



The Law Society

**General anti-abuse rule:
the draft legislation and draft guidance**
Response of the Law Society of England and Wales
February 2013



General Anti-Abuse Rule: the draft legislation and the draft guidance

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

Law Society of England and Wales is the representative body for over 166,000 solicitors in England and Wales. It negotiates on behalf of the profession and lobbies regulators, the Government and others.

We are pleased to have the opportunity to comment on the draft legislation and the draft guidance on the General Anti-Abuse Rule (GAAR) published at the time of the 2012 Autumn Statement.

This response has been prepared on behalf of the Law Society by the members of the Tax Law Committee. The Committee is made up of senior and specialist tax lawyers from across the country.

Draft legislation

Points of principle

As we have previously mentioned, we can understand the case for “an anti-abuse rule which is targeted at contrived and artificial schemes and does not apply to the centre ground of responsible tax planning”. However, for the reasons set out in our previous representations, we are concerned that the proposed GAAR is *not* restricted to these kinds of arrangements and, in some respects, does not respect the rule of law. In particular, we have suggested that the operation of the GAAR should be subject to a further filter to make it clear on the words of the statute that it is only intended to apply to contrived or artificial transactions.

We will not repeat our representations on this issue but our not doing so should not be taken as an indication that we no longer regard it as fundamental to the kind of GAAR which we would unreservedly support. We do note, however, that, in the interim, the European Commission (in a Commission Recommendation issued on 6 December 2012)¹ has recommended a form of general anti-abuse rule for adoption by EU member states. That rule applies to arrangements which are “artificial” (a defined term, which is supported by guidelines) and, in many respects, we find the drafting of the Commission Recommendation more attractive than the current proposal.

General Points

Our comments on the draft legislation and guidance are set out below. We have first commented on two more general issues.

Lack of balance between HMRC and the taxpayer

In some respects, the Consultation Draft introduces an unfair imbalance between the rights and duties of HMRC and those of the taxpayer. Our main areas of concern are set out below.

¹ European Commission Recommendation of 6 December 2012 on aggressive tax planning C(2012) 8806 final

Where tax arrangements accord with established practice, that is a fact which, in our view, *might* indicate that the arrangements are not abusive. Clause 2(5) only accepts established practice as an indicator of non-abusive arrangements if HMRC has indicated its acceptance of the practice.

The procedural requirements in Schedule 1 contain two very short time limits on actions which the taxpayer has to take to resist the operation of the GAAR (see Schedule 1, paragraphs 4 and 9). The limit in paragraph 9 is particularly short and it is inequitable that no time limits are imposed on HMRC.

The right to make compensating adjustments is confined to cases where HMRC gives a notice to the taxpayer under Schedule 1 paragraph 12 following a reference to the Advisory Panel (see clause 5) and is not available if the taxpayer on his own motion makes an adjustment in his self-assessment to counteract the tax advantage.

We have addressed these issues in more detail in our specific comments below.

Clearance applications

We accepted in our previous representations that if an anti-abuse rule which was targeted at contrived and artificial schemes (and did not apply to the centre ground of responsible tax planning) could be articulated with sufficient certainty not to interfere with commercial transactions, we would agree that there ought to be no need for a comprehensive system of clearances. For the reasons that we have previously given, we do not agree that the current formulation of the GAAR achieves this objective.

Even if HMRC does not agree with our conclusion, it is clear that there is likely to be a considerable period of uncertainty concerning the scope of the GAAR until a body of practice builds up around its operation. It is likely that large businesses with access to customer relationship managers at HMRC will be able to obtain the certainty that they require as part of their normal dialogue with their CRMs. That opportunity will not be open to smaller businesses and individual taxpayers. For that reason, we would recommend that HMRC should offer clearances in relation to the operation of the GAAR for a limited period (perhaps three years).

Clause 2(4): indicia of abusive tax arrangements

Clause 2(4) describes some factors which might indicate that certain commercial transactions are abusive. It does not include any factors which might determine whether transactions carried out under domestic, family, personal or charitable relationships are abusive. The lack of any statutory indicia of abusive private client transactions exposes them to even greater uncertainty than that to which commercial transactions are already exposed. If this defect cannot be rectified in the statute, we believe that there should be many more examples of private client transactions, with better reasoning, in Part B of the Guidance.

Clause 2(4): proviso – intended tax results which depart from the indicating factors

The proviso to clause 2(4) recognises that the presence of one of the indicating factors should not be taken as an indication that tax arrangements are abusive in circumstances where the legislation intends the tax result in question. Part A of the Guidance cites the

capital allowances legislation as an example. This situation will also often arise when legislation creates a tax incentive.

We understand the reason for the introduction of the proviso and agree with its purpose. Our concern is that the current wording of the proviso detracts from the double reasonableness test and seems to put the burden of proof on the taxpayer to show that a tax result which departs from one of the indicating factors is an intended result. It should be made clear that the onus is on HMRC to prove that the legislation did not intend that result, rather than on the taxpayer to prove that it did. This is consistent with clause 6(1).

Proposed amendment:

Delete “but in each case only if it is reasonable to assume that such a result was not the intended result ...” and replace with “but in each case only if it cannot reasonably be assumed that such a result was the intended result ...”.

Clause 2(5): established practice

The GAAR Study Report² acknowledged that evidence of established market practice could be brought to show that arrangements are not abusive³. In contrast, clause 2(5) only accepts established practice as an indicator of non-abusive arrangements if HMRC has indicated its acceptance of the practice. Where tax arrangements accord with established practice, irrespective of whether HMRC has indicated acceptance of that practice, that is a fact which, in our view, might indicate that the arrangements are not abusive. The GAAR Study Report acknowledged this.

We have a similar point in relation to clause 6(3) (see below). We acknowledge that, even if our proposed change to clause 6(3) is accepted, a case might be made for retaining the scope of the current clause 2(5) on the grounds that the two provisions play different roles in the legislation. However, we note that clause 2(5) is simply an example of an arrangement that might not be abusive. If clause 2(5) is to be limited to practice which has been endorsed by HMRC, we would expect that evidence of such a practice to be evidence that the arrangement is not abusive. Our preference therefore is for clause 2(5) to be amended in a manner consistent with our proposed change to clause 6(3).

Proposed amendment:

Delete “, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice,” and replace with “at the time the arrangements were entered into”

Clause 4: counteracting tax advantages

As we have suggested in our previous representations, in our view, the GAAR should not operate by self-assessment. It should operate by counteraction notice. The drafting of clause 4 is more consistent with this approach as is much of the remainder of the draft legislation. For example, our concerns in relation to consequential adjustments in clause 5 would fall away if this approach were to be adopted.

² The Report by Graham Aaronson QC, the GAAR Study dated 11 November 2011.

³ See GAAR Study Report Appendix I paragraph 10(3)(d) and Appendix II paragraph 8

As a more fundamental point, we are concerned that the current counteraction powers are inadequate because they do not include an effective charging provision: they simply provide for adjustments to be made (clause 4(1)). If the GAAR applies, a taxpayer will be taxed when under the law (ignoring the GAAR) he/she would not be taxed. If the GAAR is to operate by self-assessment, in order to achieve that result, the statute needs to adjust the basis of liability or impose a liability itself. It is not sufficient to make an adjustment in a vacuum⁴.

Proposed amendment:

Delete clauses 4(1) to 4(2) and substitute:

“(1) If there are tax arrangements that are abusive, the tax advantages that would (ignoring this section) arise from the arrangements are to be counteracted by the making of adjustments to the income, profits, gains, transactions, events, omissions or other things which give rise to liability to the tax in question or to any other tax to which the general anti-abuse rule applies.

(2) The adjustments required to be made under subsection (1) are such as are just and reasonable.”

Omit clause 4(3).

Clause 5: consequential relieving adjustments

If a taxpayer has carried out a transaction which is affected by the GAAR, he/she must make adjustments in his/her self-assessment to counteract the tax advantage otherwise arising from the transaction. However, neither the taxpayer nor any other affected person has the right, in their self-assessment, to make a consequential adjustment. Only HMRC can make consequential adjustments under clause 5. Furthermore, clause 5 only applies where HMRC gives a notice to the taxpayer under Schedule 1 paragraph 12 following a reference to the Advisory Panel. If the taxpayer on his own motion makes an adjustment in his self-assessment to counteract the tax advantage, there will never be a notice under Schedule 1 paragraph 12 and, as a result, no legal basis for making a consequential adjustment.

If the GAAR is going to operate by self-assessment, it is only fair that consequential adjustments can be made on the same basis. We acknowledge the difficulties that might arise if HMRC were not able to identify a related counteraction and consequential adjustment, but this difficulty is not insurmountable. For example, the legislation could provide that a taxpayer should be able to make a consequential adjustment in his/her self-assessment return but that, if the taxpayer is not the person subject to GAAR counteraction, he/she should only be able to make the consequential adjustment with the consent of the taxpayer who is subject to the GAAR counteraction so that the system would operate in a manner similar to that for group relief surrenders⁵.

⁴ In order to impose a tax, there need to be charging words. An assessment gives effect to the liability but cannot impose a liability (see Lord Dunedin in *Whitney v IRC* 10 TC 88 at 110). By way of example of a provision which counteracts a tax advantage by self-assessment, we refer to FA 2012 s.132(4). That provision refers to adjustments being made “of any income or gains chargeable to [tax]”.

⁵ Similar provision is made in the transfer pricing rules. See TIOPA 2010 s.176(1) and (3).

Clause 6(2)(a): special status of the Guidance

Clause 6(2) provides that, “in determining any issue” in connection with the GAAR, a court or tribunal “must take into account [the Guidance]”.

We have two points on this provision.

The first is that the fact that a court or tribunal must take into account the Guidance gives the guidance a very special status. In our view, that should inform the manner in which the Guidance is written. So for example, the Guidance should avoid unqualified statements as to the purpose of legislation.

The second related point is that a court or tribunal is instructed to take into account the Guidance in relation to “any issue” in connection with GAAR. The Illustrative Draft GAAR in Appendix I to the GAAR Study Report suggested that the guidance note could be brought in as evidence in relation to a *limited* number of matters which, in the context of the current drafting, broadly equate to whether the tax arrangement is “abusive”⁶. The existing guidance ranges well beyond these issues. In our view, it would be inappropriate for the court or tribunal to be required to take into account the Guidance on such wider issues and the special status of the Guidance should be limited to the question as to whether a tax arrangement is abusive. This would be consistent with the scope of the guidance envisaged by GAAR Study Report. In all other respects, the Guidance should fall within clause 6(3).

Proposed amendment:

Delete “any issue in connection with the general anti-abuse rule” and replace with “whether any tax arrangements are abusive”

Clause 6(3): evidence of market practice

Clause 6(3) allows other material to be brought into account as evidence of the reasonableness or otherwise of the arrangements. The Illustrative Draft GAAR in Appendix I to the GAAR Study Report included such a provision⁷. This included not just evidence of HMRC practice, any relevant parliamentary ministerial or HMRC material in the public domain, but also extended to evidence of practice commonly adopted at the time of the arrangement. We are concerned that the current wording of clause 6(3)(b) would lead to the conclusion that evidence of established practice is only admissible if it could be shown that HMRC accepted that practice (i.e. that the reference to “other material” in clause 6(3)(a) does not include a reference to evidence of established practice).

Proposed amendment:

Delete sub-clause (b) and replace with:

“(b) evidence of established practice at the time the arrangements were entered into”.

⁶ GAAR Study Report Appendix I paragraph 10(2)

⁷ GAAR Study Report Appendix I paragraph 10(3)

Schedule 1, paragraph 3(1): interaction of GAAR challenge by HMRC with other challenges

It is not clear to us how, in practice, HMRC will conduct a GAAR challenge in a case where it considers that it also has technical, TAAR or *Ramsay* arguments that might counteract an avoidance scheme.

When HMRC first learns of an avoidance scheme, it may take the view that there is, say, a technical argument and a *Ramsay* argument and, if they both fail, a GAAR challenge to the tax advantage that would otherwise arise. If HMRC writes to the taxpayer asserting that this is the case, that would arguably trigger the Advisory Panel procedure in Schedule 1 (see paragraph 3(1)). However, it may take many months for the technical and *Ramsay* challenges to be pursued and it may, therefore, be premature for the Schedule 1 procedure to be triggered. (This approach seems consistent with paragraph 13(1) which implies that a notice could be given at a time when other challenges have not been resolved and it is therefore possible that no tax advantage will arise that needs to be counteracted under the GAAR.)

The alternative approach is that, if HMRC only considers that a tax advantage has arisen if its other arguments all fail, it need not give the paragraph 3(1) notice which triggers the Schedule 1 procedure until it is clear that its other arguments have failed. (This latter approach seems more consistent with clause 4 of the draft legislation)

If the avoidance scheme ends up being litigated on all three challenges, when would HMRC give the paragraph 3(1) notice given that it cannot be sure until the other challenges have been determined that a tax advantage has arisen? At the very least, some guidance on this issue would be helpful.

Schedule 1, paragraph 3(2): notice to taxpayer of proposed counteraction of tax advantage

If the GAAR applies, the taxpayer may be taxed by reference to transactions which he/she has not done, income or gains he/she has not received or by ignoring transactions which he/she has done. In these circumstances, the taxpayer should be entitled to know the basis on which any proposed adjustment is being made. We assume that this is intended, but it is not clear from the wording of paragraph 3(2). We note, by way of contrast, that, in other contexts, a counteraction notice is required to state the basis on which adjustments are made⁸. In our view similar provision should be made in this case.

Proposed amendment:

In sub-paragraph (c), insert at the end “including the adjustments which the officer considers ought to be made and the basis on which they are to be made”.

Schedule 1, paragraphs 4 and 9: time limits

The procedural requirements in Schedule 1 impose time limits on actions which the taxpayer has to take in response to the issue of a notice under paragraph 3 (paragraph 4) and in response to a reference of the matter to the Advisory Panel under paragraph 8 (paragraph 9). No time limit is imposed on HMRC in relation to the reference to the Advisory Panel (paragraph 5 or 6) or the provision of comments to the Advisory Panel (paragraph 9(3)).

⁸ See, for example, ITA 2007 s.698(2)

Notwithstanding the arguments put forward in the Consultation Document, in our view, this is inequitable. HMRC has control of the timing of the Advisory Panel process through its control over the timing of the issue of a notice under paragraph 3 and there is no good reason not to impose similar time limits on the actions of HMRC.

The limit in paragraph 9 (14 days) is far too short. It is quite conceivable that a taxpayer or a person who is dealing with the process on behalf of the taxpayer will be away for this period of time. We would recommend that the taxpayer is permitted a period of at least 45 days to respond to the reference of the matter to the Advisory Panel.

For all time limits, there should be an opportunity for the taxpayer or HMRC to apply to the Advisory Panel to extend the time period.

Proposed amendments:

In paragraph 5, insert at the end:

“The designated HMRC officer has 45 days beginning with the day immediately following the end of the period referred to in paragraph 4 to refer the matter to the GAAR Advisory Panel.”

In paragraph 6, insert after paragraph 6(2):

“6(3) The designated HMRC officer has 45 days beginning with the day immediately following the receipt of representations in accordance with paragraph 4 to refer the matter to the GAAR Advisory Panel.”

In paragraph 9(1) and paragraph 9(2), delete “14” and substitute “45”.

In paragraph 9(3), insert at the end:

“The designated HMRC officer has 45 days beginning with the day immediately following the end of the period referred to in paragraph 9(1) to provide the panel with comments under paragraph 9(3)(a).”

After paragraph 9, insert:

“9A The GAAR Advisory Panel may extend the time for complying with any of the requirements of paragraphs 4, 5, 6, 7, 8 or 9 of this Schedule.”

Schedule 1, paragraph 11: question for the Advisory Panel

There are several aspects of the procedure in Schedule 1 which are not clear to us and which we would suggest require further thought and need to be addressed.

First, the only question on which the Advisory Panel can give an opinion is whether the entering into and carrying out of the tax arrangements is a reasonable course of action (Schedule 1 paragraph 11(3)). The Advisory Panel cannot give an opinion on whether the arrangements are “tax arrangements” or whether they will give rise to a “tax advantage”. That seems to us to be the correct approach: those questions should remain questions for the court or tribunal. But it needs to be clear in the drafting of the Schedule that the opinion of the panel is being given *on the assumption* that the relevant arrangements are “tax arrangements” that will achieve a “tax advantage”.

Second, the Advisory Panel is not a fact finding tribunal and would not appear to have any powers to arrange for a hearing to receive evidence of, and make findings on, the facts which are in dispute. Where the facts are in dispute, it is not clear to us on what facts the Advisory Panel is expected to base its opinion. Should there be provisions to allow HMRC and the taxpayer to agree a statement of agreed facts on which opinions can be based? If facts cannot be agreed, can the Advisory Panel produce alternative opinions based on different sets of assumed facts? Should the Advisory Panel procedure only operate after facts have been found by the tribunal?

Schedule 1, paragraph 13(1):

It seems to us more appropriate for paragraph 13 to appear in the Schedule as part of paragraph 3.

The Guidance

Part A: Paragraph 1.5 (existing anti-avoidance tools)

We believe that this section should be omitted.

Part A: Paragraph 4 (meaning of tax arrangements)

Paragraph 4 discusses the meaning of “tax advantage” by reference to the cases which decide that the concept refers to a tax benefit in the form of an improvement in the taxpayer’s tax position when compared with a comparator transaction. However, paragraph 4 fails to discuss the core element in the definition of “tax advantage”, namely “tax avoidance” (together with the associated concepts of reduction and deferral). As the fundamental objective of the GAAR is to create, not a general anti-avoidance rule, but a rule applying only to highly abusive, contrived and artificial avoidance arrangements, it is extraordinary that there is no discussion in the Guidance of the concept of “tax avoidance”. The GAAR will only achieve its fundamental policy objective if it applies, not to all avoidance transactions, but only to avoidance transactions which are highly abusive, contrived and artificial.

We believe, therefore, that the Guidance should point out that, in *IRC v Willoughby* [1997] STC 995, Lord Nolan described tax avoidance as involving the taxpayer taking a course of action “designed to conflict with or defeat the evident intention of Parliament”. HMRC uses broadly the same definition. In an “Issue briefing” called “Tackling tax avoidance” (Sept 2012), HMRC describes “tax avoidance” as “bending the rules of the tax system to gain a tax advantage that Parliament never intended. It often involves contrived, artificial transactions that serve little or no purpose other than to produce a tax advantage. It involves operating within the letter – but not the spirit – of the law”.

In our view, therefore, the Guidance should state that transactions which improve the taxpayer’s position in a way which is consistent with the principles and policy of the legislation do not involve “avoidance” (as properly defined) and, accordingly, do not give rise to any “tax advantage”. This means that these kinds of transaction are filtered out of the GAAR by clause 2(1). By contrast, transactions which improve the taxpayer’s position in a way which is inconsistent with the principles and policy of the legislation involve “avoidance” (as properly defined) and, accordingly, give rise to a “tax advantage”. However, if these kinds of transaction are a reasonable course of action, they are filtered out of the GAAR by clause 2(2). As a result, the only transactions caught by the GAAR are transactions which

improve the taxpayer's position in a way which is inconsistent with the principles and policy of the legislation *and* do not constitute a reasonable course of action.

Part A: Paragraph 5.1 (meaning of “abusive”)

Insert “may” after “The elements that” and before “make arrangements”.

Part A: Paragraph 5.2.2.1 (reasonably held view)

Insert a final paragraph to paragraph 5.2.2.1: “It is for HMRC to prove that a course of action cannot reasonably be regarded as reasonable”.

Part A: Paragraph 5.2.2.2 (conflicting views)

In the last two lines of paragraph 5.2.2.2, insert “all the circumstances, including” between “by reference to” and “the factors”.

Part A: Paragraph 5.2.2.3 (extreme views)

We feel that paragraph 5.2.2.3 should be omitted. It serves no purpose to label particular views as extreme or to say that they cannot be reasonably held. The question is whether the arrangement should reasonably be regarded as reasonable “in all the circumstances”. That question has to be answered in the context of the relevant taxing statute.

If paragraph 5.2.2.3 is to be retained, it should be balanced. Paragraph 5.2.2.3 could, for example, say that, a view that a transaction is unreasonable, which is based on an assumption that all tax planning is theft, is an extreme view that cannot be a reasonably held view. On the same basis, a view that taking steps to reduce tax consistent with the principles and policy of the legislation is, in itself, unreasonable would also be an extreme view.

We acknowledge that it may be possible, in practice, to dismiss views at opposite the ends of the spectrum. But, as a matter of principle, the guidance should not seek, in the abstract, to limit what views might be regarded as “reasonable”. The purpose of the double reasonableness test is to test whether a particular arrangement might reasonably be regarded as a reasonable course of action *in all the circumstances*. That test should be applied to the arrangement in question. For that reason, our preference is to delete this paragraph.

Part A: Paragraph 5.3.2.3 (policy objectives)

Add a final paragraph: “Other legislation may have a policy of putting transactions of a particular type on a similar (but not necessarily identical) economic footing, e.g. loans or repos.

Part A: Paragraph 5.3.4 (shortcomings)

Insert “at the time the legislation was enacted” after “Parliament, had it foreseen the arrangement and the claimed tax consequences”.

Part A: Paragraph 5.3.5 (other arrangements)

As in the case of the “bear trap”, where a transaction falls within the policy objectives of the legislation but not within its strict terms, taking steps (even contrived steps) to bring the transaction within the strict terms of the legislation should be regarded as a reasonable course of action.

Part A: Paragraph 5.4.3 (lists only indicative)

The statement that “in relation to abusive IHT arrangements, it is not expected that any of the abusive factors will be present” simply serves to illustrate our concern about private client transactions. There is nothing in the legislation to distinguish an abusive IHT arrangement from a non-abusive one. The Guidance at present provides little or no assistance.

Part B: general comments

We were disappointed by the examples in Part B of the Guidance. They give little assistance to taxpayers in determining the scope of the GAAR.

Many of the examples are drawn from the facts of cases where HMRC has successfully challenged the tax treatment advocated by the taxpayer. By definition, the GAAR cannot apply in such cases as it only applies to counteract a tax advantage. There was no tax advantage in these cases. It may have been more helpful to set out the reasoning as to how the GAAR might apply on the facts of cases which HMRC lost (e.g. *Mayes*).

As we have mentioned in these representations, the application of the GAAR to private client transactions is particularly uncertain. There need to be many more examples of cases to which the GAAR will and will not apply in the context of private client transactions.

We have set out some specific comments below.

Part B: what is an unreasonable course of action

In our view, the examples in Part B should be divided into three categories, the first being examples of non-avoidance transactions filtered out of the GAAR by clause 2(1), the second being examples of avoidance transactions filtered out of the GAAR by clause 2(2), and the third being examples of the residual class of avoidance transactions caught by the GAAR. These three categories are explained above under the heading “Part A: Paragraph 4 (meaning of tax arrangements)”. It is the first and second categories (which together represent the full spectrum of the centre ground of tax planning) which require a wide spread of examples and meticulous reasoning as to why they are consistent with the principles and policy of the legislation or inconsistent with them, but nevertheless constitute a reasonable course of action.

At present, Part B founds on the assumption that a transaction is necessarily reasonable if it is consistent with the principles and policy of the legislation and necessarily unreasonable if it is inconsistent with those principles and that policy. Whilst this approach has the merit of applying a wholly objective legal test to the application of the GAAR, it deprives the (regrettably more subjective and discretionary) test of reasonableness of its role of confining the GAAR to an anti-*abuse* rule, rather than an anti-*avoidance* rule. It is supposed to do this by dividing avoidance transactions (i.e. transactions not filtered out by clause 2(1)) into two

categories, the first consisting of avoidance transactions which are not highly abusive and the other consisting of avoidance transactions which are highly abusive. If, as Part B currently suggests, every transaction which is inconsistent with the principles and policy of the legislation is necessarily an unreasonable course of action, then the filter in clause 2(2) achieves nothing and the GAAR is a general anti-avoidance rule.

In our view, none of the examples in Part B to which the GAAR is said not to apply would pass through the filter in clause 2(1), because they are innocuous transactions which do not involve avoidance, as properly defined. Each one is said to be consistent with the principles and policy underlying the legislation and is, therefore, necessarily reasonable. But that is irrelevant. Because they do not pass through the first filter, their reasonableness should never have to be tested. These examples say nothing about what forms of tax avoidance pass through the first filter, but nevertheless fall outside the scope of the GAAR because they are reasonable.

If we turn to the examples in Part B to which the GAAR is said to apply, you will see from our comments below that, in the case of some of these examples, we do not accept that they represent abusive tax arrangements. Of the remainder, most of them are at the opposite end of the spectrum: some involve transactions with no commercial purpose, others incorporate highly artificial steps into commercial transactions, and others produce results which defy economic reality. What is needed is examples of transactions which are inconsistent with the principles and policy of the legislation, but nevertheless constitute a reasonable course of action, together with meticulous reasoning as to why this is so.

Part B: contrived transactions

We do not agree that all of the transactions described in Part B as “contrived” are indeed contrived in the sense that has to be given to that word in the context of this legislation.

For example, in the agricultural property example (in paragraph 8), we do not accept that buying a farm with an IHT saving in mind, letting it for 7 years and then transferring it into trust are contrived transactions.

This example seems to assume that every transaction which has a tax planning purpose is necessarily contrived. (Similar reasoning is used in paragraph 4.1.5.2 and paragraph 4.2.5.2). Whether or not the arrangements involve “contrived or abnormal steps” is one of the relevant circumstances listed in clause 2(2). However, this circumstance cannot be regarded as satisfied just because the arrangement is intended to obtain a tax advantage. It must mean more than this. If not, the requirement that “tax arrangements” must be “abusive” is rendered meaningless.

In our view, a transaction will be contrived if, when compared with a normal transaction resulting in broadly the same outcome, it has features that are abnormal or unnatural in the context of the commercial or other objectives that the arrangements seek to achieve. The vast majority of tax planning transactions are not of that kind.

At this point, we should note that we do agree with the conclusion in the agricultural property example that the mere fact that an arrangement contains contrived steps does not mean that it is inconsistent with the principles and policy of the legislation.

Part B: examples on which we request clarification

TCGA 1992 s.135: exchange of securities

Where, under a tripartite contract, the vendors of a target company sell that company to an acquiring company in consideration of listed shares to be issued by the acquiring company's immediate parent company, TCGA 1992 s.135 cannot apply and, accordingly, what is in both form and substance an exchange of securities constitutes a disposal for CGT purposes.

If, instead, the parties enter into a two-step, composite transaction under which the vendors sell the target company to the acquiring company in exchange for shares or loan notes in the acquiring company and then sell their shares or loan notes in the acquiring company to the parent company in exchange for shares in the parent company, TCGA 1992 s.135 is capable of applying, at least on a literal application of that provision. However, it is arguable that this two step, composite transaction is inconsistent with the principles and policy of TCGA 1992 s.135 (which does not provide relief for the single step, tripartite transaction which might be regarded as the "normal" transaction) and, therefore, constitutes "avoidance" (as properly defined). Nevertheless, we would be most surprised if any court or tribunal would regard the composite transaction as an unreasonable course of action. Do you agree? The alternative argument is that the two step, composite transaction is no less "normal" than the single step, tripartite transaction and is, therefore, consistent with the principles and policy of TCGA 1992 s.135.

TCGA 1992 s.170: groups of companies

A joint venture company ("JVco") is owned 51:49 by A plc and B plc. In order to allow for CGT grouping between A Ltd and JVco, JVco issues sufficient deferred shares with minimal economic rights to A Ltd to make it a 75% subsidiary of A Ltd.

We would argue that the CGT grouping of JVco and A Ltd could not be counteracted by the GAAR. Unlike the legislation in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, the legislation in TCGA 1992 s.170 is prescriptive and mechanical. It has both an economic interest test (the 51% test) and a formal ownership test (the 75% test), which does not measure economic interest. The issue of the deferred shares is consistent with the mechanical 75% test and, therefore, with the principles and policy of the legislation. There is no "avoidance" (as properly defined), so clause 2(1) does not apply. Do you agree?

Part B: paragraphs 2.1.5.1 and 2.1.5.2

We think the reasons given in these paragraphs are wrong. The legislation simply did not contemplate the transactions involved in this scheme. These paragraphs should be omitted, leaving the reasoning in paragraph 2.1.5.3 to apply.

Part B: paragraph 2.1.5.3

Paradoxically, this statement indicates that Parliament had in mind counteracting gains on "debt like" shares but had not considered losses, which is relevant to paragraphs 2.1.5.1 and 2.1.5.4.

Part B: paragraph 2.3.5.1

We do not agree with the reasoning. This is a case where the legislation was deficient and the scheme sought to take advantage of shortcomings in the legislation. It is not a case of a scheme which was not consistent with the policy of the legislation or at least not a policy which was ever articulated.

Part B: paragraph 2.3.5.4

Is the objection to this scheme the fact that Luxembourg law permits a refund of the Luxembourg WHT whereas, had there been no refund in Luxembourg, the tax would have been borne? Is the shortcoming the interaction between UK statutory restrictions on tax credit and Luxembourg law?

Part B: paragraph 3.1.2

In the final paragraph of paragraph 3.1.2, is “lender co” Gamma or Gamma A?

Part B: reversionary lease scheme

The policy aim of the legislation is, as HMRC say, to prevent the taxpayer “having their cake and eating it”. The gift with reservation provisions apply where the donor keeps some benefit from the asset given away. The gift with reservation provisions do not apply where the individual gives away one asset and keeps another, even where the separate assets are different interests in the same property. This principle was established in cases under estate duty and has been accepted ever since. HMRC has confirmed in its Manuals that “shearing operations” are effective. So, for example, where an individual creates a trust under which he has an interest in possession but has no interest in the reversion, HMRC does not regard the individual as having reserved a benefit in the trust. If a taxpayer assigns death in service benefits under a pension policy to a trust but keeps the pension benefits under the same policy, there is no gift with reservation.

The “normal” step at paragraph 4.1.5.2 of giving the property away and continuing to live in it can scarcely be regarded as the “normal” step when it would potentially trigger a large tax liability. It is implicit (and would be the case under the legislation) that if the donor paid the market rent for occupation there would be no gift with reservation. Why is this not the “normal step”? If this is acceptable, why is the reversionary lease scheme not acceptable?

The scheme has real consequences and does not automatically reduce tax. It involves an individual granting a long lease to a nominee for himself, to commence in the future, at a time calculated by reference to his anticipated life expectancy.

The reversionary lease is then given away.

The individual is entitled to occupy the property by virtue of his freehold interest (a separate asset from the reversionary lease) so he has not retained any benefit in the asset given away.

As to the tax position:

If the donor dies within seven years of the gift of the lease, he is taxable on the value of it when given.

If he dies during the period of deferral, he has an asset in his estate (the freehold subject to the reversionary lease) which will be taxable, albeit the value decreases as the period of deferral reduces.

If the donor lives “too long”, i.e. until after the deferred lease commences, he will have to leave the property or pay rent or be subject to inheritance tax under the gift with reservations rules.

The donor’s aim is to die at exactly the right time being more than seven years after the gift and shortly before the deferred lease commences, so that the value in his estate is very small. While death can be a very effective form of tax planning, it rarely commends itself to clients.

HMRC’s statements in paragraph 4.1.5.3 that the scheme exploits shortcomings in the legislation represents a reversal of its previous views where, as mentioned above, it has accepted, presumably on the basis of case law (which has not been overruled) that the gift with reservation rules do not apply whether there are two assets and only one is given away and no benefit is retained in the one given away.

We consider the reversionary lease scheme to be an example of the centre ground of tax planning, which should not be subject to the GAAR.

Part C: Paragraphs 1.2 and 3.6.1 (counteraction by taxpayer by self-assessment)

Paragraphs 1.2 and 3.6.1 say that the taxpayer must counteract any tax advantages caught by the GAAR by making adjustments in his self-assessment return. However clause 4 of the GAAR says that adjustments are to be made by (for instance) assessment. This suggests that an assessment must be made to adjust something in an existing return or self-assessment. It does not suggest that the adjustment should be made, at the very first stage in the process, in the taxpayer’s return or in the self-assessment which accompanies that return. At that stage, there is nothing to *adjust*.

This highlights our concern about the basic counteraction provisions. See our comments on clause 4 of the draft legislation.