



The Law Society

## **Draft Finance Bill**

Law Society evidence to the Economic Affairs Sub-Committee

January 2013

# Call for evidence: avoidance and the proposed general anti-abuse rule (“GAAR”)

## Written evidence of Law Society of England & Wales

### INTRODUCTION

1. The Law Society of England and Wales is the independent professional body, established for solicitors in 1825, that works globally to support and represent its 166,000 members, promoting the highest professional standards and the rule of law.
2. This submission has been prepared by members of the Law Society's Tax Law Committee, which is made up practitioners who are experts in the field of tax law, with experience of advising both corporate and private clients.
3. The Society has historically been reluctant to see the introduction of a general anti-avoidance rule in the UK because of the uncertainty that it would generate in respect of commercial transactions that also achieve tax benefits. When the GAAR was last considered, the Inland Revenue was unwilling to provide a clearance process and there was a risk, in any event, that any clearance process would have taken so long that it would have frustrated or materially delayed transactions<sup>i</sup>.
4. The Society therefore completely agreed with paragraph 1.5 of the GAAR Study, where Graham Aaronson QC said:

“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 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”.
5. At the time that the GAAR Study was published the Society could see that there was a case to be made for “an anti-abuse rule which [was] targeted at contrived and artificial schemes [that did] not apply to the centre ground of responsible tax planning” provided that it could be articulated with sufficient certainty not to interfere with commercial transactions. If that could actually be achieved, then the Society could agree with the Study Group’s aspiration that there ought to be “no need for a comprehensive system of clearances, with the resource burdens which such a system would require.”<sup>ii</sup>
6. The Society was persuaded, too, that there could be merits in an Advisory Panel provided that it could achieve three key factors:
  - (a) its very existence caused HMRC to consider long and hard whether something which led to a loss of tax was sufficiently “egregious” *properly* to be the subject of counter-action under the GAAR, as opposed to any other counter-action HMRC might be able to take;
  - (b) to prepare Guidance which “would be a quick and cost-effective way of helping taxpayers and HMRC identify the outer limits of the “centre ground”<sup>iii</sup>; and
  - (c) bring to bear specialist experience which would for instance, indicate what was commonplace<sup>iv</sup> in the relevant market and also background as to why

arrangements which happen to achieve a tax benefit could well have been structured in that way for financial or commercial reasons.

7. Even so, at the time the Society had some residual concerns: namely the extent to which the Advisory Panel's views would be taken into account, the appropriateness of HMRC being upon the Advisory Panel<sup>v</sup> – and indeed the constitutional position of an Advisory Panel whose opinions were to be taken into account by the Tax Tribunals.
8. Last, but certainly not least, the Society had two rather fundamental reservations. First, with the exception of the decision in *Mayes*<sup>vi</sup>, HMRC has been relatively successful in countering avoidance in the courts. Therefore there was the issue of whether, ignoring the febrile political environment even at the time (and that had only worsened since that time) there was a real need for a GAAR<sup>vii</sup>.
9. Second it is a key principle that tax continues to be governed by the “rule of law”: more precisely that taxpayers can determine the extent of their liabilities by reference to the legislation and [where necessary] guidance – i.e. be taxed by reference to the law, not “the court of Public Opinion”, whether by conferring too much of a discretionary power on HMRC or because taxpayers, although they are complying with the law, believe that they have to make voluntary contributions to the Exchequer.
10. This background provides a template by reference to which the currently proposed legislation and the arrangements for the Advisory Panel and Guidance may be tested to evaluate what the GAAR is likely to achieve and what it is *not* likely to achieve.

## THE CURRENT DRAFT GAAR LEGISLATION AND GUIDANCE

11. Currently the Society believes there are important deficiencies in the legislation and guidance that mean there will be considerable uncertainty both for commercial transactions and reasonable estate planning.
12. It may be several years before a case where HMRC wish to invoke the GAAR comes before the courts and indeed until there is a developed body of case law it will be difficult for taxpayers to be clear of the approach that HMRC will take<sup>viii</sup>.
13. In this regard the draft Guidance in its current state is of very little assistance. It currently contains cases where HMRC have been successful (with the exception of the *Mayes* case) **without any assistance from the GAAR**. Secondly, the cases put forward illustrate what might be regarded as “extreme” planning whereas the uncertainty will be in relation to commercial or financial transactions where, to a varying extent, tax benefits are also achieved. For the Guidance to be of any use, it will mean HMRC will need to indicate their views on many more commonplace arrangements which facilitate commercial transactions where there is a perception that there is at least tacit acceptance by HMRC of the tax mitigation undertaken.
14. However, it needs to be recognised that even if the Guidance over time evinces clear indications of what is no more than (or conversely goes beyond) “centre ground” planning, the need for advisers to consider and advise on this will add costs to everyday transactions or estate planning.<sup>ix</sup>
15. There are two other measures that could address uncertainty. First, it is very important that, except where it would be demonstrably easy for a taxpayer to be identified, HMRC as a matter of course publish redacted copies of opinions of the Advisory Panel and do not default only to publishing summaries or digests of the opinions of the

Advisory Panel as this would not provide a level playing field between HMRC and tax advisors<sup>x</sup>. Second, the Society could see an argument that for a limited period HMRC are required to give clearances on arrangements thought by taxpayers to fall within the GAAR where the Guidance does not assist. This would ensure that there is a level playing field as there have been suggestions that large taxpayers whose affairs merit Customer Relations Managers would be able, informally, to obtain guidance whereas other taxpayers would not have this opportunity.<sup>xi</sup> The advantage of the time limited clearance facility is that it would make the Guidance more comprehensive so justifying in due course the removal of the facility.

16. Given the way in which the GAAR legislation is currently drafted, principally because it identifies whether there are “tax arrangements” by reference to a test which involves identifying whether obtaining a tax advantage “was the main purpose or *one of the main purposes*, of the arrangements”, it has potentially a very wide scope. It is undoubtedly intended that the width of this should be cut down by the requirement that the arrangements are “abusive” but this is then simply defined to be something which could not reasonably be considered to be a reasonable course of action. The original focus of the GAAR Study on egregious planning has been lost. The Society recognises that an attempt has been made to address this by making a relevant factor whether the arrangements are “contrived” and “abnormal”<sup>xii</sup>. From the examples in the draft Guidance it seems that, if anything, these words suggest a lower test of “artificiality” than might have been thought, and so the principal determining factor is whether the effect is consistent with the principles of the legislation<sup>xiii</sup>.
17. A further attempt to restrict the width of the GAAR is the conditional, not absolute, “carve-out” where tax arrangements can be said to “accord with established practice”. However, the current draft of the legislation seems to depend on whether HMRC has positively indicated its acceptance (perhaps via a specific clearance – which it would be hard for another taxpayer to identify because of taxpayer confidentiality - or via the published manuals), whereas much established practice is a consequence of “tacit” acceptance by HMRC<sup>xiv</sup>. The Society’s view is that all established practice must be relevant to the double reasonable test. The weight given to it in particular circumstances may of course differ.
18. A particular area of difficulty relates to gifts and other transactions under the capital gains tax and inheritance tax legislation. The draft legislation identifies three particular factors that *might* be abusive, two of which are by reference to “economic purposes”<sup>xv</sup>. The very essence of capital gains tax and inheritance tax planning may be that transactions are entered into without or for less than full consideration and therefore it would be extremely difficult to use this as a filter to discern the purpose of tax legislation in this area. Currently, there is no meaningful guidance on the value by which the reasonableness of IHT or personal capital gains tax planning can be assessed. In relation to the one example given involving reversionary leases, HMRC has previously assented to the view that the gift with reservation (GWR) rules do not apply where an individual gives away one asset and keeps another, even when assets are different interests in the same property, i.e. the steps taken are consistent with the purpose of the legislation, contrary to the example given in the Guidance.
19. There is one other issue where the Society believes the legislation should be altered, and indeed it is not clear why HMRC adheres to the stance that is reflected in the legislation, namely that taxpayers should self-assess in relation to the GAAR. As drafted<sup>xvi</sup> the only tax advantages that can be counteracted under the GAAR are those that arise from arrangements ignoring the provisions of the GAAR: this acknowledges that the GAAR can only operate after all other rules of law and in practice it will not be

applied until all other legal and technical issues have been deployed<sup>xvii</sup>. Further if, as seems likely, that a taxpayer has taken advice to the effect that the GAAR should not apply to the particular arrangements concerned, whilst any tax found to be due may attract interest, it is not obvious how the penalties could be imposed by reference to the taxpayer having chosen not to assess under the GAAR (because it does not believe, erroneously as it turns out, that the GAAR applies).<sup>xviii</sup>

## THE LIMITS TO THE GAAR

20. Some commentators may expect the GAAR to have an effect on some of the practices that have been reported widely in relation to US headquartered groups such as Amazon, Google and Starbucks. The Society's perception is that the GAAR will not have the effect that those commentators may have led the public and others to believe will flow, nor would it be appropriate for it to do. If HMRC believed that they could obtain more corporation tax from those companies relying on existing legislation, including transfer pricing and other anti-avoidance provisions, they would already have done so.
21. The reason why, although the groups as a whole derive a significant amount of their *turnover* from the UK, the level of *profits* on which corporation tax is payable is small is due to developments in the way in which business is carried out as a result of globalisation and widespread access to the internet. In essence a significant amount of value in many cases is attributable to patents, trademarks and other intangibles which can be located in jurisdictions remote from those in which the goods or services contributing to the turnover are sold and delivered. This is not an issue facing the UK alone but all jurisdictions which rely on corporation tax being assessed on profits made by companies resident in those jurisdictions or operating through permanent establishments in those jurisdictions. The internet has made it easy to conduct business with customers in a territory without the need for a company to have a permanent establishment in that territory.
22. There may be a temptation for UK legislators to adopt alternative bases of tax to increase the amount of tax collected by the UK but the risk of retaliation needs to be borne in mind. In other words UK headquartered groups operating in overseas jurisdictions might find themselves subject to similar additional tax burdens if reciprocal measures were taken locally "justified" by the steps previously taken by the UK. This could lead to increased cases of unrelieved double taxation and disadvantage UK exporters.
23. In addition the UK may, by virtue of international agreements and conventions, limit its scope for introduction of additional tax. For example, Article 41 of the 2006 VAT directive<sup>xix</sup> would prevent the UK introducing any form of tax by reference to sales that could be characterised as a turnover tax in addition to VAT.
24. Accordingly, in the Society's view HM Treasury and HMRC need to work with the OECD to address the underlying structural reason for reduced corporation tax receipts rather than seek any precipitate UK focussed solution.

## OTHER ANTI AVOIDANCE MEASURES INTENDED TO BE INTRODUCED IN THE FINANCE BILL

25. There are a considerable number of anti avoidance provisions in the draft Finance Bill clauses. These include:

- (a) the attribution of gains to members of non-resident companies;
  - (b) transfer of assets abroad;
  - (c) the annual residential property tax ("ARPT");
  - (d) the sub-sale legislation; and
  - (e) the limit on income tax reliefs.
26. In relation to the legislation dealing with apportionment of gains of non-resident "close companies", the Society welcomes the 10% to 25% increase of the threshold and the improvement to the drafting in an effort to lessen the risk of an EU challenge but believe there is a continuing, admittedly reduced, risk of EU uncertainty.
27. In relation to the legislation dealing with the transfer of assets abroad, there is a welcome recognition that different legislation may be needed in relation to transactions which have an EU component and transactions which do not involve another Member State. HMRC could well find that other existing legislation could be simplified were a similar distinction to be drawn, particularly as existing EU jurisprudence on the extent to which tax avoidance permits a Member of State to introduce legislation to restrict taxpayers' exercise of one of fundamental freedoms may mean that other aspects of the UK legislation risks being challenged, whether by taxpayers or by the European Commission.
28. In relation to APRT, it remains unclear what its purpose is the context of other changes introduced to the tax system in relation to high value residential property. Clearly, to the extent that the property remains held by a "non natural person" and none of the relevant exceptions – see below – apply, the tax will be chargeable. To that extent, it could operate as an incentive to "de-envelope" and transfer the property from the relevant non natural persons depending on the costs (tax and administrative/advisory) of so doing: if it does not, it will collect tax for HMRC. Dealing with the relevant exemptions, the Society was pleased that there are similar, but not identical, exceptions operating in relation to a higher rate of stamp duty land tax (15%), ARPT and the tax on chargeable gains to be levied on non natural persons disposing of high value property. There are, however, differences in the legislation relating to SDLT and the APRT and it is not clear whether that is deliberate or inadvertent. The draft legislation to implement the extension of CGT to non-resident non-national persons has yet to be published.
29. In relation to the similar exemptions introduced into the SDLT legislation, it is unfortunate it was felt necessary to introduce legislation that had an immediate effect from March 2012 without adequate exemptions and then for those extended exemptions to be introduced only with effect from Royal Assent rather than, say, the date of the Budget in March 2013.
30. In relation to sub-sale rules, the Society's principal concern is the plethora of anti-avoidance legislation in relation to SDLT. After Royal Assent, a client or adviser considering a sub-sale or assignment of the benefit of the contract will need to consider within the sub-sale legislation itself whether there are any tax avoidance arrangement in relation to the sub-sale, for if so SDLT will be chargeable on both transactions in accordance with clause 45ZK; the minimum consideration rule contained in the sub-sale rules themselves; the SDLT anti-avoidance provisions contained in sections 75A-C FA 2003; and the GAAR itself. Also, not all of those required to consider these subtly different rules are experienced tax advisers, as opposed to "conveyancers" and those whose professional expertise lies in real estate, rather than tax, law.

31. Thus, there is a strong argument that Targeted Anti-Avoidance Rules (“TAARs”) should preclude identified SDLT planning and therefore the GAAR only apply to arrangements which are contrary to the intention of Parliament. Accordingly, there would seem to be no scope for the application of section 75A and so, as a small measure of simplification, it should be repealed.
32. The Society’s principal concern about the limit on income tax relief has been whether the legislation would limit the extent to which losses generated in genuine business activities could be used to shelter income, in circumstances which Parliament had intended. In particular, whether a percentage limit on the use of losses would create arbitrary circumstances in which a taxpayer making losses could find that the outflow of tax on income that could not sheltered by the losses would exacerbate the economic impact of the losses actually suffered. For those who do not earn significant amounts the limit is £50,000: any loss in excess of this can only be used against profits of the same trade. The issue is whether it makes sense to complicate the UK loss relief rules rather than to consider the extent to which relief should be available in the first place.

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<sup>i</sup> Indeed, this point was identified in paragraph 1.6 of the Report by Graham Aaronson QC, the GAAR Study (the “GAAR Study”) – “To reduce the risk of this consequence a broad spectrum rule would have to be accompanied by a comprehensive system for obtaining advance clearances 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 a discretionary power to HMRC who would effectively become the “arbiter of the limits of responsible tax planning”.

<sup>ii</sup> GAAR Study, paragraph 1.7(vi).

<sup>iii</sup> GAAR Study, paragraph 1.7(vii).

<sup>iv</sup> That of itself would not necessarily mean that arrangements were not capable of being challenged under the GAAR.

<sup>v</sup> Now no longer contemplated.

<sup>vi</sup> *Mayes v HMRC* [2011] EWCA Civ 409.

<sup>vii</sup> The decision in *Mayes* illustrates a key point that we (and many other commentators) have been making for some time: namely that if HMRC persist in using very detailed legislation which provides little or no scope for a purposive interpretation, there is more risk of a “scheme” being effective than if HMRC were prepared to introduce shorter legislation not seeking to cover every eventuality.

<sup>viii</sup> Paradoxically, while a measure of success of the GAAR could be how few cases are brought before the courts, either because it is a deterrent at the outset or because the cases brought before the Advisory Panel are not pursued to the Tax Tribunal in the face of adverse opinions, this may mean the position would remain unclear for longer.

<sup>ix</sup> While some commentators might glibly suggest that this cost has been brought upon tax payers by their own behaviour (or that of promoters), the cost is being imposed on all by the activities of only some.

<sup>x</sup> We are, cautiously, encouraged by the guidance material stating “it is expected that, in most cases [our italics], shortly after each opinion is given an anonymised version of the opinion will be published. Publication will be withheld only if there is a risk that a taxpayer’s identity may be deduced.

<sup>xi</sup> In discussions with HMRC it was suggested that the non-statutory clearance application procedure might, at least as regards corporate tax payers without CRMs provide a means by which comfort can be obtained. However, as this procedure requires there to be a technical uncertainty but the only uncertainty may be whether something falls within the “centre ground”, and HMRC sometimes take an extreme view as to when avoidance is involved (in which case they conclude that they are not required to provide clearance) we remain sceptical as to the scope and availability of guidance to taxpayers without CRMs.

<sup>xii</sup> See draft clause 2(2)(b).

<sup>xiii</sup> See draft clause 2(2)(a).

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- xiv Eg circumstances in which a particular course of action is not challenged by HMRC where it is apparent to them that the course of action has been followed and so as a result advisors suggest other transactions are structured in a similar manner and where it may even be the case that articles written by academics or advisors indicate that HMRC do not challenge a course of action.
- xv Clause 2(4)(a) and (b).
- xvi Clause 4(1).
- xvii There is also a technical point that relieving adjustments can only be made where a counteraction has been made following a notice from HMRC (and not where a taxpayer self-assesses under the GAAR). It seems odd that a taxpayer cannot make an adjustment that would flow from the self-assessment that the draft legislation currently requires.
- xviii We would acknowledge that if a taxpayer implemented a "scheme" which the courts ruled against in the case of another taxpayer, the first taxpayer might then decide (or be advised) to self-assess as if the GAAR applied, if only to reduce their exposure to penalties.
- xix 2006/112/EC.