the increasing complexities of modern commercial activities.

29 The purpose of safeguard 1 in section 4 is to ensure that any reasonable response by the taxpayer, whether an individual or a commercial enterprise, to the choices inherent in the existence of these different rules and regimes is not to be the subject of counteraction by the GAAR.

30 What can in any particular case reasonably be regarded as a reasonable response will, of course, depend on the precise circumstances. In exceptional circumstances this could include taking steps to avoid a wholly inappropriate tax *disadvantage* which might otherwise arise from carrying out an entirely commercial transaction.

31 The expression "*if it can reasonably be regarded as a reasonable exercise of choices of conduct*" demonstrates that the test can be satisfied even if the contrary view might also be held. In other words, safeguard 1 is designed to operate both in cases where it is clear that the arrangement constitutes a reasonable exercise of choices of conduct, and also in cases where, while contrary views may be held, it is reasonable to take the view that the arrangement should be regarded as a reasonable exercise of choices of conduct.

32 Applying this in the context of an appeal to the Tax Tribunal, it means that safeguard 1 would apply not only if the judge himself regards the arrangement as a reasonable exercise of choices of conduct but also, where he does not himself take that view, he nonetheless considers that such a view may reasonably be held.

SECTION 5

33 Safeguard 2 in section 5 protects taxpayers from the risk of counteraction in cases where they enter into transactions solely for business, investment, family or philanthropic reasons, without any thought being given to the possibility of achieving an advantageous tax result.

34 To come within this safeguard the advantaged party must show that the arrangement was neither designed, nor in fact carried out, with the intention of achieving an advantageous tax result, and must also show that no element of the arrangement was included or omitted with such an intention. The use of the passive expressions "designed" and "carried out" makes it clear that the absence of intent must be shown to extend to every person involved in the planning and execution of the arrangement.

35 If the advantaged party satisfies the burden of proving this, then no counteraction is applied even though, objectively, the arrangement would

be regarded as an abnormal arrangement contrived to achieve an abusive tax result.

SECTION 6

36 Sub-section (1) explains that “an abnormal arrangement” covers two situations.

(i) The first situation, set out in sub-section (1)(a), is where the arrangement, viewed as a whole (having regard to all the circumstances) has no significant purpose apart from achieving an abusive tax result.

The expression “*significant* purpose” is adopted to ensure that the inclusion of some trivial non-tax purpose will not affect the ability of the GAAR to counteract such an arrangement.

(ii) The second situation is set out in sub-section (1)(b). This covers an arrangement which, viewed as a whole, does have some significant non tax abusive acceptable purposes, but includes features which would not be included if the arrangement did not also have a main purpose of achieving an abusive tax result.

37 Sub-section (2) notes that section 7 (which amplifies the concept of abnormal arrangements) applies for the purposes of sub-section (1)(b). There is no need for section 7 to apply for the purposes of sub-section (1)(a), because all the features of an arrangement falling within that paragraph (i.e. one with no significant purpose apart from achieving an abusive tax result) are conclusively presumed to be abnormal.

38 Sub-section (3) aligns the substance of the definitions of “abnormal arrangements” and “abnormal features”.

SECTION 7

39 Section 7 sets out a list of features which in the context of the particular arrangement *may* be regarded as abnormal features, and which in consequence *may* be taken into account to determine whether the arrangement is an abnormal arrangement.

40 Sub-section (2) makes it clear that the list of features is intended only as a guide: the presence of one or more of those features does not necessarily lead to the conclusion that the arrangement is 'abnormal'. For example, a transfer at non-market value may be made for entirely non tax abusive reasons (such as to support a relative, a customer or a supplier). Whether such a feature is to be taken as an indication of abnormality depends very much on the facts and circumstances of the particular arrangement.

41 Conversely, sub-section 7(2) also makes it clear that the list is not exhaustive, so that there may be other, unlisted, features (such as non-recourse funding) which are included in the arrangement and which, again having regard to the facts and circumstances of the particular arrangement, can objectively be regarded as abnormal.

SECTION 8

42 Section 8 is the key operative provision in the GAAR. It states the nature of the counteraction to be applied to abnormal arrangements which are contrived to achieve an abusive tax result.

43 Sub-section (2) deals with the case where the abnormal arrangement has no significant purpose apart from achieving an abusive tax result. The counteraction to be applied in this case is to adjust the receipts or deductions of the advantaged party in such manner as is reasonable and just. In some cases the reasonable and just counteraction will take the form of simply treating the arrangement as it if had not taken place.

Arrangements which have no economic consequence at all (such as in *Ramsay v IRC* [1981] STC 174) will fall into this category. However there may be other arrangements which have no significant purpose apart from achieving an abusive tax result but which nonetheless produce an economic profit or loss. Accordingly for such cases sub-section (2) makes it possible to adjust the receipts or deductions to such amounts as reflect the economic consequence of the arrangement.

44 Sub-section (3) deals with cases where the abnormal arrangement has some other significant purpose in addition to achieving the abusive tax result. In such cases the counteraction may take one of two forms –

(i) Where it is possible to do so the counteraction operates by taking as a comparator a hypothetical arrangement which would achieve a purpose which is the same as, or similar to, that which the actual arrangement was intended to achieve, but without producing the abusive tax result. This is described by the expression "a corresponding non-abusive arrangement" (which is defined in sub-section (4)).

It should be emphasised that the adjustment of receipts or deductions by reference to a corresponding non-abusive arrangement is an objective and hypothetical exercise. It is not relevant whether the advantaged party would in practice have been willing to carry out a corresponding non-abusive arrangement.

(ii) There may be cases where it is not possible to identify or construct an arrangement which would serve as a corresponding non-abusive arrangement. If, having regard to the particular circumstances, this proves to be the case, then the counteraction to be applied is to adjust the receipts or deductions of the advantaged party in such manner as is reasonable and just.

SECTION 9

45 Safeguard 3 in section 9 uses the burden of proof to provide an additional protection for taxpayers and to strengthen the pivotal safeguard 1 in section 4.

46 For counteraction to be applied HMRC will need to demonstrate all the key factors required by the GAAR, namely –

(i) that the arrangement is an “abnormal arrangement”;

(ii) that the arrangement does not constitute reasonable tax planning;

(iii) that the arrangement is “contrived to achieve” an abusive tax result;

(iv) that the counteraction is reasonable and just; and, where relevant,

(v) what hypothetical arrangement should be taken as a corresponding non-abusive arrangement.

SECTION 10

47 Section 10 introduces rules of evidence which require the Tribunal and courts to take into account this Guidance Note, and also permit the Tribunal and courts to take into account any material which is in the public domain at the time of the arrangement and which may be relevant in showing –

(i) whether the arrangement is abnormal;

(ii) whether the arrangement constitutes reasonable tax planning;

(iii) whether the tax result is an abusive tax result; and

(iv) what would be the appropriate counteraction.

48 Sub-section (3) sets out the material which may be taken into account. It falls into four categories –

(i) these Guidance Notes;

(ii) any official (i.e. Parliamentary, ministerial or HMRC) material which is in the public domain;

(iii) evidence of HMRC practice at the time of the arrangement; and

(iv) evidence of practice commonly adopted at that time.

49 The admissibility of such contemporaneous material is intended to assist in determining whether particular arrangements could, or conversely could not, be regarded as reasonable tax planning, and what counteraction would be appropriate.

50 This provision addresses concerns that the GAAR might otherwise be used by HMRC to counteract arrangements where official material, or evidence of widespread practice, could reasonably be considered as demonstrating that the arrangement was not at the relevant time regarded by HMRC or other Government departments as abnormal or abusive.

51 The probative value of such material will, of course, depend upon its precise nature. In the case of any practice relied upon by the taxpayer its value will be affected by considerations of whether HMRC were aware of it at the time of the arrangement and, if so, whether HMRC had explicitly or tacitly led taxpayers to believe that such practice was unobjectionable.

SECTION 11

52 Sub-section (1) makes provision for corresponding adjustments to be made where counteraction takes place under the GAAR. Its purpose is to prevent unfair tax consequences arising from counteraction under section 8. The corresponding adjustments may be to the computation or assessment of –

(i) the receipts or deductions (as defined in section 15) of the advantaged party for earlier or later periods; or

(ii) the receipts or deductions of other persons, whether for that period or for earlier or later periods. In most case the "other persons" would be parties to the arrangement. However there may be cases (e.g. where trusts are involved) where it would be reasonable for a corresponding adjustment to be made to a person who is not strictly a party to the arrangement (e.g. a beneficiary where the trustee is the party).

53 The corresponding adjustment is to be such as is considered reasonable and just. In practice a corresponding adjustment will usually be specified initially by HMRC.

54 Sub-section (2) provides that if a person objects to the adjustment proposed by HMRC (which would include the case where HMRC does not propose an adjustment for that person) then there will be the normal right of appeal. On that appeal the Tribunal will itself determine what it considers to be the appropriate corresponding adjustment. Further appeals from the Tribunal will be on points of law only (i.e. in accordance with the normal rules for appeals from determinations by the Tribunal).

SECTION 12

55 Section 12 deals with applications for clearance. The general principle is that there is no rule providing for clearances under the GAAR.

56 However, where the arrangement is, or includes a step which is, within a provision of the Taxes Acts which itself provides for a clearance procedure, then the taxpayer may expand that application for clearance to include a request for confirmation that counteraction will not be applied to the arrangement. This will maintain the certainty of tax treatment of the arrangement without any significant additional costs or resources.

SECTION 13

57 This section deals with the control and management of the GAAR.

58 Sub-section 13(1) introduces a control over the exercise of the GAAR by requiring that within HMRC the GAAR can be applied only with the authorisation of specified officials. This is designed to ensure uniformity in the application of the GAAR and, specifically, to ensure that the possibility of counteraction under the GAAR is not inappropriately invoked as a means of putting pressure on taxpayers during the course of normal enquiries into their affairs.

59 Sub-sections (2)-(4) set out the procedure which needs to be followed in any case where the designated official within HMRC has to consider the application of the GAAR -

(i) The taxpayer has to be informed by the designated official that he is considering the application of the GAAR;

(ii) The taxpayer then has the opportunity to give written reasons why in his opinion the GAAR should not be applied;

SECTION 14

60 Section 14 sets out the role of the Advisory Panel in the operation of safeguard 4.

61 Safeguard 4 comes into operation if, having received the taxpayer's representations, the designated HMRC official considers it appropriate to continue seeking counteraction under the GAAR. The procedure calls for –

(i) submission to the Advisory Panel of the designated official's notification to the taxpayer, the representations received from the taxpayer in response to the notification, and any comments on those representations by the designated official; and

(ii) consideration by the Advisory Panel of these documents, which then gives the designated official its opinion as to whether it would be reasonable for him to authorise counteraction.

62 In carrying out its review the Advisory Panel will consider the case on the hypothesis that the arrangement would, apart from the possible application of the GAAR, achieve the advantageous tax result.

63 It needs to be emphasised that it is not the role of the Advisory Panel to determine whether counteraction should be applied, or what form counteraction should take. Rather, its function is to advise, having considered the taxpayer's representations, whether in its opinion there is a sufficiently cogent case for HMRC to initiate the process of counteraction under the GAAR. If HMRC decide to do so it will then be for the Tribunal to determine whether counteraction is to be applied, and what form its application should take.

64 Sub-section (3) makes it clear that the opinion of the Advisory Panel is a recommendation, which HMRC is at liberty to heed or reject.

65 However, sub-section (4) provides that the opinion of the Advisory Panel is to be admissible in evidence in any appeal against counteraction. Accordingly, if the designated official decides to proceed with counteraction in cases where the opinion of the Advisory Panel was that it would not be reasonable so to proceed, then the opinion could be referred to by the taxpayer in any appeal proceedings. In cases where the Advisory Panel is not unanimous, each of its members' opinions is admissible

66 Sub-section (5) provides for regulations to be made governing the constitution of the Advisory Panel. In each panel of three members there will be an independent chairman and an independent member, together with one HMRC member. Where practical, the independent member would have experience relevant to the particular arrangement.

SECTION 15

67 Section 15 sets out additional definitions which, apart from sub-section (3), need no further explanation.

68 Sub-section (3) defines the word "arrangement". The GAAR throughout uses the expression "arrangement" rather than "transaction". This is because "arrangement" is a looser expression which is more appropriate to cover the elements that are currently found in tax abusive schemes. For example, it is questionable whether establishing or moving residence outside the UK is aptly described as a "transaction", whereas it would fall within "arrangement". Sub-section (3)(a) amplifies this by stating that an arrangement can include any plan or understanding, even if contractually unenforceable.

69 Sub-section (3)(b) states that an arrangement includes any step or feature which was intended to be, and is, comprised in the arrangement, even if the inclusion of that step is not legally enforceable or factually

inevitable. By doing so, sub-section (3)(b) adopts the approach advocated by the minority in the House of Lords in the case of *Craven v White* [1989] AC 398.

SECTION 16

70 Sub-section (1) provides for the GAAR to apply to arrangements which are carried out, or partly carried out, after the commencement date. The fact that the arrangement may have been initiated, and the first steps carried out, before the commencement date will be irrelevant if part at least of the arrangement is carried out after that date. This is appropriate, given that introduction of the GAAR will have been preceded by an extensive period of consultation and substantial notice of its enactment.

71 Sub-section (2) extends the period during which applications for confirmation under section 12 can be made in cases where the arrangement includes steps which straddle the commencement date. In such cases the time for making the application under section 12 is extended so as to expire no earlier than 60 days after the GAAR comes into force.

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This document can be found in full on our website: http://www.hm-treasury.gov.uk

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