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Select Committee on Economic Affairs

1st Report of Session 2012–13

The Draft Finance Bill 2013

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ABSTRACT

The Finance Bill Sub-Committee (FBSC) of the Economic Affairs Committee has met each year since 2003 (except in 2010 and 2012) to examine selected aspects of the year's Finance Bill.

In December 2010 the Government introduced a "new approach" to tax policy-making including publishing a draft Finance Bill in December. The Sub-Committee can now start its work earlier in the year and examine the draft Finance Bill. The Sub-Committee began its inquiry in January 2013. It chose to look at measures in the Bill to counter the avoidance of tax, mainly the proposed General Anti-Abuse Rule (GAAR).

The Proposed GAAR

Following detailed consultations based on the findings of an independent study group, the draft Finance Bill includes proposals for a GAAR, narrowly targeted at abusive transactions which fail a stringent "double reasonableness" test. The provisions also include the formation of an Advisory Panel to agree guidance and give its opinion on the application of the double reasonableness test to a given set of tax arrangements.

Most of the representative bodies and tax specialists who gave evidence thought that the narrow focus was appropriate: this was necessary to provide as much certainty as possible for business, to promote UK competitiveness and encourage inward investment. A minority thought the proposed GAAR too narrow. None of our witnesses thought it would meet media and public expectations that international tax planning should be addressed and multinational companies made to pay more tax in the UK.

We accept the narrowly focused GAAR as a starting point. We recommend that the scope of the GAAR should be reviewed after 5 years as part of a wider post-implementation review, which would look, in particular, at how the double reasonableness test had been applied in practice and its deterrent effect.

We are fully persuaded that the proposed GAAR will not apply to structural issues around the taxation of multi-national groups. These have to be dealt with by negotiation in international fora. The current OECD rules need comprehensive, urgent review. In the meantime, we recommend that Ministers should make every effort to explain the aims of the GAAR and the reasons why it cannot apply in many of the ways public opinion would prefer, so that unrealistic expectations are managed.

Our witnesses stressed the importance of guidance from HMRC and the Advisory Panel on how the GAAR would apply so as to minimise uncertainty. We wholly agree. We recognise that progress is being made in drafting this guidance but are concerned that our witnesses felt that it was far from acceptable as it stands. We make recommendations as to what needs to be included.

It is important for the Advisory Panel to have a balance of views, though we support the exclusion of HMRC from the panel. We recommend that anonymised opinions of the panel on whether proposed tax planning schemes are caught by the GAAR should be publicised so that taxpayers can see how the GAAR is being applied.

Some of our witnesses argued that HMRC should set up a clearance system to reduce uncertainty about where the GAAR would apply. Others thought that, given the associated resource costs, clearances were unnecessary with a narrowly focussed GAAR. We accept that with clear, detailed, comprehensive guidance, produced as early as possible, the tax outcome of the vast majority of transactions should be predictable so that a clearance system is not necessary, at least initially. If the post-implementation review discloses evidence of significant uncertainty in the operation of the GAAR and damage to the UK economy, the need for a clearance system will have to be reassessed.

Many of our witnesses were very concerned at the application of the GAAR to transactions involving inheritance tax planning. We recognise these concerns and think it is particularly important for the guidance to include a variety of specific examples of both abusive and non-abusive IHT planning. We make recommendations concerning long-term IHT planning.

Finally, although many are still concerned about the detail of the proposals, we commend HMT, HMRC and all involved on an exemplary tax policy-making consultative process in the development of the GAAR.

The Annual Residential Property Tax Package (ARPT)

The ARPT is part of a package of measures to address Stamp Duty Land Tax avoidance by using companies to buy expensive residential properties ("enveloping"). We agree with our witnesses that the Government's proposals might have been more appropriately designed had it consulted interested parties at the outset. But we recognise that, once consultation was underway, the Government responded to the need to exempt certain businesses and other organisations. We share the concerns of witnesses about the practical workability of the ARPT and encourage HMRC to set out in detail how they will implement these provisions and recommend a review after 3 years. We agree that further work is needed on the capital gains tax charges on de-enveloping properties. We share the concerns expressed to us about whether the problem the legislation seeks to address justifies the length and complexity of the legislation.

The Cap on Income Tax Reliefs

We agree with evidence that the development of this measure followed an inadequate consultation process leading to ill-thought through proposals. We also note the view put to us that these proposals risk disadvantaging business by restricting reliefs for genuine trading and other losses. We recommend that the Government should carry out a more detailed review to understand better the effects of this measure on business investment in time for the House of Commons debates.

The Draft Finance Bill 2013

CHAPTER 1: INTRODUCTION

1. This is the ninth report in a series which began in 2003 when the House of Lords Select Committee on Economic Affairs first appointed a Sub-Committee to inquire into selected aspects of that year's Finance Bill. The Finance Bill Sub-Committee's inquiries address technical issues of tax administration, clarification and simplification rather than rates or incidence of tax.

2. In December 2010, the Government introduced a "new approach" to tax policy-making intended to improve the process of designing and legislating changes to the UK tax system through more effective consultation with business, practitioners and other interested parties. The approach, which was examined in our report on Finance Bill 2011, sets out a number of stages at which the Government should normally undertake consultation. It includes publishing a draft of the Finance Bill in December, some three months before it is laid before Parliament.

3. Consequent on this new approach and the publication of the draft Finance Bill in December, the House of Lords revised the terms of reference of the Sub-Committee so that it could start its work earlier in the year and examine the provisions which appear in the draft Finance Bill.

4. The draft Finance Bill 2013 was published on 11 December 2012 and the Sub-Committee began its inquiry in January 2013. As in previous years the Sub-Committee had to be selective as to what it could include for close examination.

5. This year, the Sub-Committee chose to look at measures in the draft Finance Bill to counter the avoidance of tax. Within this overall theme, the inquiry centred on the proposed General Anti-Abuse Rule (GAAR); the Sub-Committee considered it appropriate to spend most of its time on this measure, given its importance.

6. In addition, the Sub-Committee looked at two other anti-avoidance or fairness measures: the package of measures of which the new annual residential property tax (ARPT) is the major part and the cap on the availability of certain income tax reliefs.

7. As in previous years, the Sub-Committee conducted its inquiry by taking written and oral evidence from leading professional and business organisations and from HM Treasury (HMT) and HM Revenue and Customs (HMRC). A list of those who have contributed to the inquiry in this way is given in Appendix 2. All oral and written evidence is published on the Economic Affairs Finance Bill Sub-Committee website[1]. The Sub-Committee would like to thank all those who have contributed to its work. Without their help this report could not have been written.

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1 http://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-finance-bill-sub-committee/publications/

8. We owe warm thanks to our Specialist Advisers, Trevor Evans and Tony Orhnial, whose expertise and ability to work fast was invaluable.

9. Chapter 2 sets out the background to the development of the GAAR. Chapters 3 and 4 set out the Committee's findings on the draft legislation to introduce the proposed GAAR. Chapter 5 sets out the findings on the ARPT package and Chapter 6 those on the cap on reliefs. The conclusions and recommendations are summarised in Chapter 7.

CHAPTER 2: THE PROPOSED GENERAL ANTI-ABUSE RULE BACKGROUND

10. This chapter sets out the background to provisions in the draft Finance Bill 2013 to introduce a General Anti-Abuse Rule (GAAR) with effect from Royal Assent. It considers:

- the elusive definition of the term 'tax avoidance', a critical step in determining the target of any general anti-avoidance or anti-abuse rule[2];
- the main means by which UK governments have sought to tackle tax avoidance in recent years;
- the proposals put forward in 1998 by the then Government to introduce a general anti-avoidance rule limited to corporate taxes; and
- the conclusions of a study, led by Graham Aaronson QC, "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."[3] This report was published on 11 November 2011 and forms the basis for the draft legislation discussed in chapters 3 and 4.

'Tax Avoidance'

11. Pinning down a watertight definition of the term 'tax avoidance' is an impossible task. Attempts to explain the meaning of the term often start by distinguishing between avoidance and evasion. So, for example, during a debate in July 2010, David Gauke MP, the Exchequer Secretary to the Treasury, noted that:

> "Tax evasion occurs when someone acts against the law. Tax avoidance involves compliance with the letter but not the spirit of the law, and it is right that the Government seek to minimise that. Tax planning is a case of acting in both the spirit and the letter of the law. There is a distinction, although there will be occasions when the line is a little blurred."[4]

12. Expanding on the concept of tax avoidance in her evidence, Ms Judith Knott of HMRC said "We would draw a three-way distinction. We have legitimate tax planning, then tax avoidance and, finally, abusive tax avoidance." And she went on to say:

> "What we mean by legitimate tax planning is tax planning that is very much in line with Parliament's intentions when it passed the rules. A good example would be putting cash into an ISA account. That is legitimate and what Parliament intended to happen. Avoidance, on the other hand, is behaviour that seeks to bend the tax rules in a way that

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2 In this report the acronym GAAR is used to refer to the General Anti-Abuse Rule as proposed by the Aaronson study and included in the draft Finance Bill; where we wish to refer to a wider-ranging rule we refer to this in full as a general anti-avoidance rule or principle.

3 *GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system*, November 2011, paragraph 2.1

4 HC Deb, 12 July 2010, col 706

> Parliament did not intend. It is often accompanied by artificial transactions—trying to seek a result that was not intended."[5]

13. Similarly, the Organisation for Economic Co-Operation and Development (OECD) defines tax avoidance as "the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and … is usually in contradiction with the intent of the law it purports to follow."[6]

14. Although consistent with each other, all these definitions depend on the existence of a common interpretation of what the original lawmakers had in mind in enacting a particular tax statute—and thus on whether the courts adopt a literalist or purposive interpretation of that intention and on the extent to which particular judges are willing to 'stretch' their interpretation. The courts interpret Parliamentary intention as that revealed by the wording and context of the legislation itself and extraneous comment or other guidance can be taken into account only in very limited circumstances. This is a much narrower definition of Parliamentary intention than the wider colloquial definition which might either infer intention or take into account external information. Consequently, in practice, a good deal of uncertainty can often attach to the question of whether a particular arrangement constitutes 'tax avoidance' and, if so, whether it is to be regarded as 'acceptable' (tax planning or tax mitigation) or 'unacceptable' (aggressive or abusive avoidance).

15. The problem is that, as the Oxford University Centre for Business Taxation (OUCBT) notes in a paper[7] submitted by Professor Judith Freedman, the term 'tax avoidance' "has no fixed legal meaning, although courts have sought to elucidate it in some cases and, for example, to distinguish tax avoidance from tax planning or tax mitigation. Matters are often complicated but not usually clarified by the addition of adjectives such as 'aggressive', 'abusive' or 'unacceptable' to the term. All categorisation in this area is problematic …"[8]

16. The Tax Law Review Committee (TLRC) took a similar view in its 1997 report saying:

> "We think it impossible to define the expression 'tax avoidance' in any truly satisfactory manner. People routinely alter their behaviour to reduce or defer their taxation liabilities. In doing so, commentators regard some actions as legitimate tax planning and categorise others as tax avoidance. No two commentators may agree on the categorisation of certain behaviour."[9]

17. Our witnesses elaborated on the issues involved in attempting such categorisation. Mr Aaronson said he preferred to use:

> "words that are less emotive when describing the intellectual process in determining whether you should be paying a smaller amount of tax than you would otherwise pay. You can call that tax planning because it is

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5 Q 104

6 *Glossary of Tax Terms*, OECD

7 *Tax Avoidance*, one of three papers commissioned from the OUCBT by the National Audit Office (NAO) as part of the evidence underlying its report, *Tax avoidance: tackling marketed avoidance schemes*, November 2012 (see Freedman paragraph 12 for a link to the OUCBT paper)

8 *Ibid.*, page 3

9 *Tax Avoidance*, TLRC, November 1997, page ix, paragraph 7

> planning. Whether it is good planning or bad planning, whether it is abusive planning or innocent planning, it is planning. Tax avoidance is a very dangerous expression to use if you want to have a serious debate because one person's avoidance is another person's perfectly reasonable planning."[10]

18. In similar vein, Mr Malcolm Gammie QC wrote that it was not possible "to discuss sensibly the issues of tax avoidance in terms of morality, 'fair shares', what is reasonable or, even, the definition of what is or is not avoidance."[11]

19. These difficulties of definition are compounded by the indiscriminate way in which the label of tax avoidance tends to be applied by media and other commentators to describe a very wide range of activities undertaken by individuals and companies to reduce their UK tax liabilities. Professor Freedman's evidence proposes a useful taxonomy that helps to clarify the public debate and to understand the scope of different GAAR proposals. It suggests distinguishing between:

    (a) **ineffective avoidance**, which encompasses arrangements which "can be combated under existing laws provided the activity is discovered and action is taken."[12];

    (b) **effective avoidance** which "reduces tax payable due to use of a defect in the legislation or other failure in the way that the legislation is written, that cannot be corrected by purposive interpretation. The effectiveness of this activity is not always predictable with certainty since it may depend on the approach taken by the courts to interpreting the particular statute in question"[13]; and

    (c) "**using legislation or the international tax system to one's advantage**. This covers transactions and behaviour that reduce taxation either by using legislation that offers certain opportunities or by relying on the structure of the international taxation system."[14]

20. The third of these categories encompasses arrangements of the kind adopted by many multi-national companies, which many would not describe as avoidance, and is discussed in Chapter 3.

21. Of the remaining categories, it would be more accurate to say that they represent "a continuum from transactions that would not be effective to save tax under the law as it stands at present to tax planning that would be accepted by revenue authorities and courts without question."[15]

22. A key question in designing a general anti-avoidance rule is deciding where on that continuum to position the rule, or, as Tracey Bowler puts it in her discussion paper for the TLRC, "at the heart of the problems in applying a GAAR lie the problems of defining tax avoidance".[16]

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10 Q 10

11 Gammie, paragraph 2.4

12 Freedman, paragraph 14

13 *Ibid.*, paragraph 14

14 *Ibid.*, paragraph 14

15 *Tax Avoidance*, OUCBT, page 3

16 *Countering Tax Avoidance in the UK: Which Way Forward?*, TLRC Discussion Paper No 7, March 2009, paragraph 11.10

Tackling Tax Avoidance

23. However it chooses to define tax avoidance, "no country allows unfettered attacks on the integrity of its tax system. Every country adopts measures to curb avoidance."[17] UK governments have generally used two main ways of tackling avoidance: challenge in the courts to seek to strike down particular arrangements and to establish the boundaries of existing tax rules, and legislation to counter abuse of existing tax rules, including specific measures to correct defects in the underlying tax base and targeted anti-avoidance rules (TAARs). More recently these approaches have been underpinned by the Disclosure of Tax Avoidance Schemes (DOTAS) requirements[18] and by various administrative initiatives to address avoidance, such as the Code of Practice on Taxation which banks have been encouraged to sign.

24. However, although some other jurisdictions[19] have long supplemented their defences with general anti-avoidance rules, UK governments have only turned to considering such general rules relatively recently.

Litigation and statutory interpretation

25. Challenging tax arrangements in the courts must clearly form part of any revenue authority's anti-avoidance strategy. But, as the OUCBT observed, "Litigation plays an important role in defining the limits of tax law. As a means of tackling avoidance, however, it is expensive, time-consuming and uncertain in its outcome …"[20] Furthermore, the outcome of such litigation depends critically on how the courts interpret tax legislation.

26. For most of the last century, the courts tended to interpret tax statutes in a strict literalist manner so that the principal question about any arrangement that sought to reduce a taxpayer's liability was whether it was consistent with the strict letter of the law. Moreover, as the GAAR Study notes,

> "Adding to the difficulty of confronting tax avoidance which this strict interpretation imposed was another principle which required Courts, in cases where the statutory language was ambiguous, to opt for the interpretation which favours the taxpayer …"[21]

27. It was only in 1982, with the *Ramsay* case,[22] that the Courts began to take a more purposive interpretation of tax statutes, not confining themselves to a literal reading of the statute. That approach has evolved over the years so that currently:

> "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

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17 *Tax Avoidance*, TLRC, November 1997, Executive Summary, paragraph 10

18 DOTAS provides HMRC with early information on tax avoidance schemes, enabling effective risk-based investigations and rapid legislative changes.

19 Examples of such jurisdictions in Common Law countries are Canada (since 1988) and Australia (since 1916)

20 *Tax Avoidance*, OUCBT, page 18

21 *GAAR Study*, paragraph 3.9

22 Ramsay v IRC [1982]

> statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."[23]

28. In his report, Mr Aaronson adds that "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."[24] However, he expresses the reservation that "in some cases the Courts, under the guise of purposive interpretation, have been prepared to stretch the interpretation of tax legislation in order to thwart tax avoidance schemes that they regard as abusive."[25] Elsewhere he has also commented that this practice "is leading to a distortion of true purposive interpretation. It leads to uncertainty and it is increasing litigation risk …"[26]

Changes to Legislation

29. Once existing tax rules, however purposively interpreted, have been found to be deficient in tackling arrangements the Government regards as unacceptable, it has typically adopted one of two broad approaches to countering them. One is to legislate specific provisions to cover situations that had not been thought of, or been inadequately catered for, at the time the original policy was designed. The other is to introduce a Targeted Anti Avoidance Rule (TAAR) that applies to that particular part of tax law.

30. A legislative response of this kind is the most common way of countering avoidance in the UK. It is "consistent with the traditional UK legal view that legislation should state clearly the circumstances in which a liability to tax arises, leaving the minimum scope for the Revenue authorities to determine those circumstances."[27] But it has contributed to a proliferation in tax legislation in recent years and, in the case of TAARs, also to considerable reliance on extensive HMRC guidance to make the rules workable.

31. As the OUCBT have remarked, the approach of closing down loopholes as they appear can lead to "an interminable cat and mouse game. As an avoidance opportunity is closed down through legislation, another is found, which also needs to be closed down. The authorities can only play catch up and the process never ends."[28]

32. This is, of course, truer of some parts of the tax system than of others. As the 1997 TLRC Report commented:

> "Some structures for levying taxation are more prone to avoidance than others. Complex legislation, imposing special tax penalties or conferring special tax privileges, on selected kinds of economic activity, may prove a standing invitation to avoidance. The proper and satisfactory response

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23 This summary of the current approach to the interpretation of tax law is cited in the *GAAR Study* and attributed to Ribiero PJ in the *Arrowtown* case in the Hong Kong Final Court of Appeal [*Collector of Stamp Revenue v Arrowtown Assets Ltd* (2004) 6 ITLC 454]

24 *GAAR Study*, paragraph 3.12

25 *Ibid.*, paragraph 3.13

26 Interview: 'Aaronson on the progress of the GAAR Study', *Tax Journal*, 15 July 2011

27 *Tax Avoidance*, TLRC, November 1997, paragraph 2.1

28 *Tax Avoidance*, OUCBT, page 18

to avoidance may therefore be to change the structure of the system or elements within it."[29]

33. Similar sentiments were expressed by some of our witnesses. Mr Gammie, for example, wrote that "It is important to remember that tax avoidance is a function of the tax base. As the minority report of the 1955 Royal Commission observed, '*the existence of widespread tax avoidance is evidence that the system, not the taxpayer, stands in need of reform.*'"[30]

34. That said, several witnesses commented on the effectiveness of the DOTAS rules in alerting HMRC to a new tax avoidance scheme so enabling them to attempt to counteract it quickly if Ministers thought it appropriate. For example, Mr Warburton (Grant Thornton) commented "The previous Government made a major step forward on the whole issue of tax avoidance when they introduced the disclosure requirements" and "this had a major impact because it meant that people who promoted schemes have had to disclose that. They very quickly have been open to scrutiny by the specialist team at HMRC and the speed of response has therefore been much quicker."[31]

The 1997/1998 Proposals for a General Anti-Avoidance Rule

35. A TLRC Report, published in November 1997, addressed the question of "whether current methods of dealing with tax avoidance are adequate and satisfactory and what, if any, other measures might be taken."[32] It concluded that "specific anti-avoidance provisions should continue to be in the forefront of the battle against tax avoidance" and that "a sensibly targeted statutory general anti-avoidance provision, with a considered framework and appropriate safeguards for taxpayers (including a clearance procedure)" was to be preferred to "the continued development of judicial anti-avoidance doctrines."[33]

36. The TLRC suggested that such a general anti-avoidance rule "should be directed to deterring or counteracting courses of action that are designed to conflict with or defeat the evident intention of Parliament as appearing from the legislation" and should not "deter legitimate tax planning or mitigation in taxpayers' ordinary commercial or personal affairs."[34] To this end the proposed general anti-avoidance rule, an illustrative draft of which formed an appendix to the Report, contained a number of safeguards for taxpayers, including a comprehensive clearance system.

37. The report pointed to the need for the Government to strike the right balance "between the public interest in seeing that taxes are not unduly avoided and legitimate interests of taxpayers in their commercial and private affairs". They saw this balance as lying in "ensuring that (a) the rule is sensibly targeted, (b) there are sensible procedures for invoking the rule and (c) there is proper oversight of its exercise."[35] This implied the Government's

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29 *Tax Avoidance*, TLRC, November 1997, Executive Summary, paragraph 11

30 Gammie, paragraph 2.5

31 Q 96

32 *Tax Avoidance*, TLRC, Executive Summary, paragraph 1

33 *Ibid.*, paragraph 1

34 *Ibid.*, paragraph 24

35 *Ibid.*, paragraph 23

accepting "whatever cost is involved in providing the proper administrative framework and safeguards for taxpayers. If it were not prepared to incur this cost, it should not propose a statutory rule."[36]

38. The TLRC report formed the basis for the Government's proposal, published for consultation the following year, for a general anti-avoidance rule initially limited to taxes, principally corporation tax and petroleum revenue tax, on "the corporate sector where some of the most contrived and costly avoidance takes place."[37] This gave it a significantly narrower scope than the TLRC proposal.

39. The Government's 1998 consultative document rejected a narrow definition of the tax avoidance it sought to address because "a definition that is narrow enough to give certainty and confidence wherever appropriate, would also be narrow enough to be circumvented by ingenious avoidance schemes."[38] Instead it proposed drafting "a definition which is initially very wide in scope, but which can be narrowed down considerably by an exception for acceptable tax planning and which would only be in point when triggered by a purposive test."[39] The burden of proving that tax avoidance was the main purpose of a transaction would fall on the Inland Revenue, and that of showing that it constituted acceptable tax planning would fall on the taxpayer. The document accepted that this approach was likely to have the effect of generating very substantial demand for pre-transaction clearances, and it floated the idea of rationing demand by charging for clearances.

40. The TLRC's response to the consultation concluded that "the Inland Revenue's proposals … do not give effect to the objectives the Committee had in mind and fail to produce a satisfactory balance of interests between tax gatherers and taxpayers."[40] Its main concerns were with the distribution of the burden of proof between taxpayers and the Revenue and the adequacy of the proposed clearance procedure and the resources that would be devoted to it.

41. In any event, the general anti-avoidance rule proposed in 1998 came to nothing. Owen Smith MP, the Shadow Exchequer Secretary, recently explained this decision as follows:

> "The judgement of the last Labour government, when considering a GAAR, was that a weak general rule with no real substance and only addressing the most specific circumstances was no substitute for targeted anti-avoidance legislation combined with a properly resourced Revenue and Customs."[41]

The Aaronson GAAR

42. The more recent roots of the GAAR proposed in the draft Bill lie in a Liberal Democrat proposal, made in the run-up to the 2010 General Election, for

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36 *Ibid.*, paragraph 27

37 *A General Anti-Avoidance Rule for Direct Taxes: A Consultative Document*, Inland Revenue, October 1998, Foreword

38 *Ibid.*, paragraph 6.5.1

39 *Ibid.*, paragraph 6.5.1

40 *A General Anti-Avoidance Rule for Direct Taxes: A Response to the Inland Revenue's Consultative Document*, TLRC, February 1999, Foreword, page 2

41 Comment: 'The government's anti-avoidance tax rule is a toothless tiger', *The Guardian*, 28 February 2012

the introduction of a General Anti-Avoidance Principle (GAAP). This was picked up in the Coalition Government's statement of its priorities which included making "every effort to tackle tax avoidance, including detailed development of Liberal Democrat proposals."[42] In the June 2010 Budget, the Chancellor announced that the Government would "engage informally with interested parties to explore whether there is a case for developing a General Anti-Avoidance Rule"[43]

43. Those informal discussions took place over the summer and, in December 2010, the Exchequer Secretary reported that "there was some support for such a rule, but it was clear that there were also concerns that a rule would generate uncertainty about the tax treatment of business transactions and about how that uncertainty could be managed in practice." He went on to announce that he was launching a study programme, led by Graham Aaronson QC, "to establish whether a GAAR could be framed to meet the objectives of deterring and countering tax avoidance in a fair way, while providing certainty, retaining a tax regime that is attractive to business and minimising compliance costs for businesses and HMRC and, if so, how the provisions of the GAAR might be framed."[44]

44. As part of its work, the GAAR study group undertook two rounds of consultations with the major representative bodies, the first to discuss problems arising from tax avoidance schemes in practice and the second to consider the study's emerging findings and the framing of an illustrative GAAR. On tax avoidance generally, the report of the study group[45] notes that it found "unanimous disapproval, indeed distaste, for egregious tax avoidance schemes"[46]. They "made for an un-level playing field"[47], "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"[48], and "encouraged judges to give a stretched interpretation to the relevant statutory provisions."[49] On the idea of introducing a GAAR to the UK, the study group found that "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."[50]

45. The group's report, published in November 2011 (the Aaronson report), 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."[51] Reducing this risk would require "a comprehensive system for obtaining advance clearance for tax planning

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42 *The Coalition: our programme for government*, HM Government, May 2010, page 30

43 *Budget 2010*, HM Treasury, June 2010 (HC 61), paragraph 2.114

44 HC Deb, 6 December 2010, col 3WS

45 *GAAR Study*, November 2011

46 *Ibid.*, paragraph 4.6

47 *Ibid.*, paragraph 4.7

48 *Ibid.*, paragraph 4.9

49 *Ibid.*, paragraph 4.10

50 *Ibid.*, paragraph 4.19

51 *Ibid.*, paragraph 1.5

transactions" which would "impose very substantial resource burdens on taxpayers and HMRC alike."[52]

46. Instead the Aaronson report recommended "a moderate rule which does not apply to responsible tax planning, and is instead targeted at abusive arrangements."[53] This moderate rule, a General *Anti-Abuse* Rule (the GAAR), would be based on two key propositions:

- "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"[54]; and
- "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."[55]

47. This narrow focus is achieved (in the illustrative GAAR which forms Appendix 1 to the Aaronson report) by imposing two main requirements for the GAAR to apply to a particular arrangement. These are that the arrangement (i) contains an abnormal feature whose "inclusion has to be for the purpose of achieving the intended tax result" and that (ii) it "cannot be regarded as a reasonable exercise of choices of conduct afforded by the legislation."[56] This has come to be known as the 'double reasonableness test'.

48. In addition to its narrowness, the Aaronson GAAR contains a number of other safeguards for centre ground tax planning, so further reducing any uncertainty about whether particular arrangements fall foul of the GAAR.

49. Much of the rationale for the rule's narrow focus stems from the objectives the Government set the study group. As Mr Aaronson commented in his evidence, "There is unquestionably a legitimate area of debate as to whether the GAAR is too narrowly targeted. We believe that it is not, because our main concern was not to damage the competitiveness of the British economy" and "There was another absolutely key requirement not to overburden the resources of HMRC or taxpayers. If you have a more widely targeted GAAR, you will need a clearing system."[57]

50. In Mr Aaronson's view, the main benefits of such a rule would include deterring (or counteracting) "contrived and artificial schemes which are widely regarded as an intolerable attack on the integrity of the UK's tax regime", "providing a more level playing field for business" and making it possible "by eliminating the need for a battery of specific anti-avoidance sub-rules, to draft future tax rules more simply and clearly."[58] Like the TLRC in 1997, the study group saw one of the benefits of a GAAR as reducing the risk that judges would be tempted to stretch their interpretation of the law to arrive at a sensible result. And a narrowly focused GAAR targeted on abusive

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52 *Ibid.*, paragraph 1.6

53 *Ibid.*, paragraph 1.7

54 *Ibid.*, paragraph 5.1

55 *Ibid.*, paragraph 5.2

56 *Ibid.*, paragraph 6.3

57 Q 5

58 *GAAR Study*, paragraph 1.7

schemes would have the benefit of not requiring a clearance scheme with all the resources that entailed.

51. Finally, it is important to bear in mind that the study group did not see the GAAR as "a rule of construction, or interpretation, of statutory language"[59], but rather as one "which overrides the consequences which would otherwise flow from tax legislation which brings an advantage."[60] Or, as Mr Gammie remarked, "the fundamental aspect of a GAAR is that it purports to charge tax (or more tax) in circumstances in which (absent the GAAR) tax is not payable or less tax is payable. In other words, it purports to override 'black letter' law even when construed purposively and in accordance with the *Ramsay* judicial anti-avoidance approach."[61] He saw this as "the crossing of the Rubicon."[62]

Reactions to the Aaronson Report

52. Our report on the Finance Bill 2011 referred to the work of the Aaronson study group then in train. Although we reported that "we did not find great enthusiasm amongst our private sector witnesses for a GAAR"[63], we agreed with the Chartered Institute of Taxation (CIOT) that a general anti-avoidance rule was worth examining again and looked forward to the study group's report.

53. Reactions to the Aaronson report when it was published were more positive than the evidence we heard in 2011 suggested. The main concerns expressed by representative bodies were about whether the GAAR could focus on the narrow target of abusive arrangements without creating undue uncertainty and about the expectations that had built up about the types of tax avoidance that the GAAR could address. From the other end of the spectrum, others, including Richard Murphy and Owen Smith MP, Shadow Exchequer Secretary, held that the GAAR proposed by Mr Aaronson had been drawn too narrowly. These different views are reflected in the evidence we heard on the Government's draft GAAR covered in Chapters 3 and 4.

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59 *Ibid.*, paragraph 5.4

60 *Ibid.*, paragraph 5.5

61 Gammie, paragraph 1.5

62 *Ibid.*, paragraph 4.1.1

63 House of Lords Select Committee on Economic Affairs, 4th Report (2010–12): *The Finance Bill 2011*, (HL Paper 158), paragraph 192

CHAPTER 3: THE PROPOSED GAAR – SCOPE

54. This chapter looks at the scope of the proposed GAAR which is included in the draft Finance Bill. Chapter 4 looks at its other features.

Context

55. The Government announced in its 2012 Budget[64] that it accepted the approach of the Aaronson report. Its detailed response was set out in a consultation document published on 12 June 2012.[65] It confirmed "that a 'broad spectrum' general anti-avoidance rule would not be beneficial for the UK ….A broad rule risks compromising the certainty that is vital to provide the confidence to do business in the UK. The Government therefore agrees with the [Aaronson] Report that a rule targeted at abusive tax avoidance arrangements would be the right approach for the UK tax system."[66]

56. The consultation document accepted that "The proposed GAAR is intended to have narrower application than most general anti-avoidance rules found in other jurisdictions, which usually have potential application to a broad spectrum of tax avoidance. The GAAR should not affect what the [Aaronson] Report describes as ' the centre ground of tax planning'."[67] The consultation document went on to make clear that "if arrangements do not fall within the GAAR, they may still be regarded as avoidance. HMRC will challenge and, where it can, counteract all forms of tax avoidance … using the GAAR where it applies … and using existing anti-avoidance tools where the GAAR does not apply."[68]

57. Annexed to the consultation document was the first draft of the legislation implementing the Government's version of the GAAR. The draft:

> "adopts many of the principles of the [Aaronson] Report, and is structured in a way that the Government believes is an effective way of delivering the overall policy objective of a GAAR that is focussed on artificial and abusive tax avoidance schemes. In particular, what has come to be known as the 'double reasonableness' test … has been reformulated to be the key provision that drives the application of the GAAR."[69]

58. On 11 December 2012, the Government published a summary of responses to its consultation document of the previous June. On the scope of the GAAR, it concluded that "The majority of respondents support the introduction of a GAAR targeted at artificial and abusive tax avoidance. Specifically, respondents agreed with the Government's view that a 'broad-spectrum' general anti-avoidance rule would not be beneficial for the UK."[70]

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64 *Budget 2012*, HM Treasury, March 2012 (HC1853), paragraph 2.198

65 *A General Anti-Abuse Rule: Consultation Document*, HM Revenue and Customs, 12 June 2012

66 *Ibid.*, paragraphs 1.6 and 1.7

67 *Ibid.*, paragraphs 2.3 and 2.4

68 *Ibid.*, paragraph 2.5

69 *Ibid.*, paragraph 3.3

70 *A General Anti-Abuse Rule: Summary of Responses, HM Revenue and Customs*, 11 December 2012, Headline summary, page 5

However, "Many respondents were concerned that the draft legislation had the potential to have wider application than the stated target."[71]

59. The document of December 2012 set out the revised terms of the proposed GAAR which has been included in the draft Finance Bill. Both the June and December versions of the GAAR target 'abusive tax arrangements'. The scope of this GAAR hinges on the meaning of the terms 'tax arrangements', defined by the 'main purpose' rule, and 'abusive', defined by the 'double reasonableness' test. These definitions, discussed below, are the main operative provisions which determine the scope of the GAAR.

60. The draft legislation then illustrates these provisions with examples of which circumstances should be taken into account and of indicators of abusiveness. These are the supporting provisions.

The "main purpose" rule

61. This rule is concerned with whether the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements entered into. There were two distinct views on this from respondents to the June consultation: first that "a 'sole', 'dominant' or 'primary' purpose test would be preferable to a main purpose rule as providing greater assurance to taxpayers that 'centre ground planning' would not be caught;" secondly that "a 'main purpose' test would be adequate so long as the key 'double reasonableness' test … was properly formulated."[72]

62. The Government concluded "that the best way of ensuring that the GAAR applies only to its intended target is to refine the 'double reasonableness' test" rather than amending the main purpose test. It considered that "there is a risk that a sole or dominant purpose filter might exclude some of the arrangements which the GAAR is intended to counteract."[73] So the double reasonableness test is the key provision in achieving the targeting of the GAAR on abusive tax arrangements.

The double reasonableness test

63. The draft Finance Bill defines tax arrangements as "'abusive' if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances …" (emphasis supplied). The test goes on to set out examples of circumstances which must be taken into account in determining whether tax arrangements are abusive, though these examples are not exhaustive.

64. In interpreting this provision, a decision has to be taken, ultimately by a court, on whether there can be a reasonably held view that the tax arrangements are a reasonable course of action in relation to the relevant tax provision, having regard to all the circumstances. The personal view of the judge is irrelevant. So even if the judge thinks the tax arrangements are not a reasonable course of action, if, in the judge's opinion, based on the available evidence, a reasonable view can be held to the contrary (i.e. that the arrangements are a reasonable course of action), the arrangements cannot be

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71 *Ibid.*, Headline summary, page 5

72 *Ibid.*, paragraph 3.1.4

73 *Ibid.*, paragraph 3.1.6

considered abusive and the GAAR cannot apply to them. Therefore, if a court heard expert evidence which conflicted, and both views were reasonable, it is clear that the GAAR could not be applied to the arrangements in question.

65. This double reasonableness test produces a much narrower focus than a single reasonableness test. With the latter test, the judge would have to take a view as to whether the tax arrangements were a reasonable course of action in relation to the relevant tax provisions. If the judge heard expert evidence which conflicted, a final decision based on the judge's opinion of the arrangements would have to be made.

66. The December 2012 document set out the changes that the Government proposed to the June draft of the double reasonableness test in response to concerns that it went too wide. The main operative provisions as described above remained unchanged but there were three changes to the supporting provisions:

- clarifying the circumstances that have to be taken into account in determining whether the tax arrangements are abusive;
- making it clear that the specific indications that an arrangement might be abusive are not relevant if it is apparent that the relevant tax rules were intended to secure the outcome of that arrangement; and
- adding a further indicator that arrangements may not be abusive where they are in accord with established practice and HMRC has indicated its acceptance of that practice.

Amendments were also made so that transactions or agreements on non-commercial terms, for example for a consideration significantly different from market value, are no longer highlighted as indicators of abusiveness.

67. HMRC helpfully prepared for us supplementary written evidence setting out the differences between the Aaronson draft legislation and that which is now included in the draft Finance Bill.[74] Mr Aaronson gave us an overview of the various drafts: the one in the Aaronson report; the draft in the June consultative document; and the one that was now included in the draft Finance Bill:

> "The differences between the version published in June and that published a month or so ago could be described as cosmetic, but there are important cosmetic changes. In our report and in our draft, we began with the concept of artificial and contrived transactions. In essence, our draft worked by reference to what Malcolm Gammie has referred to and everyone is now calling the double reasonableness test, i.e. that if something can reasonably be regarded as reasonable tax planning then it is not caught. But we opened our draft with expressions such as contrivance and artificiality. Those were dropped by the parliamentary draftsman's draft in June because, as a matter of logic, they were not necessary but as a matter of flavour or colour they are quite significant and they have now come back into the later, December draft. You will find the expressions 'artificial' and 'contrivance', not tucked away but as factors to be taken into account in determining whether something can be regarded as abusive. So the flavour and

74 HMRC, Supplementary evidence on GAAR

colour have come back. That will help assuage people's fears that the parliamentary draftsman's version of our GAAR is wider than we intended."[75]

68. Asked whether there were any other changes that he would like to see to the GAAR included in the draft Finance Bill, Mr Aaronson responded "No, I think the current version is very good. I am not trying to be patronising—it is very well drafted. It captures the essence very well and I have no complaints about it at all."[76]

The narrow focus of the GAAR

69. The reasoning, with which the Government agreed, behind a narrow focus was set out in the Aaronson report and was discussed in chapter 2 of this report: on the one hand, to provide sufficient certainty of outcome for business and other taxpayers and not undermine UK competitiveness and, on the other hand, limiting demands on scarce resources within HMRC. Each of these is discussed further in chapter 4. The rest of this chapter looks at the evidence that we received on whether this narrow focus is appropriate, what arrangements seem likely to fall within it and what arrangements are likely to be outwith its scope.

70. A large majority of our witnesses supported a narrow focus for the GAAR. The CIOT wrote "Tackling abusive schemes is rightly the target of the GAAR."[77] The Institute of Chartered Accountants in England and Wales (ICAEW) wrote "We support the GAAR in principle."[78] Mr Cosmetatos for the British Property Federation (BPF) said that they are "very supportive of the way in which the GAAR has been designed. We agree with Mr Aaronson's approach of targeting abusive schemes."[79] The Law Society of England and Wales (LSEW) "completely agreed" with the reasons why the Aaronson report had recommended a narrow focus for the GAAR.[80] Tim Davies from Mazars said "Any law that seeks to prevent abusive arrangements is welcome … Where we are now is in a reasonably good place. There is still work to do … but in principle, yes, I am very supportive of it."[81]

71. On the other hand, Mr Chowdhury for the ACCA doubted whether the GAAR was necessary: "I am not entirely sure that we need it on top of everything else we have in the UK."[82] And there were reservations from some of the witnesses who supported the narrow focus as to whether the draft legislation achieved this. The ICAEW thought that "greater clarity is still needed about what will be caught."[83] The BPF considered that "the 'double reasonableness' test is very vulnerable to being construed differently by different people and at different times."[84] The CBI's view was "that the

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75 Q 2

76 Q 3

77 CIOT, paragraph 2.5

78 ICAEW, paragraph 15

79 Q 70

80 LSEW, paragraph 4

81 Q 93

82 Q 52

83 ICAEW, paragraph 15

84 BPF, paragraph 10(b)

legislation falls short of solely targeting transactions which are 'abusive' and 'artificial'" and offered drafting suggestions on tightening up the targeting.[85] Mr Richards (LSEW) told us that "it was important that an anti-abuse rule targeted only contrived and artificial schemes".[86] Ms Williams (LSEW) thought that "In the context of private client transactions … there is little or no clarity at the moment about how abusive arrangements are defined."[87]

72. A strongly dissenting voice came from Mr Murphy of Tax Research LLP. His view was that the GAAR "suffers from three fundamental problems: it is not general in nature; it does not tackle tax avoidance as that term is now widely understood, including by the Prime Minister; its construction makes it unlikely to succeed in its objectives."[88] He argued that a much wider-ranging GAAR should be set in place which would target tax avoidance in general and the "arrangements that have caused considerable concern to the Prime Minister, the House of Commons Public Accounts Committee, the press and general public since the beginning of 2012."[89] In both his written and oral evidence, he referred us to the Bill which he had drafted for Mr Michael Meacher MP which is before the House of Commons at present. Asked to compare the two approaches, Mr Murphy said:

> "The fundamental logics of the two Bills [the draft Finance Bill and the Meacher Bill] are in a sense very different. We have as the test of what is an abusive arrangement in the general anti-abuse rule the double-reasonableness test, which I have some significant difficulties with because I think it is an inappropriate and biased system. What I would want is there to be an economic substance test. That, by the way, is entirely consistent with the Revenue's view of what tax avoidance is: whether the economic substance of the transaction is consistent with the way in which it is reported and within the intention of the legislation, and if there is mismatch [with] that economic substance."[90]

73. Mr Murphy's argument in favour of a broader GAAR appears to have been prompted by the transactions that would not be encompassed within the proposed narrowly focused GAAR. We look at examples of those later in this chapter. His view was supported by War on Want which:

> "believes that the government's proposals for a General Anti-Abuse Rule fall far short of what is needed to tackle tax avoidance and contribute to an efficient, equitable and effective tax regime in the UK … The government should scrap its plans for an anti-abuse rule and introduce a General Anti-Avoidance Principle based on the need for a fair and equitable tax system."[91]

74. Mr Murphy accepted that a wider-ranging General Anti-Avoidance Principle would require a comprehensive clearance system so that taxpayers could confirm with HMRC, in advance of transactions taking place, whether they

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85 Letter from the CBI to HMRC (see Appendix 5)

86 Q 83

87 Q 83

88 Mr Murphy, paragraph 3.1

89 *Ibid.*, paragraph 5.1

90 Q 36

91 War on Want

could fall within its scope. Mr Murphy would meet the resource costs of such a system by making an appropriate charge for a clearance application.

75. Many of our other witnesses were concerned at the discretion Mr Murphy's approach would give to HMRC in deciding where the boundary lay between what was acceptable and what not. Mr Dodwell (CIOT) said:

> "To be honest, I think it starts from the wrong premise. In our view tax should be levied clearly by law, enforced by the tax administration and then disputes about its application resolved by the judiciary. But to impose the sort of question of whether something should or should not be taxable to the tax authority is moving the role of Parliament into the role of an executive agency and not likely to create a satisfactory outcome for anyone."[92]

76. Supporting Mr Dodwell, Mr Stevens (CIOT) made the point that "the wider concept of a GAAR … would probably mean that such a clearance system … would cover such a huge number of transactions, it would mean that much tax law would be administered through such a clearance system."[93]

77. Officials were asked whether the General Anti-Avoidance Principle set out in the Meacher Bill would be a more effective defence against tax avoidance. Mr Williams for HM Treasury (HMT) said:

> "The proposal for a general anti-avoidance principle covers a much wider range of tax planning than the GAAR, and in considering whether it lies on one side of the line that that principle would draw or on the other, businesses would have to make quite difficult decisions and consider this particular Bill in a wide range of commercial transactions … You could introduce a clearances system to deal with it, but of itself the system has frictional costs. It is not something that would remove all the uncertainty … Also, if we did try to apply a broad rule in circumstances where in reality we may want or seek to make quite fine distinctions, that might cause difficulties for the courts. Other countries have introduced more general anti-avoidance rules … but they are finding that the courts are struggling to work out exactly what it is that the legislature intended. You do not necessarily achieve a great crackdown on tax avoidance, but you can create quite a lot of uncertainty while people wait to see what the courts do."[94]

78. Agreeing with Mr Williams, Ms Knott added "The point about the difficulties for the courts is a particularly pressing one. It is also linked to the potential for giving wider discretion to HMRC."[95]

What is within the scope of the proposed GAAR?

79. We asked our witnesses for their preliminary views on what looked likely to be within the scope of the proposed GAAR. Mr Gammie thought it very difficult to draw boundaries "it is possible to produce examples but they tend to lie without necessarily addressing the very difficult ground on which

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92 Q 26

93 Q 26

94 Q 116

95 Q 116

people disagree."[96] He cited the case of Mayes where eventually the Court of Appeal held that the scheme worked because it was almost impossible to discern what the legislative intent or policy was and you could not construe the legislation in a way that defeated the scheme. "I think most would agree that the scheme in Mayes would fail under the general anti-abuse rule."[97]

80. Mr Gammie went on to describe a film scheme, designed to produce a loss which could be set against other income, which was ultimately unsuccessful because the film partnership was held not to be carrying on a trade. However, Mr Gammie thought "That sort of scheme, where there is an acquisition of certain rights to films, is presented in the *Times* as the sort of scheme that would be struck down by this rule. But I suspect there would be considerable disagreement among the people who took part in the scheme and also debate around this room as to whether that is the sort of thing to which this anti-abuse rule should apply."[98] Commenting on these types of schemes, Mr Aaronson said "Certainly, many people would regard it as tax avoidance when a person is scaling up and leveraging their investment to get more. However, is it abusive? That is quite a different issue. As Mr Gammie says, around this table there might be totally different views as to whether it is avoidance or abuse."[99]

81. Seeking to draw out a general approach, Mr Dodwell said "I think that if an individual in particular tries to enter into an arrangement with little if any commercial or economic consequence beyond a tax saving, then I think they will find themselves straight in the compass of the GAAR, of this limited anti-abuse rule." He proceeded to exclude inheritance tax from that because a commercial test was in his view not appropriate to IHT transactions but concluded "if you are dealing with business life, the loss generation schemes that we have seen, I would expect, in many cases would be caught by an anti-abuse rule once it is enacted."[100]

82. From his perspective of advocating a wider-ranging GAAR, Mr Murphy's view was that:

> "it [the narrowly focused GAAR] is not intended to challenge a whole host of other arrangements which are now normal in business but which, nonetheless, to most people on the Clapham omnibus, would appear abusive … It is basically targeted at pre-packaged and planned tax abuse schemes which involve a degree of artificialness, which are designed specifically to look at very particular opportunities to construct abuse through a series of steps which are designed to exploit a loophole in the law. So it is a very narrow piece of work."[101]

83. Although it was common ground that the proposed GAAR did have narrow scope, it was also suggested that it would have a significant deterrent effect as taxpayers sought to keep well clear of the range of transactions that could be affected. For example, the Institute of Directors (IoD), commenting that a narrowly-targeted GAAR should be effective in litigation, went on "A GAAR

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96 Q 8

97 Q 8

98 Q 8

99 Q 9

100 Q 29

101 Q 29

that is likely to succeed in litigation should deter aggressive tax planning, both because of the cost of litigation, and because of taxpayers' desire to avoid protracted uncertainty about their tax liabilities."[102] Mr Haskew thought likewise "There is a deterrent element to the GAAR which is important."[103] And Ms Elspeth Orcharton of the Institute of Chartered Accountants of Scotland (ICAS) concurred "The deterrent effect is well worthwhile."[104]

84. Asked what was likely to be caught with the GAAR and whether this was aimed more at corporates rather than individuals, Ms Knott responded:

> "Both. What we see on the personal tax side—tax avoidance involving individuals—is quite a lot of marketed tax avoidance schemes. The GAAR will be pretty effective in tackling those marketed schemes. Corporates tend to adopt more bespoke schemes rather than marketed ones, but we think the GAAR will also be effective with corporate tax … A good example in the corporate sphere would be transactions that seek to magic a tax deduction when there has been no economic loss. Or, perhaps even more egregious, is where a corporate tries to claim twice for a single economic expense. That is the sort of field where the GAAR might well apply."[105]

What is outside the scope of the proposed GAAR?

85. Our witnesses explained the types of transactions which they considered would not fall within the scope of the GAAR. In particular, we focussed on those transactions which have been the subject of much recent media comment: the arrangements entered into by multinational groups with the apparent objective of minimising the amount of global tax payable; and the delaying of the payment of bonuses to benefit from the reduction from April 2013 in the highest rate of tax.

86. None of our witnesses thought that the arrangements entered into by multinational groups would be affected by the GAAR. As Professor Freedman commented "Only certain types of activity can be addressed through a GAAR … A GAAR is not the correct tool for dealing with all problems of the tax system."[106] She added later in her evidence "there is not a GAAR in force in any jurisdiction that would tackle all the transactions that have been described as avoidance in recent media reports and political discussions in the UK."[107]

87. Mr Gammie told us that "Taxing multinationals raises a whole range of issues that really you just have to address specifically rather than through a general anti-abuse rule."[108]

88. Mr Davies, pulling together what was not included, and what was, explained it this way:

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[102] IoD, paragraph 4

[103] Q 63

[104] Q 64

[105] Q 111

[106] Freedman, paragraph 6

[107] *Ibid.*, paragraph 10

[108] Q 12

> "If you try to categorise the public anger, it falls into perhaps three areas. You have the multinationals … which I agree the GAAR was never intended to and certainly will not touch that. You have high-profile individuals who adopt what many consider to be highly aggressive schemes to mitigate income tax. I think the GAAR will successfully attack those. The third area probably is around bonuses, timing of bonuses and taking advantage of different tax rates. Personally, I do not believe the GAAR should attack that …"[109]

89. Mr Murphy accepted that "The GAAR cannot be applied to normal commercial arrangements, however abusive they might be and whatever they might cost the UK Exchequer."[110]

90. Commenting on compliance with the current system, Ms Knott said "we have been very successful in our transfer pricing efforts. Over the past four years we have taken in an extra £4 billion of yield on our transfer pricing effort … However, there may be more work to be done on looking at the way the rules work internationally and, in some circumstances, come to a different arrangement."[111]

91. In similar vein, many of our witnesses emphasised that the arrangements entered into by multinational groups involved the structure of the international tax system. As the LSEW wrote "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 … 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."[112] They added that the allocation of the appropriate tax base to the UK is an international problem:

> "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 … 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."[113]

92. There was an interesting divergence of view between Mr Murphy and Mr Stevens on what multinationals were doing with their tax arrangements. Mr Stevens said:

> "The concept of what those international companies have done, I think my colleagues would agree, is nowhere near what the GAAR is aimed at. The GAAR is aimed at those taking some specific law and seeing if they can find a loophole within it, whereas most of what the multinational companies have done, it seems to me, is simply to arrange their affairs around the world to get a result out of it without going into a specific bit of law."[114]

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[109] Q 94

[110] Murphy, paragraph 4.5.3

[111] Q 128

[112] LSEW, paragraph 20

[113] *Ibid.*, paragraphs 21 and 22

[114] Q 31

93. Mr Murphy disagreed: "I think those companies are very clearly exploiting loopholes and have structured very deliberately to get round the rules that at one time made complete sense."[115] In his written evidence he commented on the potential for the GAAR to apply to international tax arrangements: "as the GAAR Guidance notes, it can be applied to abuse of OECD double tax agreements, much of which is at the heart of what has been happening … What precludes action is that this abuse is now commercially commonplace and as such has been ruled out of consideration for the purposes of the GAAR."[116] Mr Murphy had earlier made the point that unilateral action by a country is possible: "the OECD are quite specific in their guidance on, for example, the abuse of residence and permanent establishment. Any country may take action against the artificial use of those rules and therefore it is within the scope of national sovereignty to challenge those particular abuses, which I think was quite key to what we have been saying."[117]

94. Unilateral action was also supported by ActionAid and ChristianAid who, in joint written evidence, argued that "the Finance Bill 2013 should therefore give HMRC the power to compel disclosure of international tax-advantageous transactions undertaken by UK-headed multinational groups".[118]

95. There was widespread agreement that the rules for taxing multinational groups and allocating tax bases to different jurisdictions needed revision and, with the exception of Mr Murphy and ActionAid/ChristianAid, that this could not be done unilaterally. Mr Richards summed up the approach: "If the view is that the corporate tax system, not just in this country but in other jurisdictions, is not quite taxing companies in the way that it should, it would be very dangerous to 'go it alone' in the UK … It will have to be collaborative arrangements. I think the Prime Minister is very keen that something is done at the G8."[119] Mr Baron put it this way "It [international tax arrangements] is a whole different area of tax planning which demands a whole different kind of response. The Government are absolutely right to see that in terms of needing a multinational response involving the OECD, the G8, the G20 and so on."[120]

96. For his part, Mr Woolhouse of the CBI was concerned "that we have to be very careful about how the media debate has evolved in this space. There has been a great misunderstanding about what the corporate tax base is in the UK. It is not revenues or accounting profits." After outlining how the rules for taxing multinationals had developed, he commented "The way to address this issue is to engage with the process that is going forward at the OECD on a multilateral basis and to look at updating those rules … I think also that companies probably need to do more to explain their tax position. That is where we need to move this debate on, particularly around transparency."[121]

97. Officials agreed with this view. Commenting on his role within OECD, Mr Williams said:

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115 Q 31

116 Murphy, paragraph 5.5

117 Q 31

118 ActionAid and ChristianAid, Summary paragraph 3

119 Q 88

120 Q 72

121 Q 73

> "There has been quite considerable progress over the past six months or so, not least as a result of the attention that has been given to the subject. Most countries are clear that what we are talking about is a divvying up, if you like, of taxing rights between countries that was decided before global communications became so much easier through electronic means. If you are going to revisit that, it has to be done multilaterally and by agreement between a number of different countries, otherwise you will end up with different standards. You will see double taxation and an inhibition of trade …
>
> If you want me to go on to the areas where the rules need to be looked at, there are probably two main ones. The first is what I would call selling in … of course we now have a world where it is easier to transact physical goods over the internet, which means that where the sale happens is less clear.
>
> There is also an argument on transfer pricing … In some circumstances the rules do not do enough to look at the group as a whole … The fact that this is looked at company by company enables a group to segregate capital and put a lot of it into a tax haven."[122]

98. Responding to a question about transparency prompted by ActionAid's evidence, Mr Williams said:

> "Transparency is part of this and some companies are moving towards disclosing more about their tax position in their accounts. That is a helpful and welcome development. On the other hand, if the reality is, as I think it almost certainly is, that the international tax rules need to be revisited and modernised in order better to cater for globalisation, merely knowing that a company is paying less tax than it would do if the rules were different is not in itself a solution."[123]

99. In the evidence put to us, a further issue emerged which was not within the scope of the GAAR, but where popular perception through the media may well be that it should be tackled and the GAAR ought to be the mechanism. It is the potential for deferring bonuses so as to take advantage of a future reduction in tax rates. Mr Davies referred to it in his answer as to what was included within the GAAR and what not. Mr Gammie explained:

> "The reason why that [deferring the payment of bonuses] arises is because we tax earnings, generally speaking, on a receipts basis—in other words when they are actually paid—which gives you the facility to shift when you pay something from now until three months' time, if somebody is prepared to wait for it … The reality is that you have to decide how you want to tax those things … we are talking about something which is a function of the tax base—in other words, what you are choosing to tax and how you are choosing to tax it."[124]

100. So for the taxation of multinationals, the issue is one concerning the structure of the tax system rather than avoidance involving manipulation of loopholes in the legislation. This is also true of the deferral of bonuses.

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[122] Q 122

[123] Q 123

[124] Q 12

101. **Given resource constraints and the need to provide certainty for business and to promote UK competitiveness, we regard the narrowly focused GAAR as a reasonable starting point. However, we think it important that the scope of the GAAR should be reviewed in the light of practical experience of its operation as part of the wider review that we recommend elsewhere in this report. Such a review should consider, in particular, how the double reasonableness test has been applied to deliver a narrow focus for the GAAR and whether there is significant evidence that it is deterring abusive transactions.**

102. **We are fully persuaded that the GAAR will not apply to issues involving the taxation of multinational groups or the deferral of bonuses from one tax year to another which arise from the structure of the tax system.**

103. **We recognise HMRC's recent success in tackling transfer pricing under present rules and encourage them to continue to pursue these opportunities with vigour and determination.**

104. **The practice of arbitraging competing tax jurisdictions to minimise taxation must be dealt with by negotiation at the EU, OECD, G8 or G20 level. If this is not resolved by agreement, retaliation, double taxation and harm to the UK's competitive position could result. As part of these negotiations, the current OECD rules need to be reviewed comprehensively to bring them up to date with the working of the global economy and to align them more closely with the underlying economic substance of commercial and financial transactions.**

105. **This review clearly needs to be carried out as a matter of urgency; we were glad to hear that the UK has contributed additional resource to OECD to enable the review to go forward quickly. We recommend that it should be completed as rapidly as possible.**

106. **In the meantime, we recommend that every effort should be made to communicate, particularly to the press and the public, why the GAAR is not an appropriate mechanism to address all problems with the tax system. In particular, that communication should focus on those issues, such as the taxation of multinational groups, where the widely held perception seems to be that the GAAR provides the answer, whereas it is clear that it does not.**

CHAPTER 4: THE PROPOSED GAAR – OTHER FEATURES

107. Chapter 3 looked at the scope of the proposed GAAR, how its narrow scope is achieved and which tax arrangements are likely to fall within that scope and which not. This chapter examines the remaining aspects of the GAAR which featured in the evidence presented to us.

Context

108. The provisions included in the draft Finance Bill set out the procedures and other details of how the proposed GAAR will operate. Where the GAAR applies, it counteracts any tax advantages which would otherwise arise from abusive tax arrangements. The adjustments to achieve this are to be made on a 'just and reasonable' basis and are likely to reflect the tax result that would have prevailed had the abusive tax arrangements not been entered into.

109. The procedure for HMRC to seek to apply the GAAR and therefore counteract any tax advantage is set out in a schedule in the draft Finance Bill. It is summarised in the draft HMRC guidance notes as:

> "Stage one: Written notification to a taxpayer that a designated officer considers that the GAAR may apply (with reasons and proposed counteraction), and inviting a written response.
>
> Stage two: Written response from the taxpayer (if the taxpayer wants to provide a response).
>
> Stage three: If the taxpayer does not provide a written response, a designated officer must refer the matter to the Advisory Panel. If the taxpayer provides a written response, a designated officer considers the response. If the officer is still of the view that the GAAR should apply, he or she must refer the matter to the Advisory Panel.
>
> Stage four: A sub-panel of three members of the Advisory Panel gives its opinion(s) to HMRC and to the taxpayer.
>
> Stage five: The designated officer considers the opinion(s) and decides whether the relevant tax advantage should be counteracted. He or she gives the taxpayer a notice setting out whether the relevant tax advantages are to be counteracted (and, if necessary, includes any adjustments required to give effect to the counteraction)."[125]

110. The Advisory Panel will be a panel appointed by HMRC Commissioners, and, in response to representations, HMRC will not be represented on the panel. It will have a two-fold function. The first is to give opinions, as provided for at stage four above, on whether the entering into and carrying out of the tax arrangements is a reasonable course of action in relation to the relevant tax provisions. The second is to approve guidance prepared by HMRC on the application of the GAAR. This HMRC guidance is given special legislative status in that if any issue in connection with the GAAR comes before a court or tribunal, the guidance that was approved by the GAAR Advisory Panel at the time the tax arrangements were entered into must be taken into account. An interim advisory panel has been set up in advance of the Finance Bill being enacted to approve the guidance that will

[125] *HMRC's GAAR Guidance – Consultation Draft: Part A: Scope of the GAAR Legislation*, HMRC, 11 December 2012, paragraph 2.14

be published at the time the Finance Bill receives Royal Assent and the GAAR comes into effect.

111. As well as the HMRC guidance which must be taken into account, a court or tribunal may take into account guidance, statements and other material that was in the public domain at the time the arrangements were entered into and also, evidence of established practice if it is shown that HMRC had accepted that practice, even if it would not otherwise be admissible as evidence. In proceedings before a court or tribunal, the burden of proof that the GAAR is applicable lies with HMRC, rather than the taxpayer.

112. The proposed GAAR goes wider than the version recommended in the Aaronson report in that, as well as income tax, corporation tax, capital gains tax, petroleum revenue tax and national insurance contributions, it is proposed that it should apply to inheritance tax, stamp duty land tax and the annual residential property charge, and those tax charges that are linked to corporation tax, such as the oil supplementary charge and the bank levy.

113. The GAAR is to apply to all tax arrangements entered into on or after the day on which Finance Act 2013 receives Royal Assent. Where the tax arrangements form part of any other arrangements entered into before this commencement date, the pre-commencement arrangements are to be ignored for the purposes of deciding whether the post-commencement arrangements are abusive, but they can be taken into account if, as a result of doing so, the post-commencement arrangements would not be abusive.

Guidance

114. There was almost universal agreement that HMRC's guidance, as approved by the Advisory Panel, will be of prime importance in determining the application of the GAAR, particularly in the early years of its operation. The ACCA emphasised this "Guidance has an important role to play in the implementation of any legislation within the self-assessment regime."[126]

115. The CIOT thought the workings of the GAAR "a matter for guidance, particularly in its early stages, to help give more certainty over its operation."[127] Mr Cosmetatos made the point in this way: "It is really important that, if this is a GAAR that is targeting the abusive end of the spectrum, we have to be able to identify where the Revenue thinks, or where the Revenue and panel together agree, the boundary lies between the abusive end of the spectrum and the moderate tax planning space that the GAAR is not aimed at. Having some examples that fall on the safe side of that line is very important."[128] The Association of Taxation Technicians (ATT) wrote "The way the GAAR is operated will depend very significantly upon the initial guidance drawn up and approved by the GAAR Advisory Panel … and in turn the knowledge and experience of the individuals comprised in the Panel."[129]

116. However, there was much concern that the present state of the draft guidance was inadequate for this purpose. Our witnesses expressed this in a number of different ways. The BPF thought "an important step to mitigate

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[126] ACCA, paragraph 18

[127] CIOT, paragraph 3.5

[128] Q 79

[129] ATT, paragraph 11

post-implementation uncertainty would be to provide more meaningful guidance. In particular, the guidance should include much more by way of illustrative examples … Of greatest value would be the inclusion of examples of arrangements which HMRC regards as close to, but on the right side of, the 'abusive' line."[130] Linklaters reinforced this;

> "many of the examples included in this guidance relate either to clear-cut cases of tax avoidance where the taxpayer has already lost in court on anti-avoidance grounds or to out of date legislation that has been repealed or amended. Thus the current guidance is deficient … It will need to address a number of more commonplace (and current) tax planning arrangements which are used to facilitate wider commercial transactions. At present this has not been done."[131]

117. The LSEW thought that "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."[132] Mr Bill Pagan of the Law Society of Scotland (LSS) had similar concerns "There will be huge uncertainty under this GAAR for people who are making perfectly normal and not abusive arrangements. It is not at the extremes that the guidance is given. The extremes are easy; it is the middle ground that is difficult."[133]

118. In providing us with copies of examples that they had sent to HMRC, the CBI commented "we believe it is vital that throughout the guidance it is made clear that the GAAR is only intended to be targeted at 'egregious' tax scheming."[134] Ms Williams told us that she had "some reservations about the fact that you have the guidance as drafted including schemes or arrangements that we do not view as being abusive."[135] And a little later, she commented "We are very hopeful that the interim advisory panel will be able to provide more examples of situations which would be within the scope of the GAAR as well as situations that would not be within the scope of the GAAR. That would provide the clarity that the profession needs."[136]

119. The IoD had a different concern:

> "It is not quite clear what degree of involvement the Panel will have in developing guidance, but it seems likely that the Government will stick to its original plan, with HMRC writing the guidance and the Panel approving it. The risk of a slow, gentle drift in HMRC's favour, with more and more being brought within the ambit of the GAAR, will be quite high. There is a good chance that the Panel would nod through

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130 BPF, paragraph 14

131 Linklaters

132 LSEW, paragraph 13

133 Q 83

134 Letter from the CBI to HMRC (see Appendix 5)

135 Q 84

136 Q 85

each of a long sequence of minor adjustments, that would cumulatively make a significant difference."[137]

120. Asked why our private sector witnesses did not find the guidance very helpful, Ms Knott replied:

> "They are only in draft form. I should like to say a couple of things. It may be that some of the examples we have chosen are cases that we have won or lost, but in the area of corporate tax avoidance, which I touched on earlier, there are some pretty clear examples that are not taken from tax cases where we point out that getting a double relief could be abusive. We have tried not just to cite cases. The draft guidance is out for consultation and in addition the advisory panel will be looking at it because it needs to be approved by that panel. Currently, we have an interim panel in place, which is another safeguard to make sure that the guidance is as helpful as possible."[138]

121. **We are wholly persuaded of the importance of the guidance in providing as much certainty and predictability as possible on the application of the GAAR. We recognise that progress is being made in drafting clear guidance, but we are concerned that our private sector witnesses felt that it was far from being acceptable. We recommend that HMRC and the interim Advisory Panel should work urgently to address the deficiencies raised by our witnesses and ensure that the guidance is as timely, clear and comprehensive as possible.**

122. **We think that the role of the Advisory Panel should not be limited to reviewing and approving the guidance that has been produced by HMRC. In particular, we agree with our witnesses that as many examples as possible should be included, illustrating up-to-date arrangements on both sides of the boundary between abusive and non-abusive. In addition to HMRC's examples, the interim Advisory Panel (and the permanent panel in due course) should suggest examples of its own since its members are well placed to know whether those already included are what advisers need to help them understand how the GAAR will operate.**

Advisory Panel

123. This section looks at the Advisory Panel's functions other than in relation to guidance.

124. Most of our private sector witnesses thought "The Advisory Panel is a welcome and necessary feature of the GAAR."[139] Mr Stevens thought the panel "well worth while … It is bringing in knowledge of the way in which the system works. That is what the GAAR as drafted is intended to do. That is an element of whether it should be relevant to a case or not. The panel is important."[140] However, there was concern around the independence of the panel and how it is intended that it will operate.

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[137] IoD, paragraph 11

[138] Q 119

[139] CIOT, paragraph 3.4

[140] Q 41

125. This concern was also reflected in the evidence submitted by ICAS who wrote "The draft clauses do not establish an obligation to ensure the independence of the GAAR Advisory Panel."[141] Ms Orcharton amplified this: "there is nothing in the material so far, in terms of the draft legislation, the Explanatory Notes or the official statements, which provides for the governance or charter or rules that might apply to the advisory panel."[142] Mr Woolhouse was also concerned about this:

> "The other thing that has been brought up is how the panel is appointed and whether the commissioners of HMRC should be solely responsible for the appointment of the panel. For example, another way to do it may be that the Lord Chancellor appoints the chair and they jointly appoint the panel."[143]

126. Mr Baron expressed his concern as being "to ensure that the panel has a more active role than seems likely in areas other than advising on specific cases that come to it."[144] Mr Woolhouse thought that "it may be advantageous to have members of the panel paid. That would broaden the scope and expertise that you would be able to address. Those who can afford it may be a limited subset of that group."[145]

127. Both ICAS and the CBI were concerned that the role of the Advisory Panel appeared more circumscribed than originally expected, being limited to expressing an opinion on whether the tax arrangements were a reasonable course of action in relation to the legislation. ICAS wrote "it would be preferable for the opinion provided to be on whether the general anti-abuse provision … either applied, or did not apply."[146] The CBI wrote "The Aaronson Report suggested that the Panel should be asked to advise on whether there was a sufficiently clear case for HMRC to initiate GAAR."[147]

128. A number of witnesses argued that the anonymised opinions should be published in full, rather than just key principles from them. The IoD suggested this, as did the LSEW,

> "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."[148]

129. Given that at an earlier stage in the consultative process, many private sector witnesses had argued that HMRC should not be represented on the panel, it was not surprising that most of them echoed this view. As Mr Chowdhury put it "We do not want HMRC on the panel because it would be a bit like judge and jury."[149]

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141 ICAS, paragraph 9a

142 Q 60

143 Q 79

144 Q 78

145 Q 79

146 ICAS, paragraph 9d

147 Letter from the CBI to HMRC (see Appendix 5)

148 LSEW, paragraph 15

149 Q 60

130. The dissenting voice came from Mr Murphy:

> "I think HMRC should be allowed to take action in response to a general anti-avoidance principle on its own initiative. I do not think it is right that HMRC has to go out to a body that is made up from people entirely outside HMRC to ask permission to enforce UK taxation law. I think HMRC is accountable, ultimately through Ministers, to Parliament. I do not think there should be an advisory panel who can say yes or not to whether HMRC is allowed to do that, before it even gets to the point of making the enquiry as such. I think that is quite wrong."[150]

131. The Aaronson report had recommended that HMRC should have a representative on the Advisory panel. We asked Mr Aaronson whether he was surprised at the reaction from the representative bodies to this, and whether he thought HMRC were right to acquiesce in excluding themselves. He told us:

> "I was a bit surprised at the response to the proposal that HMRC should have one representative out of three on the advisory panel. We, as the GAAR Study Group, thought that was a sensible idea because then HMRC would be involved and would not feel that its views were not taken into account … The majority of respondents in the consultation process thought that HMRC should not have an involvement and that it should be seen to be completely independent. I am perfectly happy with that. HMRC is equally happy with it. Do I think it would be better for HMRC to have a representative? I am agnostic on that. I thought at the time that it was a better idea but now, seeing peoples' responses, I do not think that it matters."[151]

132. **Whilst we accept that HMRC should not be represented on the Advisory Panel, we think it important to achieve an appropriate balance of views on the panel so that it is not confined just to those of practitioners. We are surprised that the decision on appointments to this panel lies wholly with the HMRC Commissioners. We recommend that the Government should consider introducing a selection and appointment process involving an element that is independent of HMRC.**

133. **In addition, we recommend that anonymised opinions of the Advisory Panel should be published so that taxpayers can see how the application of the GAAR is developing.**

Uncertainty

134. The most widely articulated concern from our private sector witnesses about the application of the GAAR concerned the uncertainty remaining—and likely to remain for some time—around whether or not particular arrangements fell within the scope of the GAAR. This was notwithstanding the safeguards that had been built into the procedures, including the double reasonableness test, the referral of cases to the Advisory Panel and the guidance. Reflecting this concern, some of our witnesses argued for a

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[150] Q 36

[151] Q 15

clearance system so that transactions could be put to HMRC for confirmation, or otherwise, that the GAAR would not apply.

135. As Mike Warburton of Grant Thornton said:

> "It would concern people making investment decisions. In particular, I believe it would concern people from overseas making investment decisions in the UK because they want to know what the tax implications of their decisions are. If, as is likely to be the case, advisers will have to write letters saying, 'Well, this is what we believe the position is but we cannot be sure. There is always this threat of an anti-abuse rule overriding that, that is what leads to uncertainty."[152]

136. The LSEW wrote "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."[153] They went on to suggest a clearance system for a limited period:

> "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. 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."[154]

137. Chris Wales was equally robust "I believe that uncertainty is deeply damaging. If there is to be a GAAR, there should be a clearance mechanism to deal with the issue of certainty, notwithstanding the costs and difficulties. Those issues stand separate from the principle and can be dealt with if there is the political will to do so."[155] Mr Wales also picked up on the point that there may be a difference between the respective situations of larger companies and smaller ones "there will be a perception among the general body of taxpayers that large companies and their advisers are able to get effective certainty, through informal clearance, while others are not. That perception will be undesirable even if it is completely unfounded."[156]

138. Linklaters, Stephen Hoyle, the BPF and the ICAEW were also concerned about the uncertainty created by the GAAR. Mr Hoyle thought that:

> "The GAAR will be a very real issue for all taxpayers who are involved in tax planning and its chief weapon will be uncertainty."[157] His view was that "the concept of 'main' does nothing to secure the centre ground of tax planning so far as that means taking a commercial transaction and carrying it out in the optimal way for tax."[158]

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[152] Q 97

[153] LSEW, paragraph 11

[154] LSEW, paragraph 15

[155] Wales

[156] *Ibid.*

[157] Hoyle

[158] *Ibid.*

The ICAEW wrote:

> "While we have consistently supported the proposed GAAR, there remains considerable uncertainty as to whether particular arrangements will actually be caught. This potential uncertainty could have been addressed by adopting a clearance procedure within the GAAR. However the GAAR does not include a clearance procedure because it is believed that the GAAR is sufficiently targeted only at abusive schemes."[159]

139. There were, however, equally strong voices arguing that a clearance procedure was not necessary, given the narrow focus of this GAAR and the other safeguards built into its application. Mr Aaronson, whose study group had designed the GAAR so as not to need clearances, said:

> "There was another absolutely key requirement not to overburden the resources of HMRC or taxpayers. If you have a more widely targeted GAAR, you will need a clearing system, because otherwise there will be uncertainty … Not merely would that impose a great resource burden on the Revenue, it would also effectively give discretion to the Revenue to determine what is acceptable and what is not acceptable."[160]

140. Mr Gammie thought any uncertainty would be limited:

> "When one actually looks at the legislation … it does not seek to define 'abusive' as such but approaches it from a different angle by asking whether or not the tax planning or arrangements entered into can be viewed as reasonable and, in particular, meet what is called a double reasonableness test. In that sense, Mr Aaronson's approach has differed from some of the approaches used in other jurisdictions … I think most people recognise that the aim is to have a general anti-abuse rule that will not affect directly what most people would regard as legitimate tax planning."[161]

141. Professor Freedman, who was a member of Mr Aaronson's study group, put it this way "The GAAR contained in the draft clauses for the 2013 Finance Bill is a targeted GAAR. In addition to seeking to balance the need to control abuse against the need for a degree of certainty in the tax system, this is a sensible feature in terms of likely success and sustainability."[162]

142. The CIOT, the CBI and the IoD thought that a clearance system was not necessary. The CIOT wrote "the biggest challenge for a GAAR is to control its target without creating damaging uncertainty. We think, therefore, that framing the GAAR as an anti-**abuse** rule is correct as that should signal its target (itself an important feature) but then allow business and advisers not to have to worry about general planning."[163]

143. Mr Dodwell responded to our question on whether HMRC would have the resources to operate a clearance regime, provided they were paid under some fair system, by saying "No, I do not. The issue is not the money; the issue is

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[159] ICAEW, paragraph 32

[160] Q 5

[161] Q 2

[162] Freedman, paragraph 10

[163] CIOT, paragraph 3.1

that they do not have lots of extra, highly experienced inspectors available."[164]

144. Mr Woolhouse for the CBI said:

> "We think this should be very narrowly focused … I think that a clearance system would be enormously costly and much more likely to lead to a sort of systemic uncertainty."[165] Mr Baron for the IoD said "We are in agreement that we do not need a clearance system for the GAAR that is being proposed."[166]

145. We asked officials about the uncertainty that might be created by the GAAR and why the Government had come to the view that a clearance system was not necessary. Mr Williams told us:

> "The advantage of targeting the GAAR at the abusive end of the spectrum, if you like, is that those on the borderline have to work out where they are, but that is because they are flirting with the borderline at the abusive end. They are not faced with having to work out whether a commercial purpose predominates over an avoidance purpose or something like that. This is very much at the abusive end, and if the GAAR drives them well away from that boundary because they are concerned not to be caught by it, that is a positive effect."[167]

Commenting specifically on a clearance procedure, Mr Williams' view was that:

> "it could still consume a huge amount of resource on work that to a large extent would be ineffective. People would ask for clearances for things that they probably thought were quite legitimate, and that would divert HMRC from its main purpose which is bringing in tax revenue. That is the difficulty. You could do it, but you have to assume that HMRC could readily go out into the market and get large numbers of extra people to do all the clearances work, and that it would not get in the way of other tasks."[168]

146. **We recognise the concern felt by some of our witnesses about the uncertainty that the GAAR might create. This is understandable, given the fundamental nature of the change involved. We also recognise the concern that large companies may be able to get informal clearances whereas smaller businesses and other taxpayers will not.**

147. **However, we consider that the resource costs of introducing a clearance system would be very substantial indeed. We agree with those who said that introduction of a clearance system would lead to clearances being sought in most cases whether or not the GAAR had a reasonable chance of applying.**

148. **We accept that a clearance system is not being introduced at this stage on the basis that the guidance will be sufficiently clear and comprehensive to ensure a predictable tax outcome. We recommend,**

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[164] Q 51

[165] Q 77

[166] Q 77

[167] Q 112

[168] Q 116

however, that the review we propose elsewhere in this report should look specifically at how effectively any uncertainty arising from the GAAR is being managed in the absence of a clearance system. If at that stage there is evidence that uncertainty in the operation of the GAAR is damaging the UK economy, the pros and cons of a clearance system will need to be revisited.

The Range of Taxes Covered

149. Of the additional taxes covered by the proposed GAAR (see paragraph 112 above), inheritance tax caused our private sector witnesses most difficulty As Ms Williams put it:

> "In the context of inheritance tax, the problem is that the indicia of abuse contained within the draft legislation are not relevant in the context of inheritance tax planning arrangements. You have to look at the policy and principles of the legislation in order to determine whether a result has been achieved which is consistent with those policies and principles. As regards inheritance tax, that is quite tricky. Inheritance tax was brought in and in effect was grafted on to capital transfer tax with some estate duty principles. We do not think that it is entirely clear how those policies can be interpreted."[169]

Referring to the guidance, she commented "We have some reservations about the fact that you have the guidance as drafted including schemes or arrangements that we do not view as being abusive."[170] Mr Gammie took a similar view suggesting that for inheritance tax "there are no very clear indicia that address the question of whether a transaction is regarded as abusive."[171]

150. Mr Aaronson was asked why, in his report, he had excluded IHT from the scope of the GAAR. He explained:

> "In our discussions, we thought it sensible since we were introducing something that would be highly controversial and novel to limit its scope to the main direct taxes in order to allow a bedding-down period where people could see that this form of legislation would not have the dire consequences that so many people forecasted."[172]

Asked whether practical considerations and resource constraints persuaded them initially to exclude IHT, he answered:

> "Completely. It was just a bedding-down period. We thought it would be difficult to administer. It was something completely novel so we thought to limit it, but the Government are putting more resource into it."[173]

151. The ICAEW also commented "the scope of the GAAR has been extended to include IHT and, while in principle we can appreciate why this step was done, in practice IHT planning will often be undertaken for personal/family

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169 Q 84

170 Q 84

171 Q 7

172 Q 6

173 Q 6

reasons with little or no commercial rationale, thus potentially triggering the GAAR."[174]

152. Mr Pagan focused on the long period for which IHT planning arrangements can be set in place:

> "Although here we are specifically talking tax, in private client business, one is actually more of a—if I can put it this way—family planner than just a tax planner and you are planning over many years. I am not at all clear from the legislation or the guidance that we do not have, in effect, retrospective legislation coming in, or retrospective impact."[175]

153. We asked officials about the extension to IHT and whether there was a real problem because of the different nature of IHT planning. Ms Knott told us:

> "We accept that IHT is different from some taxes in two respects. It deals with family relationships rather than commercial transactions and it involves long timescales, so there are different characteristics. As the consultation on the GAAR has developed, we have modified some of the tests, so in the original draft of the legislation that we put out last summer, there was a test of commerciality. We received representations that that did not work in the context, for example, of inheritance tax, and so we changed the test … On the other hand, we do see abusive arrangements involving IHT, so it seemed wrong to omit it completely from the GAAR, and we have therefore included it. The draft guidance is just that and we are looking at the comments we have received to make sure that we address the concerns."[176]

154. We asked Ms Knott whether it might be the case that arrangements put in place at an earlier stage would have been acceptable at that time but later when the planning became effective, perhaps on someone's death, opinion had changed. She replied: "when the GAAR advisory panel looks at such a case … it is most unlikely that it would regard them as being unreasonable in their totality."[177]

155. **We recognise the concerns of our witnesses that IHT planning is different from other forms of tax planning. We therefore think it is particularly important for the guidance to include a variety of specific examples of both abusive and non-abusive IHT planning. We recommend that these examples should be drafted urgently so that taxpayers and their advisers can consider them in good time. We also recommend that the guidance should set out clearly that, where arrangements extend over a long period, it is the view at the time those arrangements were entered into that should prevail.**

Other Issues

156. Our witnesses also raised with us two more limited, but nevertheless important, issues. The first concerned whether the GAAR could override the application of double tax agreements (DTAs) since these are agreements between countries. The ICAEW explained the point in this way:

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[174] ICAEW, paragraph 33

[175] Q 85

[176] Q 120

[177] Q 120

> "we are also concerned about whether the GAAR is lawful in relation to its application to the UK's tax treaties … The proposed GAAR will over-ride the UK's international obligations already written into its double tax treaties and could therefore be held to be unlawful.
>
> We accept that in relation to treaties with fellow OECD members this concern is probably addressed by specific OECD agreements, but this still leaves about 100 [treaties] with non-OECD countries where the GAAR may be unlawful as it stands."[178]

157. Mr Aaronson told us:

> "We … discussed this on the GAAR committee and our original draft was quite subtle. I think it said that it applies to double tax treaties so far as it can apply to double tax treaties, recognising that there is room for legal argument as to whether a bilateral treaty can be overridden by our domestic legislation. In practical terms, there should be no problem … Most double tax treaties are based on the OECD model, which is accompanied by the equivalent of guidance notes."

They make it clear that "The abusive use of a double taxation convention will be ineffective."[179]

158. We asked officials whether there was an issue here. Ms Knott said:

> "we believe that the GAAR does not override our international obligations. We have a wide network of treaties and we apply them in line with the OECD model convention. Under the OECD guidelines, we are able to deny treaty benefits where they have been obtained by abusive transactions … In relation to non-OECD countries, even outside the OECD it is a general principle that people look at the OECD guidelines as a general international framework. We really do not see that there is an issue there."[180]

159. The second issue was raised by Mr Gammie. He helpfully spelt this out for us in written evidence:

> "In my view, to be effective where the GAAR conditions are satisfied, the GAAR counteraction provisions must provide for HMRC to 'declare the liability', i.e. specify what persons in respect of what property are liable to tax, and the GAAR legislation must charge tax on that basis. HMRC will then be free to make such adjustments (including assessments) as are needed to give effect to the GAAR."[181]

160. Ms Knott told us "We think Mr Gammie's point is an interesting one and we discussed it with him on Friday, to try to understand the point he was making. We … are going to take it away and consider it, to see whether we need to tighten up the rules to make sure they are effective."[182]

161. **We recommend that HMRC should fully consider Mr Gammie's stipulation that the GAAR counteraction provisions should provide for HMRC to specify what persons in respect of what property are**

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178 ICAEW, paragraphs 36 and 37

179 Q 19

180 Q 130

181 Gammie, paragraph 1.11

182 Q 130

liable to tax, and that the GAAR legislation must charge tax on that basis.

The Effect of the GAAR and Post-Implementation Review

162. We asked our private sector witnesses how the market was changing and how they thought the GAAR would impact on the services they offered to their clients. Andrew Hubbard of RSM Tenon told us:

> "There is no doubt at all that the market has changed and the client perception has changed. I think that it is a combination of the publicity, HMRC getting its act together in a much greater sense around disclosure rules and the attitude of the courts. I think there is a squeezing of the market, although there will always be the marketplace."[183]

163. Mr Warburton thought that:

> "The market for tax avoidance schemes has changed. In my experience, a large number of the schemes that have been sold have not been sold by the major firms of accountants; they have been sold by smaller, boutique operations. I do not wish to be unkind about smaller, boutique operations but the hard-sell approach and mass-marketing of those schemes has become apparent."[184]

164. The CIOT wrote "We think it will take several years to evaluate the success or failure of the GAAR."[185] Mr Haskew commented:

> "We have a new approach here to countering tax avoidance schemes. We have to give this as much help as we can to make sure that it works. I agree with the concerns about what may happen in the future. It is important that the ground rules for the establishment of the GAAR are set down. I do not think that how we do that necessarily has to be in legislation but how it will operate needs to be clear. Then we need to see how it works out in practice. Perhaps there needs to be a review in, say, five years on the efficacy of the whole GAAR, including the legislation and the advisory panel, to see if it is acting properly and effectively, and in a way which stops egregious tax avoidance schemes but in which people have reasonable certainty."[186]

165. In his evidence, Mr Wales argued strongly in favour of the legislation containing a review clause. He wrote:

> "Over the next few years, it ought to be possible to determine whether the GAAR is having the desired impact or not, and to form a view as to what the broader effect has been. It will not be particularly easy … However, it should be possible, particularly if officials at the sharp end of the GAAR's application know in advance that there will be such a review. It will encourage the development of monitoring and record-keeping techniques that might not otherwise be prioritised.

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183 Q 99

184 Q 99

185 CIOT, paragraph 3.6

186 Q 60

> … It should be carried out by an external team, with full access to information and the support and co-operation of the Treasury and HMRC.
>
> I would recommend that this Sub-Committee include in its Report a suggestion to the Government that it put into the legislation a requirement for an independent review, five years after the implementation of the GAAR." [187]

166. We asked officials about the need for a review after around five years and whether this should be required by legislation. Ms Knott told us "We certainly keep anti-avoidance legislation under review."[188] She accepted that this was an internal review:

> "but Ministers would want us to make sure that we were doing that. We would be feeding any problems up to Ministers. We think that this is probably an area that we will want to keep under review to make sure that it is fulfilling Ministers' objectives but we would not necessarily say that that required a legislative provision in the GAAR to require that sort of review."[189]

167. Asked for her views on whether there was a case for the review being carried out by someone independent of HMRC, Ms Knott responded:

> "There might be, but one thing that I would point to is that we have the advisory panel, which is an independent panel that will be looking both at individual cases of the application of the GAAR and at the guidance each year, to make sure that the guidance is kept up to date … There will be that independent scrutiny of the way that the GAAR is applied."[190]

168. **We recommend that HMRC should plan for an independent, post-implementation review after 5 years. It would be for consideration whether such a requirement should be built into the legislation or, failing that, a firm Ministerial commitment should be made in the House of Commons at the time the legislation is being considered.**

169. **We recommend that this review should cover all aspects of the operation of the GAAR during its early years. In particular, in line with our recommendations elsewhere in this report, the review should cover:**

- **the scope of the GAAR in the light of practical experience of its operation, including how the double reasonableness test has been applied and whether there is significant evidence of the deterrent effect that is claimed for the GAAR; and**
- **whether there is evidence that uncertainty in the operation of the GAAR is damaging the UK economy; if so, the need for a clearance system will have to be re-examined.**

170. Finally for the GAAR, we comment on the policy-making process that has been followed in its development. Notwithstanding the reservations of our

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[187] Wales

[188] Q 131

[189] Q 131

[190] Q 131

private sector witnesses as to the precise form of the draft legislation, everyone agreed that the development process had been exemplary and was a model for the new policy-making process.

171. **Although not everyone agreed with every detail of the draft legislation, we commend HM Treasury, HMRC and all those involved in the development of the GAAR on an exemplary tax policy-making process.**

CHAPTER 5: THE ANNUAL RESIDENTIAL PROPERTY TAX PACKAGE

172. This chapter looks at the package of measures of which the new Annual Residential Property Tax (ARPT) is a major component. This was announced in the 2012 Budget and there followed a consultation process leading up to the publication of the draft legislation in December 2012 and subsequently.

Context

173. In March 2012, the Chancellor announced in his Budget speech that the Government would be taking action against "the way in which some people avoid the stamp duty the rest of the population pays, including by using companies to buy expensive residential property".[191]

174. The practice referred to by the Chancellor involves one or more individuals setting up a company to buy a residential property which they or their family then live in or otherwise benefit from. This is known as 'enveloping' the property. The company, or other 'non-natural person' (NNP) such as a collective investment vehicle, pays Stamp Duty Land Tax (SDLT) on this initial purchase of the property in the usual way. The tax advantage from enveloping arises from future transfers of ownership, when, rather than selling the property itself, the owners can sell shares in the company holding it and so pay stamp duty on the share transfer at 0% or 0.5% rather than SDLT at the relevant rate (7% on properties valued at over £2 million).

175. The package of measures the Government proposed to counter this form of avoidance consists of three elements

- from 21 March 2012, a new 15% rate of SDLT which would apply to purchases of residential dwellings costing more than £2 million by certain NNPs;
- from 1 April 2013, a new annual charge, the ARPT, on residential properties owned by NNPs and valued at more than £2 million; and
- from 6 April 2013, the extension of CGT to gains on the disposal of residential properties owned by non-resident companies and other NNPs.

The new higher rate of SDLT was introduced by Finance Act 2012 and took effect as planned.

Consultation on ARPT and CGT proposals

176. A consultation document covering the other two elements in the package was published in May 2012.

177. The main purpose of the ARPT was to "encourage individuals who have put such high value property into envelopes for reasons including tax avoidance to take them out, thereby ensuring that the onward sale of the property is subject to SDLT".[192] The consultation document therefore proposed that the ARPT apply to all NNPs owning such residential properties with the

[191] HC debates, 21 March 2012, col 804

[192] *Ensuring the fair taxation of residential property transactions*, HM Treasury, May 2012, paragraph 2.12

exception of charities, certain bona fide development businesses, and companies owning land in their capacity as trustees.

178. The ARPT would be levied according to a scale of charges rising from £15,000 per year on properties valued at between £2 million and £5 million to £140,000 per year on properties valued at over £20 million. The charge would be based on the value of the property on 1 April 2012 (or the value on acquisition if bought later). Property valuations would be self-assessed with HMRC offering a pre-return valuation checking service. The scale of charges would be indexed to the Consumer Prices Index (CPI) and properties would be revalued every 5 years.

179. Under existing rules CGT is payable only on chargeable gains accruing to UK residents. The consultation document proposed extending the charge to gains made by non-resident NNPs on sales of residential properties disposed of for more than £2 million. The main purpose of this extension was "to support the annual charge by creating a further deterrent to enveloping".[193] The consultation focused mainly on the mechanics of the extension and the proposed exclusions.

180. The consultation attracted nearly 150 responses from interested parties and HMRC also used two technical working groups, one on the ARPT and the other on CGT, to help develop the proposals in the document.

181. In December 2012, the Government published its response[194] to the points raised in the consultation. The main issues concerned:

- the impact of the ARPT on property investment, development and rental businesses, on historic houses, farmhouses and rural estates, and on those who had enveloped their properties for inheritance tax planning and other reasons unrelated to SDLT avoidance;
- the disincentive effect of the CGT charge on the decision to de-envelope properties, and the lack of time, and transitional arrangements, to do so in an orderly manner;
- the lack of alignment between the three measures in the package;
- the potentially adverse effects of the package on the UK, and particularly the London, property market; and
- the proportionality of the measures relative to the avoidance in question.

182. The Government have attempted to address the majority of these concerns by proposing:

- to exclude genuine businesses carrying out genuine commercial activities, including property rental, property development and property trading, and certain properties open to the public on a commercial basis;
- to exclude certain farmhouses and certain dwellings held by companies, or charities to provide employee accommodation;

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193 *Ibid.*, paragraph 1.6

194 *Ensuring the fair taxation of residential property transactions: summary of responses*, HM Treasury, December 2012

- to mirror these exclusions in the legislation establishing the 15 per cent rate of SDLT and in the provisions to extend the CGT regime to non-resident NNPs;
- to apply CGT only to that part of the gain which accrues from 6 April 2013 on the disposal of a property held by non-resident NNPs. The rate applied would be 28% and there would also be a tapering relief for properties valued at just over £2 million to counteract any perverse incentives at the margins of the threshold for the ARPT. For consistency, it is also proposed to extend the CGT regime to disposals of high-value residential property held by UK NNPs. This would mean that all NNPs—both UK and non-resident—within the scope of ARPT, would be subject to CGT.

183. The package of measures, after allowing for these exclusions, is estimated to yield £35 million per year from 2013–14.[195]

Draft Finance Bill 2013 legislation

184. The draft Finance Bill published for consultation on 11 December 2012 embodied most of these proposed changes, but a number, including those affecting the CGT measure, were due to follow shortly after. The second batch of draft legislation, on further aspects of the ARPT and on related Capital Gains Tax (CGT) changes, was not published until 31 January, too late to influence the evidence from private sector witnesses on which this report is largely based.

General

185. This delay created uncertainty about how effectively some of the proposed changes had been reflected in the draft legislation and caused concern to some of our witnesses. Mr Haskew, for example, commented:

> "At the moment, we do not have all the rules. We have got 50 pages of legislation here but we still do not have the anti-fragmentation rules, as they are calling it, or the aspects in relation to charities. We have not seen the CGT aspect related to this at all. ….This is all meant to be in on 1 April, so it seems a tall order to introduce all this on the timescale that we have got."[196]

Exemptions

186. Nonetheless, the process of consultation since May 2012, if not the overall outcome, appears to have satisfied participants. The CIOT commented that "The FB draft clauses have benefited considerably from the well-managed consultation process to frame reliefs from ARPT (and the higher rate of SDLT) that will take most genuine businesses out of the scope of the charge(s)."[197] And the ICAEW were happy to "welcome the various reliefs that have been introduced in order to try and improve the targeting."[198]

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[195] *Overview of Tax Legislation in Draft*, HMT and HMRC, 11 December 2012, Tax Information and Impact Note A 151

[196] Q 65

[197] CIOT, paragraph 4.5

[198] ICAEW, paragraph 57

187. Some uncertainty continues around the drafting of the exemption for certain farmhouses where the ICAEW wrote that the ARPT rules would catch many residential properties connected to farming businesses that were put into farming companies for various reasons not connected with SDLT avoidance.[199] Ms Orcharton confirmed that an exemption for such farmhouses had been drafted but that there remained concerns about its effectiveness. "The solution to that is for us to continue to work with HMRC to try to resolve the anomaly and the drafting of the exemption …"[200]

188. We asked HMT about this exemption and Mr Williams confirmed that discussions on the details of the draft exemption were continuing,[201] and HMRC elaborated on the issues in supplementary written evidence.[202]

189. **We commend the Government's responsiveness to the need to exempt certain businesses and other organisations from the ARPT, and encourage HMT and HMRC to continue to work with interested parties to arrive at an appropriate formulation of the relief for farmhouses.**

CGT on disposals by NNPs

190. The Government has responded to points raised about this charge by reducing its scope so that the ARPT-related part applies only to gains accruing after 6 April 2013. However, for UK-resident NNPs, there will remain a charge to corporation tax on the non-ARPT-related part. Various witnesses expressed continuing concerns, ranging from detailed worries about specific situations to outright opposition.

191. Ms Williams emphasised, as had other witnesses, that there were reasons other than SDLT avoidance for which people held residential properties in corporate envelopes. An important example was inheritance tax planning, particularly by non-domiciled individuals. Some of these structures had been in place for a very long time and the properties in the envelope had increased beyond the £2 million limit. De-enveloping could mean exposing the owners to charges on a capital gain under the existing rules, and potentially their estates to inheritance tax. She suggested that a solution might be some form of holdover relief.[203]

192. Ms Orcharton regarded the idea that people could de-envelope properties before 6 April as unrealistic and suggested either extending the start date for the new charge to Royal Assent or some later date, or introducing "some kind of disincorporation relief … to take away the capital gains issue".[204] The ICAEW called for "proper transitional provisions and time given for existing structures to be reorganised or unwound without giving rise to further tax charges."[205]

193. Some commentators remain concerned about the consistency of the CGT charge with the objective of encouraging de-enveloping. The CIOT wrote:

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[199] *Ibid.*, paragraph 59

[200] Q 66

[201] Q 133

[202] HMRC, Supplementary evidence on Annual Residential Property Tax

[203] Q 91

[204] Q 68

[205] ICAEW, paragraph 58

> "Elements of the package work against the policy objective to encourage de-enveloping. The extended CGT charge will only apply if **the company** disposes of the property but a non-resident individual selling shares in a non-resident company holding a high value property will not be subject to CGT"[206] thus "creating a perverse incentive to keep the property within the envelope".[207]

194. Mr Cosmetatos commented on similar lines, maintaining that the charge "runs completely counter to what the Government are trying to do and what the other measures try to encourage. It penalises the de-enveloping."[208] The BPF remain opposed to the charge altogether and recommend its withdrawal.[209]

195. When these points were put to him, Mr Williams replied that:

> "the CGT charge is now only going to apply to the part of the gain that arises on or after 6 April 2013. Rebasing in that way should ensure that the non-natural persons affected by the regime can make appropriate decisions to de-envelope their properties before then. Equally, if they take the decisions after that date, the only gain affected is the gain that accrues between April 2013 and the date of disposal."[210]

196. **We agree with the Government that rebasing the CGT charge on disposals by non-resident NNPs to 6 April 2013 is an appropriate response to some of the concerns expressed, but it does not meet the point for UK-resident NNPs. We recommend that the Government should consider whether more could be done, possibly deferring the charge on any gain, to help those affected to de-envelope their properties without incurring high tax costs.**

Other issues

Potential implementation problems

197. The ICAEW pointed out that, because the first ARPT returns and payments are due on 31 October 2013, HMRC has less than "nine months to design, build, test and implement ARPT."[211]

198. We asked about the administrative challenges the new tax posed. Mr Haskew was particularly concerned about HMRC's ability to cope with bringing in the ARPT when it is already committed to introducing real time information for PAYE and the Child Benefit changes at the same time as implementing major staff reductions. He commented that "There is a serious concern that it will be difficult to police" and in particular that "it will be exceedingly difficult—obviously, not in all cases—to establish who ultimately is, say, the beneficial owner of properties."[212]

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206 CIOT, paragraph 4.4

207 *Ibid.*, paragraph 4.4

208 Q 81

209 BPF, paragraph 18

210 Q 132

211 ICAEW, paragraph 60

212 Q 65

199. Mr Murphy made a similar point. "The most fundamental point about taxing anything is actually identifying your tax base. I do not think that this legislation is built upon the premise of an identifiable tax base at the moment. If you are going to charge companies that own properties in the UK tax, you have to require those companies … to disclose somewhere the nature of their beneficial ownership …"[213]

200. We put these concerns to Ms Knott. She replied that, although HMRC estimated that there were about 90,000 enveloped properties, they believed that:

> "the target population of properties is about 5000. Within that, we generally find that only a minority of taxpayers seek to evade tax, so we would be dealing with a minority of that 5,000 where a policing effort would be required. We are preparing both our plans to make owners aware of the charge and our compliance plans to make sure that we do police it properly."

HMRC were working closely with the Land Registry to identify the properties involved. On the issue of beneficial ownership, "the onus will essentially be on the company to show that they are not beneficial owners, if that is not the case." In cases of offshore ownership "the property is in the UK so we would be able to, for example, take a charge on that property if there were issues of compliance with the tax".[214]

201. **Despite HMRC's assurances, we share the concerns of witnesses about the workability of the ARPT as currently designed and would encourage HMRC to set out clearly how they intend implementing these provisions. We recommend that, in 3 years' time, the Government should review how effectively it is delivering the objectives of this policy.**

Nature of SDLT avoidance

202. There was no disagreement with the Government that there was significant SDLT avoidance which should be addressed, but several witnesses criticised the target of the Budget 2012 package and of HMRC's record on SDLT compliance. For example, Mr Stevens stated that:

> "The amount of SDLT avoidance before last year's Budget was enormous on expensive houses. It was just generally well known that it was so. Most of it, my understanding is, was various arrangements around sub-sale relief, which is just a technical provision in the legislation and different people came up with different ideas on how you got round it."[215]

203. Mr Dodwell added that:

> "the problem with stamp duty land tax started with pretty poor enforcement and compliance activities from HMRC. It has massively stepped up its endeavours now to resolve the issue. It sort of became the

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[213] Q 45

[214] Q133

[215] Q 44

> norm that you could go and buy a house of £1 million or more—or even half a million—and you would be offered a scheme."[216]

204. Responding to the issues of compliance and of the target of the legislation, Ms Knott said:

> "We are very active in our compliance activity on stamp duty. We have had a number of cases going through the courts. We have won one—the Vardy case—and we lost another, the DV3 case. It is never a certain way of addressing it and a lot of the avoidance has been around the subsales legislation, which is addressed in this Finance Bill. While we can try to tackle it by challenging the schemes, that is not always going to be successful."[217]

Consultation

205. Most of our evidence was critical of the way in which this package of measures had been handled in its early stages, particularly in the light of the Government's commitment to the new approach to tax policy making which we examined in detail in our report on the 2011 Finance Bill.

206. The BPF were particularly exercised by this apparent failure of process. Mr Cosmetatos set out their concerns:

> "Starting with the policy making process, I think that the origin of this package of measures for the fair taxation of residential property was awful. We have a Government who took the very bold and wise step when they came into power of introducing a new approach to tax policy making, which was clearly binding the Government to take a deliberative, consultative approach to the policy making process."[218] But "In the case of the 15 per cent charge in particular, they did not do that, for no obvious reason. They implemented it with immediate effect without any prior discussion with any industry bodies, not even informal soundings or anything else. After the Budget, it emerged very quickly that the thinking had been very uncertain."[219]

207. Mr Dodwell commented on similar lines "It is probably fair to say that, for this piece of legislation, the Government's *Tax Policy Making* approach was suspended. It launched on an unsuspecting world in a not terribly focused manner. I do think that HMRC has worked to try to improve it. Whether it has actually got to the best answer is questionable."[220]

208. We asked whether a more efficient and effective system might have been designed with the benefit of consultation. Mr Murphy replied "If they had gone through a better consultation process, we would have ended up with better legislation in this case. This is a case where they have clearly started on the wrong foot and have ended up on the wrong foot."[221]

209. Mr Cosmetatos made a similar point:

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216 Q 44

217 Q135

218 Q 80

219 Q 80

220 Q 47

221 Q 48

> "A more consultative process and a more considered and deliberative process for targeting that form of tax avoidance would more quickly, more easily and more painlessly have resulted in effective measures to stop those bad behaviours, without alarming ordinary businesses and inbound investors unnecessarily."[222]

210. **We agree with our witnesses that the Government's response to SDLT avoidance might have been more appropriately designed had it consulted interested parties at the outset as its 'new approach to tax policy making' stipulates. We recommend that the Government adhere to that approach in designing future tax changes.**

Complexity and length of legislation

211. Finally, a related point that was raised by several of our witnesses was whether the length and complexity of the ARPT (and related CGT) legislation was justified by the apparent target of the legislation—an estimated yield of £35 million per year from companies holding about 5000 properties. For example, Ms Orcharton remarked that:

> "we have a tax introduced, which has then a huge number of exemptions for people who we did not mean to catch in the first place. That gives the pages, the complexity and the complications that we have, which make you wonder whether this was the right approach in the first place."[223]

212. The CIOT made the same point in their written evidence:

> "we question whether the introduction of a wholly new tax (with draft legislation currently running at 60 clauses and two schedules with more to come) where its primary rationale is to enforce another existing tax (SDLT) is the right route. The history of using one tax to enforce another one is not a happy one …"[224]

And the ICAEW concluded that the ARPT "adds considerable extra complexity into the UK tax system."[225]

213. **We share our witnesses' concern about whether the problem the legislation seeks to address justifies its length and complexity, particularly in view of the Government's commitment to a simpler tax system. In line with our earlier recommendation on better consultation, we think that there were probably simpler and more effective ways of achieving the Government's objectives. We recommend that the lessons from the development of these measures should be learned and applied to the design of future tax policies.**

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[222] Q 80

[223] Q 66

[224] CIOT, paragraph 4.2

[225] ICAEW, paragraph 63

CHAPTER 6: THE CAP ON INCOME TAX RELIEFS

214. This chapter examines the proposal to introduce a limit on the extent to which certain currently unlimited income tax reliefs may be deducted from taxpayers' general income in computing their taxable income.

Context

215. The measure was announced in Budget 2012:

> "The Government will, from 6 April 2013, introduce a new cap on income tax reliefs to ensure that those on higher incomes cannot use income tax reliefs excessively. For anyone seeking to claim more than £50,000 of relief, a cap will be set at 25 per cent of income (or £50,000, whichever is the greater). The Government will explore with philanthropists ways to ensure this new limit of uncapped reliefs will not impact significantly on charities that depend on large donations."[226]

216. This announcement was met with dismay by the charitable sector which lobbied extensively against any limit on tax reliefs for charitable donations. A technical consultation paper published in July 2012 confirmed that this restriction would not apply to charitable reliefs such as gift aid, relief for gifts of land and shares, payroll giving and community investment tax relief.[227]

217. The consultation paper also made it clear that reliefs subject to existing limits as part of the rules governing their operation would not be affected by the cap. This would apply to reliefs such as those under the enterprise investment scheme (EIS), the venture capital trust (VCT) scheme, seed EIS investments, and to business premises renovation allowances and relief for pension savings.[228]

218. In introducing the consultation, David Gauke MP, Exchequer Secretary to the Treasury, wrote:

> "This measure is about fairness: a tax system should provide relief to support those who take risks by investing in their business or in certain types of shares—but that support should not be without limit. Wealthy individuals should not be able to reduce their income tax bills to zero, year after year by using these income tax reliefs to excess. Unlimited relief is at the cost of the general taxpayer. Further, this policy is not designed to specifically target tax avoidance, but limiting currently uncapped reliefs will reduce the scope for those who wish to exploit these reliefs for tax avoidance purposes."[229]

219. In December 2012, alongside the draft Finance Bill, a summary of responses to the July consultation was published. In the light of responses, certain relatively minor adjustments were proposed to the scope of the cap. After these adjustments, it will apply to:

- trade loss relief/early trade loss relief/post-cessation trade relief;
- property loss relief/post-cessation property relief;

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[226] *Budget 2012*, HM Treasury, March 2012 (HC1853), paragraph 2.40

[227] *Delivering a cap on income tax relief: a technical consultation*, HMT and HMRC, July 2012, paragraph 2.13

[228] *Ibid.*, paragraphs 2.9 to 2.12

[229] *Ibid.*, Foreword by the Exchequer Secretary

- employment loss relief against general income;
- share loss relief on non EIS/SEIS shares;
- relief for qualifying loan interest;
- relief for loss/ liabilities relating to former employment;
- relief for losses on strips of government securities; and
- relief for losses on certain deeply discounted securities.

Of these, the ones that are probably most significant, certainly those that concerned our private sector witnesses most, were relief for losses of a trade or a property letting business and relief for qualifying loan interest.

220. The draft Tax Information and Impact Note(TIIN)[230] published alongside the draft legislation showed the yield from the cap, after allowing for the exclusion of charitable reliefs, as around £425m for 2014/15, £175m for 2015/16 and £235m for 2016/17[231]. The draft TIIN explained:

> "It is estimated that around 8,000 individuals each year will be affected due to use of unlimited tax relief in excess of both £50,000 and 25 per cent of their income. Those impacted are likely to have high incomes, with over 90 per cent of the static yield attributable to individuals with incomes over £150,000, with a median loss of £20,000 per person. Some individuals with very high gross incomes will be impacted significantly more."[232]

The impact of the proposed cap

221. All of our private sector witnesses who commented on this measure were concerned about its impact on the ability of business owners to absorb business losses by setting them against their other income in the year in which they are incurred or the previous year. The CIOT wrote:

> "We can also understand why the Government wishes to cap some reliefs in a period of austerity. Unfortunately, the proposed cap is a blunt instrument: while one of the aims seems to be to target avoidance and those few individuals who misuse reliefs, it has a far wider effect, which is not acknowledged in either the consultation document or the Government response document. The cap does reduce the scope for using avoidance schemes, but it has the economic disadvantage of restricting other activities … It does not only affect those on high incomes; those affected by the cap will often be on modest incomes."[233]

Trading losses

222. The CIOT explained how the cap might discourage businesses "from making that very expenditure or taking risks that are essential in a growing business because the scope for obtaining relief for the loss arising from such

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230 *Overview of Tax Legislation in Draft*, HMRC and HMT, 11 December 2012, Annex A7

231 The precise costings will be published at Budget 2013

232 *Overview of Tax Legislation in Draft*, HMRC and HMT, 11 December 2012, Annex A7, Impact on individuals and households

233 CIOT, paragraphs 4.1 to 4.2

expenditure will be curtailed."[234] This was echoed by other witnesses. Mr Murphy thought the cap "entirely arbitrary"[235] and referring specifically to the restriction on trading losses wrote:

> "in general a loss is considered to be negative income for tax purposes. These provisions are therefore not reliefs as such, but are instead offsets against other income to be made when calculating what a person's income for tax purposes might be. I have real difficulty seeing how such a cap can encourage entrepreneurship. It would be better to have enhanced provisions restricting the use of losses not incurred in the ordinary course of trade."[236]

223. The ICAEW thought the cap "potentially restricts the effective offset of ordinary commercial losses."[237] They continued "We have a real concern that these proposals simply seek to raise money through a further form of tax on business."[238] Their understanding was that:

> "The policy purpose of this measure was to target 'wealthy individuals using reliefs year after year and to excess to reduce their income tax bills to zero'. We understand that policy target but that is not what the measure in the Finance Bill actually does: there is no targeting of 'year after year' but instead a blunderbuss that limits relief in the very first year that it might apply."[239]

ICAS thought the "justification of fairness is therefore flawed in principle. This instrument is too blunt."[240]

224. Mr Richards asked:

> "… why are we having to have these restrictions? We are either saying that loss relief should not be available or there is a genuine loss. If the point is, 'Well how do we tell if it is a genuine loss or not?', increasingly tax legislation has started restricting some of the areas where you used to get a loss from not doing very much activity in a particular area—so called artificial schemes.
>
> Essentially, we are not really attacking the problem. We are attacking a symptom by putting a cap on reliefs rather than saying, 'Are we giving relief in the right circumstances?'"[241]

Loan Interest

225. The concerns focused not just on restricting the use of genuine trading losses, but also on the restriction of relief on loan interest. The CIOT wrote:

> "The tax system permits the deduction against profits of finance costs when loans are taken out by the business, yet under the cap there would be a restriction if the loans are 'outside' the business, eg to minimise the

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234 *Ibid.*, paragraph 4.3

235 Murphy, paragraph 8.2

236 *Ibid.*, paragraph 8.3

237 ICAEW, paragraph 40

238 *Ibid.*, paragraph 41

239 *Ibid.*, paragraph 42

240 ICAS, paragraph 10a

241 Q 92

> need for refinancing each time partners change. With a cap in place … the tax cost 'tail' may 'wag the dog', resulting in arrangements that, tax aside, are not in their best commercial interest."[242]

226. The ATT echoed this concern when they wrote "that the penalty of exceeding the cap in certain circumstances could result in a business being structured to avoid the cap and not in the most appropriate form from a commercial point of view."[243]

227. The ICAEW expressed the view that "Transitional provisions are needed to exempt loans obtained before this legislation is enacted." [244]

Reliefs not capped

228. Some of our witnesses took the view that those reliefs which had their own individual limits should have been brought within the scope of the cap. Mr Murphy wrote:

> "the resulting measures make no sense unless there is added to that list [of capped reliefs] other reliefs already capped, which then need to be included in the calculation of an overall limit on tax relief … Only then does a cap make sense."[245]

229. Mr Dodwell agreed: "Investment-style reliefs should all have been picked up in one go, and all subject to a cap." Illustrating this he continued "We see no reason to leave out enterprise investment schemes. They are no more meritorious than some of the other things that have gone into the cap."[246]

Avoidance

230. Some witnesses commented on the read across to transactions seeking to avoid tax and anti-avoidance legislation. Mr Haskew said:

> "We have never objected to the underlying government policy here which was to stop people using year on year—say, artificial tax losses—to reduce their income tax liabilities. We have supported the Government in stopping that … We are in a position now that people who incur genuine commercial losses will get caught up in this. In principle, that potentially will hit UK growth and the UK growth agenda. We have taken the view that there needs to be some protection for those sorts of people who are not serial users of loss relief but who need loss relief to get them through a particularly difficult trading period."[247]

231. ICAS suggested that "this capping provision suggests the GAAR … together with existing targeted restrictions on the use of trade losses, and HMRC's anti-avoidance efforts are not regarded as sufficient to have a meaningful impact on any abuse of tax reliefs from losses. If that is the case, it is the

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[242] CIOT, paragraph 4.5

[243] ATT, paragraph 15

[244] ICAEW, paragraph 44

[245] Murphy, paragraph 8.4

[246] Q 49

[247] Q 69

GAAR or existing targeted provisions that require revision; the case for this additional wide provision is questionable."[248]

232. Mr Baron commented:

> "Whether you should introduce a cap or a cap of this nature rather depends on what you want to do. I have interpreted this cap as largely directed at cutting down on tax avoidance by individuals. That is not exactly what the Government say."

He went on to discuss a range of options and ended up with the thought that "it is perfectly possible that what the Government are actually doing is the best of an unsatisfactory set of options."[249]

233. Mr Pagan sought to distinguish tax avoidance from genuine transactions when he said:

> "There is no tax avoidance in incurring a loss or in paying genuine interest to a third party—to a bank or whoever. It seems very odd to us that at this particular economic time there should be any threat to people who are prepared to put their own money and energy into business."[250]

Response from Officials

234. Responding to various points, Mr Williams said that the cap had:

> "always been about fairness to taxpayers but, equally, it will have some impact in tackling abuse of loss and other reliefs. But the main aim is a fairness one: the proposition is that wealthy individuals should not be able to reduce their income tax bills to zero, year after year, by using some of these reliefs in circumstances where other individuals could never take advantage of them. You have to have other income and many people will have pretty insignificant other income."[251]

235. Challenged on whether many of these reliefs had been put in place to encourage outcomes the Government favoured, Mr Williams responded:

> "They are either to achieve positive outcomes and/or they have their own specific limits on relief already. Many of those that are designed to achieve positive outcomes are not unlimited. The Government is committed to supporting investment and entrepreneurship through tax reliefs, among other measures, but it equally believes that the support should not be without limit."[252]

236. Mr Williams was asked about the specific point that restricting genuine trading losses will have an adverse effect on business. He replied:

> "Given that the first £50,000 of loss is entirely unaffected by this and that most people will not have other income beyond their trade of anywhere near £50,000, in most circumstances, most people will not be affected by this. When we did the costing, the outcome, taking into account all the assumptions, was that most of the impact of this would

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[248] ICAS, paragraph 10b

[249] Q 82

[250] Q 92

[251] Q 136

[252] Q 136

be on people on higher incomes, for example more than £100,000 or £150,000. That is precisely because they are more likely to have significant amounts of other income, whereas in most circumstances at the moment, there is already a cap based on the fact that most people have very little other income against which they can take the loss relief."[253]

The Policy-Making Process

237. Some of our witnesses thought that the new policy-making process had not worked well in the development of this measure. The CIOT wrote:

"It is unfortunate that the development of the cap missed out the first two stages of the Government's own 'Tax Consultation Framework' published in March 2011:

- Stage 1 – Setting out objectives and identifying options; and
- Stage 2 – Determining the best option and developing a framework for implementation including detailed policy design.

Thus alternative routes, such as attacking artificial loss creation, were not explored."[254]

238. The IoD suggested that:

"It would have been much better if the Government had started with a non-committal one-page announcement, along the lines of 'We think we have a problem with uncapped reliefs, do you agree that there is a problem, and if so which reliefs should be capped?' Then the pressure to exclude charitable donations would have been much easier to handle. The lesson for future policy changes is that non-committal announcements can make amendments to policies much easier politically, and therefore much more likely to be made when appropriate."[255]

239. The CIOT accepted that a few welcome changes had been made to the original proposals and:

"While we would prefer to see no cap, due to the additional complexity that brings and the potential damaging side effects, we recommend that, if the Government is minded to proceed with a cap, it could be better designed as to minimise the effect on business and the economy while still meeting its objective to increase tax on certain taxpayers. Our key suggestion is that the cap should not apply to the offsetting of genuine business losses and related reliefs including loan interest, particularly against other business profits."[256]

240. Responding to these criticisms, Mr Williams accepted:

"that the views are honestly held and that we need to take them into account and see whether we could improve the process … Obviously, it is for Ministers to decide what policy they wish to include in legislation

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[253] Q 137

[254] CIOT, paragraph 4.6

[255] IoD, paragraph 21

[256] CIOT, paragraph 4.8

that goes to Parliament, but equally it is very important that we work with stakeholders to get the policy intention as clear as we can through that."[257]

241. **In our report on Finance Bill 2011 we commented favourably on the new tax policy-making process that the Government had committed itself to in 2010. We agree with those witnesses who felt that the failure to consult from the outset meant that alternative ways of addressing excessive reliefs had not been properly explored.**

242. **We heard much evidence from our private sector witnesses that this restriction on reliefs risks disadvantaging business at a time of austerity. Officials' argument that not many people will be affected because not many will have other income of over £50,000 has some force, but HMRC's own explanatory note records that around 8,000 individuals are likely to be affected, with a median loss of £20,000 per person and some very much more than that.**

243. **We consider that the effects of this cap on genuine trading losses could have significant, adverse effects on economic growth. We recommend that the Government carries out a more detailed review, including a wider consultation, to understand better the effect of this measure on business investment. This review should be carried out in time to inform the Finance Bill debates in the House of Commons.**

244. **More generally, we recommend that HMT and HMRC should examine closely why the new policy-making process worked well in developing the GAAR and less well in developing the ARPT package and the cap on reliefs. Whatever steps are necessary to achieve a uniformly good outcome should then be taken.**

[257] Q 138

CHAPTER 7: SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

The Proposed GAAR

245. Given resource constraints and the need to provide certainty for business and to promote UK competitiveness, we regard the narrowly focused GAAR as a reasonable starting point. However, we think it important that the scope of the GAAR should be reviewed in the light of practical experience of its operation as part of the wider review that we recommend elsewhere in this report. Such a review should consider, in particular, how the double reasonableness test has been applied to deliver a narrow focus for the GAAR and whether there is significant evidence that it is deterring abusive transactions. (paragraph 101)

246. We are fully persuaded that the GAAR will not apply to issues involving the taxation of multinational groups or the deferral of bonuses from one tax year to another which arise from the structure of the tax system. (paragraph 102)

247. We recognise HMRC's recent success in tackling transfer pricing under present rules and encourage them to continue to pursue these opportunities with vigour and determination. (paragraph 103)

248. The practice of arbitraging competing tax jurisdictions to minimise taxation must be dealt with by negotiation at the EU, OECD, G8 or G20 level. If this is not resolved by agreement, retaliation, double taxation and harm to the UK's competitive position could result. As part of these negotiations, the current OECD rules need to be reviewed comprehensively to bring them up to date with the working of the global economy and to align them more closely with the underlying economic substance of commercial and financial transactions. (paragraph 104)

249. This review clearly needs to be carried out as a matter of urgency; we were glad to hear that the UK has contributed additional resource to OECD to enable the review to go forward quickly. We recommend that it should be completed as rapidly as possible. (paragraph 105)

250. In the meantime, we recommend that every effort should be made to communicate, particularly to the press and the public, why the GAAR is not an appropriate mechanism to address all problems with the tax system. In particular, that communication should focus on those issues, such as the taxation of multinational groups, where the widely held perception seems to be that the GAAR provides the answer, whereas it is clear that it does not. (paragraph 106)

251. We are wholly persuaded of the importance of the guidance in providing as much certainty and predictability as possible on the application of the GAAR. We recognise that progress is being made in drafting clear guidance, but we are concerned that our private sector witnesses felt that it was far from being acceptable. We recommend that HMRC and the interim Advisory Panel should work urgently to address the deficiencies raised by our witnesses and ensure that the guidance is as timely, clear and comprehensive as possible. (paragraph 121)

252. We think that the role of the Advisory Panel should not be limited to reviewing and approving the guidance that has been produced by HMRC. In

particular, we agree with our witnesses that as many examples as possible should be included, illustrating up-to-date arrangements on both sides of the boundary between abusive and non-abusive. In addition to HMRC's examples, the interim Advisory Panel (and the permanent panel in due course) should suggest examples of its own since its members are well placed to know whether those already included are what advisers need to help them understand how the GAAR will operate. (paragraph 122)

253. Whilst we accept that HMRC should not be represented on the Advisory Panel, we think it important to achieve an appropriate balance of views on the panel so that it is not confined just to those of practitioners. We are surprised that the decision on appointments to this panel lies wholly with the HMRC Commissioners. We recommend that the Government should consider introducing a selection and appointment process involving an element that is independent of HMRC. (paragraph 132)

254. In addition, we recommend that anonymised opinions of the Advisory Panel should be published so that taxpayers can see how the application of the GAAR is developing. (paragraph 133)

255. We recognise the concern felt by some of our witnesses about the uncertainty that the GAAR might create. This is understandable, given the fundamental nature of the change involved. We also recognise the concern that large companies may be able to get informal clearances whereas smaller businesses and other taxpayers will not. (paragraph 146)

256. However, we consider that the resource costs of introducing a clearance system would be very substantial indeed. We agree with those who said that introduction of a clearance system would lead to clearances being sought in most cases whether or not the GAAR had a reasonable chance of applying. (paragraph 147)

257. We accept that a clearance system is not being introduced at this stage on the basis that the guidance will be sufficiently clear and comprehensive to ensure a predictable tax outcome. We recommend, however, that the review we propose elsewhere in this report should look specifically at how effectively any uncertainty arising from the GAAR is being managed in the absence of a clearance system. If at that stage there is evidence that uncertainty in the operation of the GAAR is damaging the UK economy, the pros and cons of a clearance system will need to be revisited. (paragraph 148)

258. We recognise the concerns of our witnesses that IHT planning is different from other forms of tax planning. We therefore think it is particularly important for the guidance to include a variety of specific examples of both abusive and non-abusive IHT planning. We recommend that these examples should be drafted urgently so that taxpayers and their advisers can consider them in good time. We also recommend that the guidance should set out clearly that, where arrangements extend over a long period, it is the view at the time those arrangements were entered into that should prevail. (paragraph 155)

259. We **recommend** that HMRC should fully consider Mr Gammie's stipulation that the GAAR counteraction provisions should provide for HMRC to specify what persons in respect of what property are liable to tax, and that the GAAR legislation must charge tax on that basis. (paragraph 161)

260. We **recommend** that HMRC should plan for an independent, post-implementation review after 5 years. It would be for consideration whether such a requirement should be built into the legislation or, failing that, a firm Ministerial commitment should be made in the House of Commons at the time the legislation is being considered. (paragraph 168)

261. We **recommend** that this review should cover all aspects of the operation of the GAAR during its early years. In particular, in line with our recommendations elsewhere in this report, the review should cover:

    - the scope of the GAAR in the light of practical experience of its operation, including how the double reasonableness test has been applied and whether there is significant evidence of the deterrent effect that is claimed for the GAAR; and
    - whether there is evidence that uncertainty in the operation of the GAAR is damaging the UK economy; if so, the need for a clearance system will have to be re-examined. (paragraph 169)

262. Although not everyone agreed with every detail of the draft legislation, we commend HM Treasury, HMRC and all those involved in the development of the GAAR on an exemplary tax policy-making process. (paragraph 171)

The ARPT Package

263. We commend the Government's responsiveness to the need to exempt certain businesses and other organisations from the ARPT, and encourage HMT and HMRC to continue to work with interested parties to arrive at an appropriate formulation of the relief for farmhouses. (paragraph 189)

264. We agree with the Government that rebasing the CGT charge on disposals by non-resident NNPs to 6 April 2013 is an appropriate response to some of the concerns expressed, but it does not meet the point for UK-resident NNPs. We **recommend** that the Government should consider whether more could be done, possibly deferring the charge on any gain, to help those affected to de-envelope their properties without incurring high tax costs. (paragraph 196)

265. Despite HMRC's assurances, we share the concerns of witnesses about the workability of the ARPT as currently designed and would encourage HMRC to set out clearly how they intend implementing these provisions. We **recommend** that, in 3 years' time, the Government should review how effectively it is delivering the objectives of this policy. (paragraph 201)

266. We agree with our witnesses that the Government's response to SDLT avoidance might have been more appropriately designed had it consulted interested parties at the outset as its 'new approach to tax policy making' stipulates. We **recommend** that the Government adhere to that approach in designing future tax changes. (paragraph 210)

267. We share our witnesses' concern about whether the problem the legislation seeks to address justifies its length and complexity, particularly in view of the Government's commitment to a simpler tax system. In line with our earlier recommendation on better consultation, we think that there were probably simpler and more effective ways of achieving the Government's objectives. We **recommend** that the lessons from the development of these measures should be learned and applied to the design of future tax policies. (paragraph 213)

The Cap on Income Tax Reliefs

268. In our report on Finance Bill 2011 we commented favourably on the new tax policy-making process that the Government had committed itself to in 2010. We agree with those witnesses who felt that the failure to consult from the outset meant that alternative ways of addressing excessive reliefs had not been properly explored. (paragraph 241)

269. We heard much evidence from our private sector witnesses that this restriction on reliefs risks disadvantaging business at a time of austerity. Officials' argument that not many people will be affected because not many will have other income of over £50,000 has some force, but HMRC's own explanatory note records that around 8,000 individuals are likely to be affected, with a median loss of £20,000 per person and some very much more than that. (paragraph 242)

270. We consider that the effects of this cap on genuine trading losses could have significant, adverse effects on economic growth. We **recommend** that the Government carries out a more detailed review, including a wider consultation, to understand better the effect of this measure on business investment. This review should be carried out in time to inform the Finance Bill debates in the House of Commons. (paragraph 243)

271. More generally, we **recommend** that HMT and HMRC should examine closely why the new policy-making process worked well in developing the GAAR and less well in developing the ARPT package and the cap on reliefs. Whatever steps are necessary to achieve a uniformly good outcome should then be taken. (paragraph 244)

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

The members of the Sub-Committee which conducted the inquiry were:

Lord Bilimoria
Lord Hollick
Baroness Kramer
Lord Lipsey
Lord MacGregor of Pulham Market (Chairman)
Baroness Noakes
Lord Rowe-Beddoe
Lord Tugendhat
Lord Wakeham
Baroness Wheatcroft

Dr Trevor Evans CBE JP and Mr Tony Orhnial CB, retired senior officials of HM Revenue and Customs and HM Treasury, were appointed as Specialist Advisers to the inquiry.

Declarations of Interest

Members of the Finance Bill Sub-Committee declared the following interests as relevant to the inquiry:

Lord Bilimoria

Directorships
Minmar (900) Limited
BHL (incorporated in Cayman Islands. Registered with HMRC)
Bilimoria & Bilimoria LLP
General Bilimoria Wines Limited
Cobra India Newco Limited (incorporated in Cayman Islands. Dormant – no activity)
Chairman, Molson Coors Cobra India Limited
Chairman, Cobra Beer Partnership Ltd
Senior non-executive Director, Booker Group plc
Remunerated employment, office, profession etc.
Consultancy fees for the Member's professional services are paid by Molson Coors Brewing Company (UK) to Bilimoria & Bilimoria LLP
Fees for the Member's speaking engagements are paid by The London Speaker Bureau to Bilimoria & Bilimoria LLP
Consultancy fees from BHL paid to Bilimoria & Bilimoria LLP
Consultancy fees from Molson Coors Cobra India Limited paid to Bilimoria & Bilimoria LLP
Shareholdings (a)
BHL
Cobra India Newco
Minmar (900) Limited
Mulberry Asset Holdings (British Virgin Islands)
General Bilimoria Wines Limited
Shareholdings (b)
Booker PLC
Land and property

Residential properties in London and Cape Town

Non-financial interests (b)

Member, Advisory Board, Judge Business School, Cambridge University
Chair, India Partnership Board, Cambridge University
Member, Advisory Board, Birmingham Business School
Member, Birmingham University International Advisory Board
Member, Indian Prime Minister's Global Advisory Council of Overseas Indians
Member, UK-India Roundtable

Non-financial interests (e)

Chairman, Advisory Board, Shrimati Pushpa Wati Loombsa Memorial Trust (education of poor in India)
Governor, Ditchley Foundation
Trustee, Cobra Foundation
Trustee, British Cardiac Research Trust
Trustee, A-T (Ataxia Telangiectasia) Foundation
Member, Memorial Gates Committee, 2009-
Trustee, Saint Paul's Cathedral Foundation

Lord Hollick

Directorships

Honeywell International Inc (diversified technology US)
ProSieben Media Group AG (TV) (Germany)
BMG Music Rights Management AG GMBH (music publishing) (Germany)

Remunerated employment, office, profession etc.

Member, Advisory Board, Jefferies Inc (financial services US)
Ambassador Theatre Group Ltd (theatres)
Member, Advisory Board, MarketShare (demand analytics US)

Partner

G.P Bullhound Ltd
Strand Film Partners
Ingenious Film Partners
Inside Track i and ii Film Partners

Baroness Kramer

Director, Infra-structure Capital Partners (Now dormant)

Lord Lipsey

No relevant interests declared

Lord MacGregor of Pulham Market (Chairman)

No relevant interests declared

Baroness Noakes

Directorships

Royal Bank of Scotland Group plc
Carpetright plc
Severn Trent plc (water)

Shareholdings

Shareholdings in a wide range of listed companies as listed in the Register of members' interests

Lord Rowe-Beddoe

Remunerated

Deputy Chairman, Toye & Co plc (design and manufacture of military and civil uniforms, decorations etc)

Chairman, GFTA – The Euro/Dollar Technology Company Ltd (software technology, FX markets)
Chairman, GFTA MathTec Ltd (holding company for the other two GFTA companies registered in category 1)

Non-Remunerated

Chairman, The Aloud Charity
Life President, Wales Millennium Centre
President, Royal Welsh College of Music and Drama

Lord Tugendhat

Shareholdings (b)

HSBC Holdings plc
Rio Tinto (mining)
Barclays Bank
Citigroup Capital (banking)
A portfolio of investment vehicles managed on behalf of my wife and myself and at their discretion by Coutts & Co
A portfolio of US$ based mutual funds, index tracking stocks and funds investing in India, Korea, and Taiwan held on behalf of my wife and myself by Barclays Wealth
Term deposits at Coutts & Co, Northern Rock plc and the Nationwide Building Society
Prudential Financial Services (US mutual fund)
MetLife (US insurance and other financial services)

Miscellaneous financial interests

Member, Trilantic Capital Partnership Advisory Council (investment in businesses)

Lord Wakeham

Directorships

Genner Securities Ltd (family-owned investment company)
Genner Farms Ltd (family-owned company)
Genner Holdings Ltd (family-owned investment company)

Remunerated employment, office, profession etc.

Chartered Accountant (retired)

Shareholdings (a)

Genner Securities Ltd, owned jointly with family
Genner Holdings Ltd, owned jointly with family
Genner Farms Ltd, owned jointly with family

Non-financial interests (b)

President, Cothill Educational Trust

Non-financial interests (c)

Trustee, HMS Warrior 1860

Non-financial interests (e)

Governor, Sutton's Hospital, Charterhouse
Vice President, Alexandra Rose Charities
Trustee, Carlton Club

Baroness Wheatcroft

Director, St James's Place Plc

A full list of Members' interests can be found in the Register of Lords' Interests:

http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-interests

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at www.parliament.uk/hlfinancebill and available for inspection at the Parliamentary Archives (020 7219 5314).

Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with * gave both oral evidence and written evidence. Those marked with ** gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

Oral evidence in chronological order

**	(QQ 1–24)	Mr Graham Aaronson QC
*		Mr Malcolm Gammie CBE QC
*	(QQ 25–51)	The Chartered Institute of Taxation (CIOT)
*		Mr Richard Murphy FCA
*	(QQ 52–69)	The Association of Chartered Certified Accountants (ACCA)
*		The Institute of Chartered Accountants in England and Wales (ICAEW)
*		The Institute of Chartered Accountants of Scotland (ICAS)
*	(QQ 70–82)	British Property Federation (BPF)
**		Confederation of British Industry (CBI)
*		Institute of Directors (IoD)
*	(QQ 83–92)	Law Society of England and Wales (LSEW)
**		Law Society of Scotland (LSS)
**	(QQ 93–103)	Mazars
**		RSM Tenon
**		Grant Thornton
*	(QQ 104–138)	HM Revenue and Customs (HMRC)
*		HM Treasury (HMT)

Alphabetical list of all witnesses

**	Mr Graham Aaronson QC
*	The Association of Chartered Certified Accountants (ACCA)
	ActionAid (joint submission with ChristianAid)
	The Association of Taxation Technicians (ATT)
*	British Property Federation (BPF)
**	Confederation of British Industry (CBI)
*	The Chartered Institute of Taxation (CIOT)

ChristianAid (joint submission with ActionAid)
Professor Judith Freedman (OUCBT)
* Mr Malcolm Gammie CBE QC
* HM Revenue and Customs (HMRC) (joint submission with HMT)
* HM Treasury (HMT) (joint submission with HMRC)
Mr Stephen Hoyle
* The Institute of Chartered Accountants in England and Wales (ICAEW)
* The Institute of Chartered Accountants of Scotland (ICAS)
* Institute of Directors (IoD)
Linklaters LLP
* Law Society of England and Wales (LSEW)
** Law Society of Scotland (LSS)
** Mazars
* Mr Richard Murphy FCA
Mr Ben Saunders CTA
** RSM Tenon
** Grant Thornton
Mr Chris Wales
War on Want

APPENDIX 3: CALL FOR EVIDENCE

The House of Lords Economic Affairs Committee has set up a Sub-Committee (the FBSC) to inquire into the draft Finance Bill 2013 published on 11 December.

The FBSC focuses on technical issues of tax administration, clarification and simplification rather than on rates or incidence of tax. It aims to publish its report in March.

The FBSC would welcome written evidence by 28 January on the issues set out below:

The FBSC has decided to concentrate on one generic theme: countering the avoidance of tax. It expects to focus on the General Anti-Abuse Rule, including how effective it is likely to be in addressing the various types of avoidance recently highlighted in the media.

The FBSC would also welcome views on other anti-avoidance measures in the draft Bill including those to cap the use of certain tax reliefs and to introduce the annual residential property charge.

APPENDIX 4: GLOSSARY

ACCA	The Association of Chartered Certified Accountants
ATT	The Association of Taxation Technicians
BPF	British Property Federation
CBI	Confederation of British Industry
CIOT	The Chartered Institute of Taxation
HMRC	HM Revenue and Customs
HMT	HM Treasury
ICAEW	The Institute of Chartered Accountants in England & Wales
ICAS	The Institute of Chartered Accountants of Scotland
IoD	Institute of Directors
LSEW	Law Society of England and Wales
LSS	Law Society of Scotland
OUCBT	Oxford University Centre for Business Taxation

APPENDIX 5: LETTER FROM THE CONFEDERATION OF BRITISH INDUSTRY (CBI) TO HM REVENUE AND CUSTOMS (HMRC)

CBI Comments on General Anti-Abuse Rule Draft Clauses Finance Bill 2013 and Draft Guidance

The CBI[258] welcomes the opportunity to comment on the draft legislation and draft GAAR guidance. This has been a good example of consultation and we have been grateful for the constructive dialogue with HMRC.

We believe the draft legislation is moving in a positive direction and are pleased to see that a number of the points we raised in September are reflected in the latest draft. Although not all of our concerns have been met, we recognise that HMRC is advancing towards a workable rule that will be effective against abusive schemes, while not creating uncertainty for normal tax arrangements.

However we still believe it is crucial that the legislation be as clear as possible on the vital issue of the focus on abusive and artificial transactions. As presently drafted, we think that the legislation falls short of solely targeting transactions which are "abusive" and "artificial". Therefore, we believe it is of upmost importance that it is reiterated throughout the GAAR guidance that its scope only covers abusive and artificial transactions and that it is not designed to prohibit straightforward tax management.

Below we list some of the key areas we are still concerned in relation to the December draft.

Meaning of "tax arrangements"

We question whether the position might not be made more uncertain by adding in the "contrived or abnormal" step circumstance in section 2(2)(b). The main test in section 2(1) brings into potential scope commercially-driven transactions that also have a tax aspect. The result of this is that entirely commercial deals with a tax impact need to be looked at under 2(2). To focus in, it is assumed in the draft guidance that, for example, changing a holding structure to carry out a commercial action in an indirect way (i.e. through a trust) rather than directly, as had been the case until then, is an "abnormal or contrived" step. So are circular flows of money. In these circumstances which run afoul of the 2(2)(b) test, the principle that the draft guidance seems to state is that as there is no commercial purpose for that specific tax feature, it is "abnormal or contrived". The logical conclusion of this would be that if there is a tax impact to the overall commercial transaction, the tax feature would be a "contrived or abnormal" step unless that step itself has a commercial purpose. This seems too harsh, potentially under-cutting any value of the "commercial" exception.

Our question, therefore, is whether to be abusive, does a transaction have to "fail" just section 2(2)(b), or all of subsections (a) to (c)? We believe it should be the latter.

In the new paragraph in 2 (5), "might" should be replaced with "will".

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258 As the UK's leading business organisation, the CBI speaks for some 240,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

Meaning of "artificial" – the double reasonable test

There are two changes to the "double reasonableness clause":

(a) the addition of the words "in relation to the relevant tax provisions"; and

(b) the addition of a circumstance which one should have regard to which is "whether the means of achieving those results involves one or more contrived or abnormal steps".

The latter change is helpful but it should be made stronger in order to address concerns that nowhere elsewhere in the legislation there is reference to the arrangements needing to be abusive or artificial.

Commencement and transitional provision

We welcome the assurance that the GAAR will not apply to arrangements which begin prior to Royal Assent of Finance Bill 2013. This extra time is needed to debate the examples and draft guidance to make sure they are both clear.

Administration - self-assessment

As there is still some uncertainty on the face of the statute we believe that the GAAR should not operate through the self-assessment regime and that the onus should be on HMRC to consider the application of the GAAR.

The GAAR Advisory Panel

We welcome the announcement that "no HMRC officer is a member of the [advisory] panel" and therefore it will be truly independent. We wonder whether the Panel members should be appointed by someone other than the Commissioners. If so, this process should then be embodied in the legislation.

We do, nevertheless still have some concerns in this area. The Advisory Panel is to be asked to make a reasonable decision under section 2(2). This section is legislation and as such it should be left to a court of law to interpret what the various words mean. As it is, if a taxpayer receives a Panel result where at least one of the members decided that what they were doing was not reasonable under the 2(2) test, then part of the actual court case might need to be taken up with arguments by the taxpayer as to how the Panel might have misdirected itself on the meaning of some of the terms used in 2(2) so as to "neutralise" that Panel's judgement.

The Aaronson Report suggested that the Panel should be asked to advise on whether there was a sufficiently clear case for HMRC to initiate GAAR. That would require the Advisory Panel to think about the tests in the legislation of course, but perhaps looser terms of reference would suit a non-judicial body better.

Guidance and examples

As we state above, we believe it is vital that throughout the guidance it is made clear that the GAAR is only intended to be targeted at "egregious" tax scheming. There is some very helpful wording on this in section 5.2.2, which could benefit from being brought forward and repeated.

We are pleased to see publication of the document setting out 15 situations with HMRC's views on whether or not the GAAR applies. This is a very constructive addition, and attached to this letter (Annex A) are some other examples that we

would ask you to consider including. We have also attached to this letter some comments on the GAAR procedural schedule (Annex B).

Finally, it would also seem appropriate, given that what is considered reasonable in relation to tax planning changes over time, for the guidance to be clear that the reasonableness test should be applied at the time the transaction is entered into. This protects the government but also prevents uncertainty for taxpayers who do not want to try to predict future trends.

Again, we thank you for the consultation on this important issue, and we would be happy to discuss any of the points raised above with you in more detail.

Yours sincerely

William Morris

Chair of the CBI Taxation Committee

30 January 2013

ANNEX A - Examples where a GAARgaar should/should not apply

1 B Share Scheme

1.1 Background

A UK Group, X Plc, has made a significant disposal of part of its business. It wants to return the proceeds to shareholders.

1.2 The Arrangement

X Plc is aware that some shareholders would prefer to receive an income distribution, whereas others would prefer capital. X Plc therefore decides to offer shareholders a choice, via a "B share scheme".

A new class of shares, the B shares, is created in X Plc and issued as a bonus issue to shareholders. Each B share is entitled to a special dividend of (say) £100 per share, or can be sold back to a bank for £100.

The B shares have no rights beyond the special dividend, and become of negligible value after its payment.

Each shareholder can therefore choose to receive either:

(a) a special dividend, treated as income, or

(b) capital proceeds on sale

1.3 The relevant tax provisions

A higher or additional rate individual taxpayer who would otherwise have suffered income tax on a special dividend avoids income tax by choosing to sell the B shares rather than receiving the special dividend. This means that the individual does not pay income tax and either does not pay capital gains tax as the gain is covered by the CGT annual exempt amount or a capital loss or pays CGT at the rate of 28%, which is lower than the rate of income tax on a dividend for an additional rate taxpayer.

The transactions in securities anti avoidance provisions in section 703 ICTA1988 used to potentially apply to this sort of transaction. The provisions have been rewritten for income tax purposes in Part 13 ITA 2007 and allow the counteraction of an income tax advantage obtained by an individual as a result of a transaction in securities where the main purpose or one of the main purposes of being party to the transaction in securities is to obtain an income tax advantage. However part 13 does not apply unless a close company is involved and X plc is unlikely to be close.

1.4 The taxpayer's tax analysis

A company is free to choose to pay income or capital payments to shareholders. The company is returning capital to its shareholders in a way that will be tax effective for both its individual shareholders (who will probably want capital treatment) and its corporate shareholders (who will probably want dividend treatment).

1.5 What is the GAAR analysis under clause 2(2)?

1.5.1 Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those principles?

The substantive results of the transactions are consistent with the principles on which the relevant provisions are based. Each shareholder who opts to receive a dividend is taxed on income; each shareholder who sells his B shares has made a CGT disposal and is taxed accordingly.

1.5.2 Do the means of achieving the substantive tax results involve one or more contrived or artificial steps?

Yes. Either an income or capital distribution could have been achieved by a simple dividend declaration, or return of capital. The creation of the B shares, and their terms, are inserted steps.

1.5.3 Were the arrangements intended to exploit any shortcomings in the relevant tax provisions?

No.

1.5.4 Does the arrangement include any of the indicators of abusiveness within

clause 2(4) of the draft GAAR?

No.

1.5.5 Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?

B share schemes have been common for several years, and have been set out in full in various public documents. While HMRC have not publicly indicated that they are acceptable, the arrangements accord with established practice and have not been challenged by HMRC.

1.6 Conclusion

On the facts, the arrangements are not abusive and HMRC would not seek to apply the GAAR.

2 Distressed Debt Restructuring

2.1 Background

Company A is the holding company of a group in financial difficulty. Its balance sheet shows £50m share capital, £10m mezzanine loans and £20m senior bank debt but its enterprise value is now only £15m.

2.2 Arrangements

A financial rescue of Company A is proposed whereby (i) the mezzanine loans will be released in full in consideration of the issue of minimal value deferred ordinary shares; and (ii) unrelated Company B will, on arm's length terms (a) buy the existing shares of Company A for £1, and (b) take an assignment of the bank debt for consideration of £15m cash.

2.3 The relevant tax provisions

Sections 321, 322(4), 361, 361A and 363A CTA 2009.

2.4 The taxpayer's tax analysis

Although the release of the mezzanine loans potentially gives rise to a taxable credit for Company A (section 321 CTA 2009), and although the purchase of the senior debt by Company B at a discount to its carrying value potentially produces a deemed release also with a consequent taxable credit for Company A (section 361 CTA 2009), it is considered that the former charge is excluded by section 322(4) (debt for equity relief) and the latter is excluded by section 361A (corporate rescue exemption). The TAAR in section 363A is considered not to apply because it is not a main purpose of the arrangements to avoid or reduce a release charge under sections 361 or 362.

2.5 What is the GAAR analysis under clause 2(2)?

2.5.1 Consistency with principles and policy?

The substantive results of the transactions are consistent with the principles on which the relevant provisions are based. In particular, the relieving provisions sought to be relied upon (sections 322(4) and 361A) are, where their conditions are fulfilled, intended to relieve a company, particularly in the context of financial distress, from the need to recognise a taxable credit upon the capitalisation of its debt/where a company is acquired in a way which prevents its insolvency. "The rules are intended to facilitate the rescue of ailing companies by unconnected parties….where a company acquires impaired debt and….becomes connected at the same time" (CFM 35440).

2.5.2 Do the means of achieving the substantive tax results involve one of more contrived or artificial steps?

Arguably, the use of the deferred ordinary shares to capitalise the mezzanine loans could be seen as a contrived aspect given that those shares may have little or no commercial value. On the other hand, that value proposition in fact reflects the negligible commercial value of the mezzanine debt which sat below the "value break" in Company A's capital structure.

2.5.3 Were the arrangements intended to exploit any shortcomings in the relevant tax provisions?

No. The arrangements were intended to fall squarely within the relevant relieving provisions.

2.5.4 Do the arrangements include any of the indicators of abusiveness within clause 2(4) of the draft GAAR?

No.

2.5.5 Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?

Yes. See CFM 33200 and 35540.

2.6 Conclusion

On the facts, the arrangements are not abusive and HMRC would not seek to apply the GAAR.

3 Supply Chain Optimisation

3.1 Background

A multinational group has decided to reorganise its business model for commercial purposes. Functional activities in the business (for example, strategic decision making, credit risk, manufacturing, intellectual property management) are identified and categorised depending on their risk/reward profile, and charges are, and will continue to be, made on arm's length terms compliant with OECD transfer pricing methodology.

3.2 Arrangements

To undertake the restructuring, the group considers a range of jurisdictions in which to locate separate functional activities, having regard in particular to its ability to staff such activities in the relevant jurisdictions appropriately. A range of commercial factors are taken into account in arriving at the restructuring plan, but one of the factors in determining the location of certain functional activities is the attractiveness of a low local tax rate in a particular non-EU country. A specific branch of activity, together with associated tangible and intangible assets, is to be moved from Company C, a UK resident member of the group, to Company D resident in that low tax territory.

3.3 The relevant tax provisions

Sections 1, 2, 8 TCGA 1992

Section 457 CTA 2009

Part 4 TIOPA 2010

3.4 The taxpayer's tax analysis

To the extent that the transfer of the activity by Company C to Company D results in the disposal by Company C of any chargeable assets, chargeable gains may be recognised in respect of such assets. Moreover, to the extent that the post-restructuring arrangements between Company C and Company D involve ongoing "provisions" in transfer pricing terms, those provisions will be priced at an appropriate arm's length rate. Company C does not, however, expect to pay corporation tax in respect of any chargeable gains "exit charge" upon the transferred assets because it has available tax losses (e.g. current or brought forward capital losses or non-trading loan relationship deficits) which can be set against the relevant gains.

3.5 What is the GAAR analysis under clause 2(2)?

3.5.1 Consistency with principles and policy?

The substantive results of the transaction are consistent with the principles on which the relevant provisions are based. Chargeable gains may be recognised by Company C upon the transfer of the assets used within the function to Company

D, but there is no objection to such gains being sheltered by losses of the types mentioned which are specifically envisaged by the legislation to be available for offset against chargeable gains. Any ongoing provisions between the companies will be subject to the operation of transfer pricing rules in the ordinary way.

3.5.2 Do the means of achieving the substantive tax results involve one or more contrived or artificial steps?

No. The transfer of the function to Company D is a straightforward business reorganisation which includes the transfer of certain tangible and intangible assets, and that function will henceforth be operated in Country D by an appropriate number of suitably qualified personnel.

3.5.3 Were the arrangements intended to exploit any shortcomings in the relevant tax provisions?

No. Any chargeable gain upon exit of the function is recognised in full. The availability of other reliefs to set against the gain cannot be regarded as a legislative shortcoming.

3.5.4 Does the arrangement include any of the indicators of abusiveness within clause 2(4) of the draft GAAR?

No.

3.5.5 Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?

Yes.

3.6 Conclusion

On the facts the arrangements are not abusive and HMRC would not seek to apply the GAAR. To the extent that asset valuation questions arise, or the adequacy of remuneration for ongoing "provisions" is in dispute, these are matters for the capital gains and transfer pricing legislation.

4 SDLT Examples to which the GAAR applies/does not apply

4.1 Share purchase followed by intra-group transfer on sale

4.1.1 Background

SDLT in Part 4 of FA 2003 applies only to land transactions, being acquisitions of "chargeable interests". These are defined in Section 48, FA 2003 and there are various rules (for example in Schedule 15 FA 2003 relating to interests in partnerships and Schedule 16 FA 2003 relating to trusts) that deem certain acquisitions to be acquisitions of "chargeable interests" for SDLT purposes.

The share capital of a company is not a "chargeable interest" as defined, nor is it deemed to be a "chargeable interest" under any other provisions. It follows that SDLT is not payable in respect of an acquisition of share capital.

There are various reliefs from SDLT, one of which is group relief as set out in Part 1 of Schedule 7 FA 2003.

4.1.2 The scheme

A agrees to sell to B, a company, the shares in another company, T, that owns a chargeable interest. Shortly after the acquisition, company T sells the chargeable interest to B.

4.1.3 The relevant tax provisions

Section 48 FA 2003

Part 1 of Schedule 4 FA 2003

Section 75A FA 2003

Section 75C FA 2003

4.1.4 The taxpayer's tax analysis

B contends that there is no SDLT on the acquisition of the shares in T because those shares are not, nor are they deemed to be, "chargeable interests". In addition, B contends that, on the subsequent sale of the "chargeable interest" by T to B, group relief under Part 1 of Schedule 7 FA 2003 is available.

In particular, B contends that, even if the overall effect of the arrangement is that B acquires a "chargeable interest" without any SDLT becoming payable and/or without any future growth in capital value falling within the charge to UK tax on chargeable gains (for example if T is a UK resident corporation tax paying company but B is non-UK resident and does not pay corporation tax or capital gains tax on any possible gains on a future disposal), that does not in itself mean that group relief is denied under any of the provisions of paragraph 2 of Schedule 7 FA 2003.

As regards Section 75A FA 2003, B contends that Section 75C(1) applies so as to disregard the acquisition by B of the shares in T, with the result that the condition in Section 75A(1)(b) is not satisfied because there is only one transaction (the sale of the "chargeable interest" by T to B) and Section 75C(2) specifically preserves the ability of B to obtain group relief, subject to the conditions of that relief set out in Part 1 of Schedule 7 FA 2003.

4.2 Conclusion

It may be that this example is very much a fact sensitive one to which the GAAR may or may not apply, depending on those facts. To illustrate, if B has no commercial alternative but to buy the shares in T in order to acquire control of the "chargeable interest", even though ideally B would not wish to acquire the shares in T, this arrangement may be reasonably regarded as a reasonable course of action. By contrast, if B has the choice to buy either the shares in T or the "chargeable interest" itself and chooses to buy the shares in T with T then selling the "chargeable interest" to B, there being no other reason to arrange matters in this way other than to ensure that no SDLT arises overall, that might not be reasonably regarded as a reasonable course of action, especially if, in addition to the basic arrangements, there are also arrangements for B to pay A more for the shares in T if it transpires that no SDLT is ultimately payable.

5 Corporation Tax

5.1 Purchases of shares or assets

5.1.1 Background

A sale and purchase of a trading operation normally takes one of two legal forms. Either there is a sale of the business and its assets by the company that carries on the trading operation or there is a sale by the shareholders in that company of their shares.

In some cases, the seller(s) may prefer one legal form whereas the buyer may prefer the other legal form. This difference in preference may arise, for example, because the company carrying on the business has a long and complex history with unknown potential issues or known but unresolved issues arising in its past that the buyer does not wish to inherit. It may also arise out of tax considerations; for example, if relief under the substantial shareholdings exemption rules in Schedule 7AC TCGA 1992 may be available to the seller, then it may prefer to sell the shares in the trading company, even though the buyer may prefer to acquire the business and assets if, for example, significant relief for the purchase price may be available to the buyer under the intangible fixed assets regime as set out in Part 8 CTA 2009.

5.1.2 The scheme

Company T carries on a trade. Company T is owned by Company A. Company B wishes to buy the business and assets of Company T but Company A wishes to sell the shares in Company T. Following negotiation, Company B agrees to acquire the shares in Company T from Company A, but for a lower price.

5.1.3 The relevant tax provisions

Schedule 7AC TCGA 1992

5.1.4 The taxpayer's tax analysis

Assuming that the various conditions set out in Schedule 7AC TCGA 1992 are satisfied, Company A contends that no tax is payable in respect of the disposal by it of the shares in Company T. This is the case regardless of whether or not Company B has in an economic sense been able to share in the tax saving enjoyed by Company A.

5.2 Conclusion

GAAR would never apply to this example, even if tax aspects are one of the reasons, or possibly even the main reason, why the transaction takes the legal form in question.

ANNEX B - COMMENTS ON THE GAAR PROCEDURAL SCHEDULE

In general, the draft procedural requirements appear to include a number of improvements over the original proposals outlined in the GAAR Study Report. There remain, however, some aspects of the administrative and process mechanisms that could perhaps benefit from a slightly different approach.

The observations below refer to the paragraphs set out in Part C of the Consultation Draft of HMRC's GAAR Guidance.

1.3.3 It is helpful that a formal notice of the potential application of the GAAR is required and that the contents of such notice are outlined in the draft legislation. It would also be helpful, however, if a statement of principle could be embodied in the legislation to the effect that such contents of the notice must contain sufficient detail to enable a taxpayer to understand clearly and precisely what HMRC considers to be abusive, why it is abusive and what exactly is the proposed counteraction (preferably with supporting calculations).

In addition, given that the arrangements described in the notice and the proposed counteraction may be lengthy and/or complex, the time limit for the taxpayer's reply should be 45 days or such longer period as may be agreed by HMRC and the taxpayer, acting reasonably.

1.3.4 There should be a time limit for the designated officer to refer the matter to the Advisory panel, which should perhaps, for consistency, be 45 days or such longer period as may be agreed by HRC and the taxpayer, acting reasonably, from the earlier of the expiry of the first 45 day (or longer) period and the date on which the taxpayer delivers its initial representations to HMRC.

1.3.5 The taxpayer should have 45 days (not merely 14 days) to make further representations about HMRC's submissions to the Advisory Panel

1.3.6 The complete absence of time limits on the Advisory Panel potentially promotes uncertainty. Recognising that the Advisory Panel should be afforded an appropriate length of time in order to reach a properly considered view, perhaps there should therefore be provisions merely imposing obligations on the Chair to select the members of the sub-panel within a specified time frame and to indicate to HMRC and the taxpayer a time frame within which that sub-panel expects to be able to consider the matter referred, though without any requirement to commit to a time limit for the provision of its final opinion(s). In this connection, perhaps regulation making power in respect of the processes of the Advisory Panel may be appropriate.

1.3.7 Again, as for paragraph 1.3.3, perhaps a requirement as to the level of detail to be contained in the Advisory Panel's opinion(s) would be appropriate.

1.3.9 It is not clear why a separate time limit system cannot be proposed for the GAAR as outlined above, that not being dissimilar to the processes for Customs and Excise duties.

2.1/2.2 Given that no members of the Advisory Panel are to be HMRC officers or employees, should it not be the case that they should be appointed by someone other than the Commissioners? For example, perhaps the Lord Chancellor should appoint the Chair and the Lord Chancellor and the Chair together appoint the Panel. This should then be embodied in the legislation.

2.3.1 If the opinions of the Advisory Panel are not binding judicial decisions, then should it not be the case that any Tribunal may, but not must, take those opinions into account?

5.1 Given that the essence of the GAAR is the double reasonableness test, should the standard of proof required not be 'beyond a reasonable doubt' rather than 'on a balance of probabilities'?

5.2 The comment on clause 2.3.1 applies here. Should it not be left to the Tribunal or Court to decide for itself what it 'must' take into account and, to the extent it decides to take something into account, to further decide for itself what weight to attach to it?