



The Law Society

Consultation On Tax Treaties Anti-Avoidance

Comments of the Tax Law Committee of the Law Society of England and Wales

Introduction

1. The Law Society is the representative body for over 140,000 solicitors in England and Wales. It negotiates on behalf of the profession and lobbies regulators, the Government and others. We welcome the opportunity to comment on the proposed tax treaties anti-avoidance rules as set out in the August 2011 consultation document issued by HM Revenue & Customs.
2. This response has been prepared on behalf of the Law Society by the members of the International Tax Sub-Committee of its Tax Law Committee. The Committee is made up of senior and specialist tax lawyers from across the country.

General comments

3. The Law Society, in common with other representative bodies, feels that the timing and form of this consultation has not been appropriate. In particular, it has led to unnecessary uncertainty for some of our clients and fellow lawyers in other countries who have been concerned to see the apparent breadth of the proposals. The breadth of the draft legislation has not been assisted by the lack of any real explanation in the consultation document as to the mischief at which the provisions are aimed.
4. The Law Society has therefore been placed in the position of having to advise clients that the concerns of HMRC and the potential application of the legislation are completely unclear. This undermines confidence in the UK tax system as a whole and in turn is potentially damaging to the UK economy. This is particularly the case in relation to non-residents, which we deal with in more detail below.
5. We have made this point before in relation to the manner in which past consultations have been carried out, where HMRC has had to cure the position by radically amending legislation and/or dealing with outstanding issues by guidance. In our view, more consideration should be given to the potential impact of issuing consultation documents, especially in such an important field, before they are issued. Nor do we believe it is helpful for draft legislation to be issued before there has been an opportunity for consultation on the principles which any legislation should follow. Rightly or wrongly, the issue of draft legislation gives rise to a belief that HMRC intends to enact legislation in at least similar form.

6. We understand that HMRC has taken on board the strength of feeling of the representative bodies in general, which we welcome. We also welcomed the opportunity to meet with HMRC in relation to the consultation. The Law Society has always indicated its willingness to assist HMRC in the early stages of consultation. In our view, early consultation in this instance would have been of great assistance. In the remainder of this paper we comment on the principles behind the draft provisions rather than any specific drafting points as we do not believe the draft legislation is appropriate in its current form.

The principle of a treaty anti-avoidance provision

7. The Law Society believes that it would be inappropriate to implement proposals for a general treaty anti-avoidance provision until the current work in relation to a general anti-avoidance rule ("GAAR") being carried out by the Expert Group led by Graham Aaronson QC has been completed.
8. The proposals in the consultation document are effectively a GAAR applicable to treaties. We think it would be more sensible to wait for the conclusions of the Expert Group on the GAAR before proceeding further. That group is already considering whether or not it is possible to enact such a principle into effective legislation. There may be much in their conclusions which would usefully inform the approach to be taken in relation to treaty anti-avoidance. It would be particularly unhelpful in our view if the GAAR and treaty anti-avoidance provision took separate paths unless that was determined to be the right course of action after all the issues had been considered in relation to both areas. This does not seem to be a case where there is such a risk to the Exchequer that immediate action is required.
9. Accordingly, the Law Society's strong recommendation is that further work on the treaty anti-avoidance consultation be postponed until the Expert Group has reported fully in relation to the GAAR.

Avoidance involving treaties by UK residents

10. The Law Society appreciates that HMRC has concerns around the way some UK taxpayers have sought to utilise treaties. However, in some circumstances that appears to be due to perceived issues with the underlying legislation. Temporary non-residence is perhaps one example where we understand that HMRC perceives there to be a quite specific defect in the way the rules operate in certain circumstances.
11. In our view, where there is an issue with the way specific existing provisions are working in practice, in principle the correct approach is to amend those provisions so that their application is clear. It only adds to the lack of clarity in the UK tax system to cure perceived defects in legislation by general anti-avoidance provisions.
12. We understand that there are other situations which give rise to HMRC concern and which do not fall within the description of defects in current legislation. As regards a general provision to deal with this, we would repeat our view above that this should be considered in the light of the Expert Group's consideration of the GAAR. We would also add that we believe litigation is an appropriate remedy in certain circumstances. There have been several cases in relation to individual avoidance which HMRC has won. We do not

believe that it is always necessary to legislate where the outcome of litigation has given or might give a sufficiently certain position.

Avoidance involving non-UK residents

13. It is perhaps in this area where the proposals have the potential to cause the most damage. This is partly because it is very difficult to draw a line between when the desire to use a treaty is legitimate and when it is artificial. The test in the draft provisions in the consultation document is not adequate for this purpose given its breadth.
14. Some of the issues which give rise to concern are similar to those which were discussed with HMRC when the guidance on the Indofood case was released. So for example, there are a number of structures commonly used in the capital markets which rely on the application of the interest article of treaties to pay interest from the UK without UK withholding tax. The treaty avoidance provisions as drafted give rise to uncertainty in those areas as to whether the benefit of the treaty might be obtained.
15. Equally, in the private equity and debt fund worlds, many structures are set up with holding or lending companies established in Luxembourg or another appropriate country which hold and/or lend to European entities. In all those cases, the existence of the treaty is essential, and so it might be said that the choice of holding jurisdiction is to make use of a treaty. We do not believe that taking into account a treaty as part of a decision where to establish a holding or lending company should be seen as abusive of that treaty. Indeed the encouragement of the establishment of companies and groups is surely one aim of a country in having a treaty network.
16. At a time when there are severe restrictions on the availability of credit in the traditional banking markets, we do not believe it is appropriate to enact provisions which could make it more difficult for UK companies to access credit from the developing sources of credit, such as credit funds. Whilst we do not understand this to be HMRC's aim, it must be clear beyond doubt if legislation is to be enacted, that the effect of that legislation is not to make it more difficult for such sources of credit to lend into the UK.
17. We have previously understood HMRC to be content with the way that the Indofood case has been applied in practice. In our view, the test of beneficial ownership, whilst having its own issues, is at least one which we as lawyers can advise upon with some degree of certainty. We find that sort of approach to be preferable in practice to a very broad anti-avoidance provision.
18. We believe that there are very real conceptual difficulties in determining whether the use of a treaty is unacceptable avoidance or not. Some of those issues may be informed by the conclusions on how a GAAR might be drafted. Indeed some countries, notably Australia, apply their GAAR to their treaties. Any provision should comply with OECD guidance in relation to when avoidance provisions might be applied to prevent the application of a treaty. In our view the OECD commentary implies a much narrower test than the one in the draft provisions.
19. We do not consider that we are yet at an appropriate point to comment fully on whether or not it might ever be appropriate to apply a GAAR or a general treaty specific anti-avoidance provision in a way which provided sufficient certainty of outcome and which did

not potentially damage the UK economy in terms of inward capital flows, and the Law Society will make further submissions on those matters at the appropriate time.

20. It is our understanding that there are a relatively small number of treaties which give rise to concern in terms of abuse, particularly in the case of abuse by non-residents. We would suggest that a more certain outcome, and one less potentially damaging to the UK economy, would be obtained by concentrating current efforts of HMRC on renegotiating those treaties, or dealing with anti-avoidance provisions within them by way of appropriate protocols, rather than proceeding with the proposed legislation.

Contact details:

If you have any questions concerning these representations or would like to discuss anything contained in them, please contact the Chair of the International Tax Sub-Committee, Peter Nias (tel: 020 7577 6920, e-mail: pnias@mwe.com), or the Vice-Chair, John Baldry (tel: 020 3122 1131, e-mail: john.baldry@ropesgray.com).