TAX LAW REVIEW COMMITTEE

A GENERAL ANTI-AVOIDANCE RULE FOR DIRECT TAXES

A Response to the Inland Revenue's Consultative Document

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FOREWORD

By the President of the Tax Law Review Committee
The Rt. Hon. The Lord Howe of Aberavon CH QC

In its November 1997 Report on Tax Avoidance, the Committee concluded that a sensibly targeted statutory general anti-avoidance provision, with a considered framework and appropriate safeguards for taxpayers, could have a part to play in deterring and counteracting tax avoidance. The Committee expressed a preference for such a statutory rule, if sensibly targeted, to the continued development of judicial general anti-avoidance doctrines.

The Committee has been pleased to note the attention that the Inland Revenue has given to the Committee's 1997 Report in preparing its October 1998 Consultative Document on a General Anti-avoidance Rule for Direct Taxes. The Committee has given careful consideration to the proposals set out by the Inland Revenue in that Consultative Document.

The Committee's Report contained clear objectives to underpin its conclusions. The Committee particularly had in mind the desirability of reducing the uncertainties that arise from the continuing development on a case by case basis of judicial doctrines. It also wished to facilitate the process of simplifying and clarifying tax law currently being undertaken by the Tax Law Rewrite Project.

In a carefully constructed framework, expressed through its illustrative clauses, the Committee sought to balance the need to counteract avoidance against the need, in adopting such a statutory general rule, not to interfere unduly with taxpayers' legitimate commercial and private affairs. In many aspects, the Inland Revenue's Consultative Document follows closely the Committee's illustrative clauses, but it also alters them. In doing so, it changes fundamentally the balance that the Committee sought to achieve.

In my foreword to the 1997 Report, I noted that a problem with this subject is that there is little agreement on the boundaries between acceptable tax mitigation and transactions designed to defeat the taxing intentions of Parliament. It is not this difficulty that causes the Committee to respond as it does to the Inland Revenue's proposals. Rather, it is the Committee's clear view that the Inland Revenue's proposals do not give effect to the objectives that the Committee had in mind and fail to produce a satisfactory balance of interests between tax gatherers and taxpayers.

In its 1997 Report, the Committee was careful not to treat as a matter of principle the question of whether or not to adopt a general anti-avoidance rule. In this response it has followed the same approach. For it is the *form* of any statutory provision that is at the heart of the question. In 1997 I warned against the unintended consequences of ill-judged change. And the Committee cautioned that a statutory provision which failed the Committee's standards—especially as to the framework and resources for its administration and the safeguards for taxpayers—would be a recipe for disastrous disruption of ordinary commercial and personal affairs, as well as an administrative nightmare for the Revenue authorities.

Those severely practical standards remain the yardstick for today—and it is by those standards that the Committee concludes that the proposals set out in the Inland Revenue's Consultative Document are not well-judged. This response seeks to explain the reasons for that conclusion. As with its 1997 Report, the Committee presents its response as a contribution to the continuing debate on a subject that goes to the heart of the tax system and of the relationship between Inland Revenue and taxpayers.

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SUMMARY OF CONCLUSIONS

Fundamental issues

1. We have not revisited the conclusions of our 1997 Report ("the TLRC Report") nor questioned whether there should be a GAAR. We have not attempted to deal with all the questions raised in the Inland Revenue's Consultative Document.

2. We accept that there are administrative reasons for limiting the proposed GAAR to corporate taxpayers. Nevertheless, this is less than ideal and we see no justification for it as a matter of principle. As the GAAR may be extended to other taxpayers and other taxes, we think it appropriate to review and comment on it as if it applied beyond the corporate sector.

3. The questions that we have addressed, and our answers, are these—

   3.1 Does the framework for a GAAR discussed in the Consultative Document represent a sensibly targeted statutory provision? – **No**.

   3.2 Do the proposals offer appropriate safeguards for taxpayers? – **No**.

We therefore oppose the adoption of a statutory GAAR in the form proposed.

4. There are three main reasons for our conclusion—

   4.1 The proposed GAAR places no adequate burden on the Inland Revenue to justify its use of the Rule to impose tax where it cannot otherwise bring the taxpayer's arrangements within the clear taxing words of the Act. We believe that the Inland Revenue should be required to show, as a gateway to its imposition of tax under the GAAR, that the taxpayer's arrangements fall within the scheme of the Act so as *prima facie* to give rise to a charge to tax. The proposed GAAR places on the taxpayer the obligation of proving Parliament's intentions and not, as we contend it should, on the Revenue.

   4.2 The scope of the proposed GAAR and the reservations expressed in the Consultative Document on the administrative arrangements proposed in the TLRC Report make us doubt the adequacy of the proposed clearance procedure and of the resources that would be devoted to it. The breadth of the proposed GAAR is likely to place undue emphasis on the use of non-statutory guidance by the Inland Revenue as the practical method of administering the Rule. We consider that the proposed GAAR fails to strike a proper balance between a reasonable statutory rule and reliance on extra-statutory guidance.

   4.3 The proposed GAAR also offers no limitation on the parallel development of judicial anti-avoidance doctrines and no satisfactory opportunities for legislative simplification. The TLRC Report considered these to be major objectives of any proposed GAAR.

5. The TLRC Report had clear objectives in mind for a GAAR and in its illustrative Clause sought to demonstrate a satisfactory balance of interests. The Consultative Document fails to give effect to those objectives or to that balance.

Detailed aspects

6. The definition proposed in the Consultative Document for determining what is a composite transaction sets too low a standard. All manner of transactions designed to conduct on-going commercial operations on a tax efficient basis will be within the GAAR, multiplying further the impact of the Rule and the need for clearances.

7. The Consultative Document proposes that the Rule should apply to a composite transaction if tax avoidance is one of the main purposes of any step in the transaction. This is the broadest proposed formulation and again sets too low a standard, bearing in mind practical commercial and administrative considerations.

8. As a practical measure to limit the occasions on which a clearance application will be required, we think that the qualification of "acceptable tax planning" for specific reliefs and exceptions does not adequately reflect what we envisaged as a "protected transaction". In the end, the results of any changes to limit the safeguards we proposed will have to be measured by their impact on commercial transactions and the necessity for GAAR clearances.

9. We think that it is inadvisable for the legislation to be over-prescriptive on how transactions are to be recharacterised by the GAAR. What is needed is a clear statement of the guiding principles under which recharacterisation proceeds. This should deal with such matters as double taxation, third party rights, the consequences for third parties of recharacterisation and the enduring consequences of transactions that are subject to the GAAR

Administration

10. We continue to believe that the essential features of a notice invoking the GAAR ought to be part of a statutory requirement. We continue to think that each taxpayer to whom a notice is given should be informed who else has received notice and to what effect.

11. We see no reason to change our view that the taxpayer be entitled to seek an internal review of the GAAR section's decision to invoke the Rule and its basis for proceeding. We see no reason for changing our view there should be a dedicated appeals process against the issue of a notice invoking the GAAR. The appeal would be made in all cases to the Special Commissioners.

12. We are concerned that several proposals are concerned to find administrative means of restricting the number of clearance applications. Achieving a manageable demand for clearance applications is a function of a sensibly targeted Rule. We do not regard it as a matter to be managed solely through administrative expedients.

13. We believe that clearance should be refused only in those cases where on the available information, the Board would expect to invoke the GAAR. It should be in exceptional circumstances only that no explanation is given for refusing a clearance application. We think that the Inland Revenue ought to be obliged to respond to all GAAR clearance applications.

14. We think that a specialist section within the Inland Revenue should handle clearances. This does not preclude the recruitment to the section of appropriately qualified persons from outside the Inland Revenue.

15. It may be necessary to specify a longer response period, for example 60 days, to clearance applications but a period ought to be laid down in statute. The solution is to frame a Rule that it impinges as little as possible on commercial transactions. Companies and their advisers can then proceed with ordinary commercial transactions knowing that in most cases the GAAR is irrelevant to the transaction. Subject to that, we consider it an overriding requirement that the clearance section has whatever resources it needs to administer the GAAR properly.

16. The proposed information requirements go further than is appropriate for a GAAR clearance. An alternative approach is to require an applicant to state why it is making the application and to offer a description of the transaction bearing in mind the factors that are used to determine the purpose of the transaction. An applicant would not have to describe alternative transactions or possible recharacterisations. We agree that the details of clearance applications should be a matter of administrative practice.

17. Some of us are strongly opposed to any idea that a charge be made for a clearance application. Others feel that some charge can be accepted, if it secures the resources to administer the system properly and guarantees a satisfactory response time for commercial transactions. None of us, however, supports the idea of *ad valorem* charging arrangements.

18. We support publishing both specific clearance applications (in anonymised form) and "general consents". Specimen general consents ought to form part of any consultation on the wording of GAAR legislation.

19. We see no reason to alter our earlier proposal for a single stage review of a refusal of a clearance under a paper-based system.

20. We remain of the view that the Board of Inland Revenue be required to report each year to Parliament on the operation of the Rule.

21. The relationship between the GAAR and self-assessment, especially in respect of interest and penalties, should be a matter for specific debate.

22. The effective date of any GAAR and how (if at all) it affects transactions or planning commenced before the Rule is enacted should be clarified in any further consultation.

CHAPTER 1. INTRODUCTION

The Committee's 1997 Report

1.1 In November 1997 the Committee published a Report on Tax Avoidance.[1] The Executive Summary stated our main conclusions in these terms—

- Specific anti-avoidance provisions should continue to be in the forefront of the battle against tax avoidance. There remains, however, the question of whether specific provisions should be supported by the deterrent effect of the developing judicial general anti-avoidance doctrines or a statutory general anti-avoidance provision.

- We prefer a sensibly targeted statutory general anti-avoidance provision, with a considered framework and appropriate safeguards for taxpayers (including a clearance procedure), to the continued development of judicial anti-avoidance doctrines.

- We believe that such a statutory provision could make a contribution to the effort to deter and counter-act tax avoidance and may offer some opportunities for simplifying existing legislation.

- A statutory provision that fails to address satisfactorily the issues to which we draw attention or to meet the criteria we identify (in particular for safeguarding taxpayers' rights), will inhibit the conduct of ordinary commercial and personal affairs and prove an administrative nightmare for the Revenue authorities. The Committee would vehemently oppose such a provision.

The Inland Revenue's Consultative Document

1.2 On 5th October 1998, the Inland Revenue published its Consultative Document on a proposal for a general anti-avoidance rule (hereafter "GAAR") for direct taxes.[2] The Consultative Document draws extensively upon the TLRC Report and we have therefore considered it particularly appropriate that we should express our views of the Inland Revenue's proposals.

The Committee's Response

1.3 In considering the Consultative Document, we felt that we ought not revisit the conclusions of our Report nor question whether there should be a GAAR. We have therefore confined our response to a consideration of the Inland Revenue's "examples

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[1] *Tax Avoidance: A Report by the Tax Law Review Committee*, IFS November 1997 (hereafter "TLRC Report").

[2] Inland Revenue, *A General Anti-Avoidance Rule for Direct Taxes, A Consultative Document*, October 1998 (hereafter "Consultative Document").

of possible wording for key parts of a GAAR" [3] including the framework within which the Inland Revenue proposes the GAAR should operate.

1.4 Based on our previous conclusions, the questions that we have addressed,[4] and our answers, are these—

1.4.1 Does the framework for a GAAR discussed in the Consultative Document represent a sensibly targeted statutory provision? – **No.**

1.4.2 Do the proposals incorporate appropriate safeguards for taxpayers? – **No.**

We therefore oppose the adoption of a statutory GAAR in the form proposed in the Consultative Document. We give our reasons for this conclusion in Chapter 2.

Should the UK adopt a statutory GAAR?

1.5 We have not sought to answer the question posed by the Consultative Document whether in principle the government should adopt a statutory GAAR.[5] The TLRC Report and the substantial literature on this subject illustrate that there are few absolute answers to the question whether a government should adopt a statutory GAAR and, if so, in what form. It is a matter of striking a balance and of what is practically workable, given the resources that the government is prepared to devote to the operation of a GAAR.

Limiting the GAAR to corporate taxpayers

1.6 The Consultative Document proposes to limit the GAAR (initially, at least) to the corporate sector. The taxes covered by the GAAR would be corporation tax, petroleum revenue tax and income tax payable by companies.[6]

1.7 The Consultative Document justifies this approach on the basis that the corporate sector is "where some of the most contrived and costly avoidance takes place" [7] and that [8]—

> "This would make [the GAAR] more manageable from an administrative point of view and less burdensome for the public at large..."

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[3] Consultative Document, page 5, paragraph 2.1

[4] We have not sought to answer specifically the questions raised by, and summarised in Chapter 18 of, the Consultative Document

[5] Consultative Document, page 3, paragraph 4.

[6] Consultative Document, page 13, paragraph 6.4.3. Non-resident companies with UK branches or sources of income within the United Kingdom are therefore within the rule. As a point of detail it may need to be clear whether income tax payable by companies includes or not income tax deducted at source from payments on account of other taxpayer's liabilities.

[7] Consultative Document, page 3, paragraph 1.

[8] Consultative Document, page 13, paragraph 6.4.2.

We accept that this approach can be justified administratively, on the basis that some testing of the water is needed and that the corporate sector may be better able to cope with the demands of a GAAR.[9]

1.8 Nevertheless, the limitation of the GAAR to corporate taxpayers leads to some obvious potential anomalies that makes it less than ideal—

1.8.1 The GAAR would counteract a tax avoidance scheme undertaken by a company but would allow an individual to effect the identical scheme with impunity.[10]

1.8.2 If we are correct about 1.8.1, it would follow that a scheme effected by a partnership comprising individual and corporate partners would be effective for some partners and ineffective for others.

1.8.3 The approach raises difficult questions on the interaction of taxes. Thus, basic choices by private companies as to how to extract corporate profits (as salary, rent, interest or dividend) often depend upon the mixed tax circumstances of the individual proprietors (outside the Rule) and the company (within the Rule).

1.8.4 Related to 1.8.3, to the extent that the GAAR relies upon purpose, it may be necessary to distinguish the company's purpose from the purposes of its shareholders and the purposes of corporate taxes from the purposes of personal taxes.

1.8.5 The GAAR may affect personal savings products that depend for their return upon tax planning by UK companies but not those offered by others forms of intermediary.

1.9 We therefore see no justification for the limitation as a matter of principle.[11] And as the GAAR may be extended to other taxpayers and other taxes,[12] we think it appropriate to review and comment on the Rule as if it extended beyond the corporate sector.[13]

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[9] The Consultative Document indicates that the limitation of the GAAR to the corporate sector is an initial position, Consultative Document, page 13, paragraph 6.4.2.

[10] Subject only to the application of judicial anti-avoidance doctrines, but some would say that if the judicial doctrine already counteracts a scheme a statutory rule is not needed.

[11] If the aim of the GAAR is to promote fairness in the tax system its natural target might better be tax planning by high net worth individuals. In this respect, the majority of the leading cases on the judicial anti-avoidance rule have concerned tax avoidance by individuals.

[12] The Financial Secretary states that "if it was felt to be in the wider interests of the Exchequer and of taxpayers as a whole, the Government could consider extending its scope at a later date". Consultative Document, page 3, paragraph 1.

[13] We would think it highly undesirable, for example, to adopt one formulation of the GAAR for companies and a different one for individuals. This suggests that the GAAR ought to be framed in a way that makes it practical to extend it to other taxpayers, if desired.

Application of the GAAR to VAT

1.10 The Consultative Document notes that the very different nature of direct and indirect taxes makes it infeasible to combine them under a single GAAR.[14] Nevertheless, HM Customs & Excise have adopted a similar rule in its proposed 'mini' GAAR on construction services.[15] Although limited to construction services, the Rule is proposed as a self-contained Schedule that, following enactment, could extend to any aspect of VAT.

1.11 The TLRC Report acknowledged that VAT raised different issues to direct taxes and might have to be covered by a separate rule.[16] We have not considered in this response the specific European issues that arise from a proposed 'mini' GAAR for VAT or whether, indeed, the similarity of wording, structure and approach is apposite given the different structures of VAT and corporation tax. To the extent that the VAT proposal raises similar issues to those of the Inland Revenue's Consultative Document, our views are unlikely to differ.

Further consultation on the wording of any GAAR legislation

1.12 The Inland Revenue's press release of 5th October 1998 stated that

> "If the Government decides to introduce a GAAR there will be a further consultation on the precise wording."

This reflects the statement in the Consultative Document that the clauses are intended to illustrate what elements a GAAR might contain and what it might look like.[17] We accept, therefore, that the precise words used in the Consultative Document may not be intended as the final language of any legislation.

1.13 Our main concerns with the proposed GAAR, however, reflect its structure and approach rather than the detailed language used. And, as regards the language, we have noted that the Consultative Document issued by HM Customs & Excise reproduces almost precisely the same language for a VAT 'mini' GAAR but in this instance drawn up in a form that you would expect for a clause proposed for enactment.

Layout of the Committee's Response

1.14 With those general comments, in Chapter 2 we set out the reasons why we consider that a GAAR in the form proposed in the Consultative Document does not offer a satisfactory balance or adequate safeguards for taxpayers. In subsequent Chapters we deal with a number of detailed aspects of the proposals.

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[14] Consultative Document, page 12, paragraph 6.4.1 and page 7, section 3.

[15] *A VAT MiniGeneral Anti-Avoidance Rule in Construction Services*, Consultative Document, 20th January 1999.

[16] TLRC Report, page 40, paragraphs 5.20 and 5.21.

[17] Consultative Document, page 5, paragraph 2.1 and page 11, paragraph 6.2.2.

CHAPTER 2. FUNDAMENTAL ISSUES

Objections to the proposed GAAR

2.1 We have two major objections to the form of GAAR proposed in the Consultative Document—

> 2.1.1 The proposed GAAR places no adequate burden on the Inland Revenue to justify its use of the Rule to impose tax where it cannot otherwise bring the taxpayer's arrangements within the clear taxing words of the Act.
>
> 2.1.2 The scope of the proposed GAAR and the reservations expressed in the Consultative Document on the administrative arrangements proposed in the TLRC Report make us doubt the adequacy of the proposed clearance procedure and of the resources that would be devoted to it.

The proposed GAAR also offers no limitation on the parallel development of judicial anti-avoidance doctrines and no satisfactory opportunities for legislative simplification. The TLRC Report considered these to be major objectives of any proposed GAAR.

The standard required to invoke the GAAR

2.2 Clause 1 of the illustrative GAAR in the TLRC Report stated that [18]—

> "The purpose of this rule is to deter or counteract transactions that are designed to avoid tax in a way that conflicts with or defeats the evident intention of Parliament. This rule shall be interpreted and applied in a manner consistent with that purpose."

This language adopted the words used by Lord Nolan in his speech in *IRC* v *Willoughby*.[19]

2.3 The TLRC Report acknowledged that it is not always easy to discern Parliament's taxing intentions, especially in the case of novel and complex transactions. A GAAR is necessarily aimed at transactions and arrangements that Parliament has not addressed in explicit terms and that Parliament may not have anticipated. Acts of Parliament rarely address every set of circumstances. But they do create a framework or scheme of taxation within which it is possible to assert that Parliament, had it addressed the matter expressly, would have imposed taxation. In this respect, we envisaged that the growing use of explanatory materials in enacting legislation and progress with the Tax Law Rewrite project would underpin the purposive aspects of our illustrative Clause 1.

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[18] TLRC Report, page 36, illustrative clause 1.
[19] [1997] STC 995 at p. 1004c.

2.4 Our illustrative clause placed squarely on the Inland Revenue the obligation at the outset to justify that its assertion of taxing rights through its proposed counteraction of the taxpayer's arrangements, accords with Parliament's intention. Our conclusion was that the Inland Revenue ought to show, as a gateway to its imposition of tax under the GAAR, that the taxpayer's arrangements fell within the scheme of the Act so as *prima facie* to give rise to a charge to tax. The application of the GAAR involves, after all is said and done, those cases in which the Inland Revenue has been unable to point to a specific charging provision to justify the tax they are seeking to levy. [20]

2.5 The Consultative Document draws attention to the difficulties inherent in referring to the evident intention of Parliament. It does not, however, reject its use in the proposed GAAR but instead adopts the concept in its definition of "acceptable tax planning". The Consultative Document suggests that [21]—

> "***Acceptable tax planning*** means arranging one's affairs so as to avoid tax in a way that does not conflict with or defeat the purpose of the tax legislation."

As we note in our comments in Chapter 3 below, this definition follows in part our definition of a "protected transaction". We envisaged that the Inland Revenue should have to show that the taxpayer's actions fell within the broad intentions of the taxing Acts and, once it had discharged that onus, it would fall on the taxpayer to justify his action as a protected transaction. The Consultative Document, in effect, switches to the taxpayer the entire burden of establishing the Parliamentary intention.[22]

2.6 The Inland Revenue need not show, as an opening proposition, that they are invoking the GAAR to counteract arrangements by which a taxpayer seeks to defeat the purpose of tax legislation.[23] Instead, the Consultative Document proposes that the purpose of the GAAR should be stated as follows [24]—

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[20] In formulating the judicial anti-avoidance doctrine in *Ramsay*, Lord Wilberforce still noted that a person should only be taxed by clear words. In this respect, if it is not possible to point to clear charging words in the main body of the Act, we consider that a taxpayer should only fall within the GAAR if the Inland Revenue can show at the outset that the transaction falls within Parliament's general taxing intent. It should not be enough merely to show that the taxpayer could have conducted his activities or carried out his transactions in a way that would have produced a higher tax liability.

[21] Consultative Document, top of page 16.

[22] Consultative Document, page 24, paragraph 6.9.2. The concept of acceptable tax planning and the burden of proof it involves follows our proposal for protected transactions, see Chapter 3 below.

[23] If this were a hurdle that the Inland Revenue had to surmount the defence of acceptable tax planning would be meaningless. In this regard, the Committee's proposal incorporated two references to the Parliamentary purpose. The first was the overriding requirement of illustrative clause 1, which qualified the Inland Revenue's evidentiary obligation. The other was in the Committee's definition of a protected transaction.

[24] Consultative Document, page 12, paragraph 6.3.4.

"The purpose of this Rule is to deter or counteract tax avoidance by companies. The provisions of this Rule shall be interpreted and applied so as to achieve that purpose."

2.7 How far this limits the scope of the Inland Revenue to invoke the GAAR depends on the definition of tax avoidance. The Consultative Document proposes an extensive definition of tax avoidance.[25] Any action by a company to conduct its commercial transactions or affairs in a tax efficient manner counts as tax avoidance and therefore falls within the purpose of the GAAR. Demonstrating that the transaction involves tax avoidance accordingly presents no significant hurdle to the Inland Revenue's application of the GAAR.[26]

2.8 The Consultative Document accepts (as the TLRC Report proposed) that the Inland Revenue must shoulder the burden of showing that tax avoidance is one of the main purposes of the transaction. But here again, tax avoidance encompasses any tax planning—including acceptable tax planning. And in the case of a transaction comprising more than one step, tax planning need only be *a main purpose of any step* in the transaction.[27]

2.9 The very fact that "tax avoidance" may require a wide definition makes it the more important to ensure that the burden with respect to Parliamentary intention is correctly placed. Overall, we consider that the Consultative Document's formulation of the GAAR places no adequate burden on the Inland Revenue to justify their use of the Rule. The real burden falls on the company to demonstrate that what it has done qualifies as acceptable tax planning.

2.10 One way to express this is that any and all tax planning is within the Rule until the taxpayer can show that it is acceptable tax planning. In effect, the presumption underlying the purposive clause quoted in paragraph 2.6 is a presumption against the taxpayer because it is a presumption even against acceptable tax planning. This contrasts with our view that the GAAR should be targeted at unacceptable tax planning. In a criminal context, the analogy would be to move from a presumption of innocence to a presumption of guilt.

The administrative arrangements for the proposed GAAR

2.11 In our view, the practical consequence of a GAAR along the lines proposed will be to affect any commercial transactions or activities that are designed or are conducted in a tax efficient manner. Applications for clearance under the GAAR will become the normal course rather than the exception. As a result, the proposed GAAR is likely to be particularly intrusive of commercial transactions.

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[25] Consultative Document, page 14, paragraph 6.5.2.

[26] If only because "no commercial man in his senses is going to carry out commercial transactions except upon the footing of paying the smallest amount of tax involved" *IRC* v *Brebner* 43 TC 703 per Lord Upjohn at page 718. For any commercial man to proceed in that way would risk the application of the proposed GAAR.

[27] Consultative Document, page 19, paragraph 6.7.10.

2.12 Taxpayers will require either clear professional advice that the GAAR does not apply to their case or a binding pre-clearance from the Inland Revenue that it will not invoke the GAAR. The ability to give clear professional advice depends upon the structure and language of the GAAR. The more broadly it is cast, the greater is the need for taxpayers and their advisers to seek advance clearances to secure the certainty that they require.

2.13 The Inland Revenue must therefore have the necessary resources to deal adequately with the clearances that taxpayers and their advisers are likely to require. If the breadth of the GAAR makes it likely that it will affect large numbers of commercial transactions, the Inland Revenue personnel must be adequately experienced and trained to enable them to make the appropriate judgments that will be needed in clearing such transactions or refusing clearance.

2.14 Familiarity with the operational policy of the GAAR may in time facilitate professional advice but at the outset there can be no such familiarity. And once it has become established professional practice to obtain a clearance in particular cases, it may be difficult to dispense with the continuing need for a clearance.[28] We note the proposal for the Inland Revenue to issue non-statutory guidance on the scope and practical application of the Rule. But this is likely to be cast in general terms and to have attached to it suitable caveats regarding the reliance that can be made of it.[29]

2.15 We think that the use of extra-statutory guidance to some extent is an unavoidable aspect of a GAAR. But the breadth of the proposed GAAR is likely to place undue emphasis on the use of non-statutory guidance by the Inland Revenue as the practical method of administering the Rule. In this respect we consider that the proposed GAAR fails to strike a proper balance between a reasonable statutory rule and reliance on extra-statutory guidance.

2.16 We deal in Chapter 5 below with various specific points on the administrative arrangements suggested in the Consultative Document. In the final analysis, the issue is whether there are available the necessary resources in the form of properly trained Revenue personnel to administer the proposed GAAR properly. On the basis of the Consultative Document, we doubt the adequacy of the proposed clearance procedure and of the resources that would be devoted to it.

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[28] Revenue clearances are routinely sought under s. 707 Income and Corporation Taxes Act 1988 (transactions in securities) and under s. 138 Taxation of Chargeable Gains Act 1992 (share exchanges and other company reorganisations) even in cases where long-established practice suggests that clearance will be given.

[29] It is usual to attach to extra-statutory concessions and published Revenue practice a requirement that they not be used in connection with tax avoidance. The application of such a rubric to general consents under the GAAR might render them valueless. The general consents would presumably state what the Revenue regarded as acceptable tax avoidance.

The relationship between the proposed GAAR, judicial anti-avoidance approaches and legislative simplification

The simplification of specific anti-avoidance legislation

2.17 The TLRC Report expressed the Committee's view that specific anti-avoidance provisions should continue to be in the forefront of the battle against tax avoidance. We accepted nevertheless that a GAAR might act as a suitable backstop to specific provision. With the benefit of the backstop, the Inland Revenue would be able to rewrite those specific provisions as part of the Tax Law Rewrite Project, in clearer terms and with a clearly expressed purpose. In this way we hoped that a GAAR would offer opportunities for simplifying existing legislation. Indeed, our decision to study a GAAR arose initially from the simplification issues raised by our tax legislation project.

2.18 It may be that the breadth of the proposed GAAR offers opportunities to dispense with some specific anti-avoidance measures. But we see no obvious merit in putting general provision in the vanguard of measures to counter tax avoidance. Furthermore, if a broadly drawn GAAR were to encourage growing imprecision in the basic legislation—on the basis that the GAAR would cover any loopholes—it would be counter-productive.

2.19 The Consultative Document is silent on such issues. We have been unable to discern a desire to see the proposed GAAR as part of a simplification process or of broader measures designed to achieve greater coherence in the tax system. In particular, the GAAR can have no impact on legislation that applies to non-corporate taxpayers, even in cases where the legislation extends also to companies.

The development of judicial anti-avoidance doctrines

2.20 Our acceptance of a suitable GAAR was also founded on the proposition that a sensibly targeted statutory GAAR was preferable to the continued development of judicial anti-avoidance doctrines. The Consultative Document makes no proposal to limit the application of judicial anti-avoidance doctrines developed since the *Ramsay* decision. This is consistent with the TLRC Report. We concluded that we would not wish any statutory repeal of *Ramsay* and related cases to inhibit the purposive approach to statutory interpretation or to limit the courts' ability to decide upon the true legal effect of arrangements entered into by taxpayers. [30]

2.21 Subject to those points, however, our view was that the *Ramsay* doctrine should not be capable of being used in combination with a statutory GAAR or of being developed as an independent judicial rule. We accept that there might be some residual development of judicial doctrines in pre-GAAR cases still to come before the courts. There would also be the possibility that judicial anti-avoidance doctrines might develop to cover taxes outside the scope of the GAAR. Nevertheless, we envisaged

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[30] TLRC Report, page 36, paragraphs 5.6–5.8.

that development in the main areas of income tax, corporation tax and capital gains tax would in practice cease.

2.22 The Consultative Document is silent on the relationship of the proposed GAAR to existing judicial anti-avoidance doctrines. Of necessity, however, those doctrines must continue to apply and develop as the only general anti-avoidance approach applicable to non-corporate taxpayers in the income tax and capital gains tax fields. The uncertainties of a case by case development will remain unresolved, even if by statute or by self-denying ordinance, the Inland Revenue no longer advances arguments based on *Ramsay* and related cases against corporate taxpayers.

Conclusion

2.23 The TLRC Report had clear objectives in mind for a GAAR and in its illustrative Clause sought to demonstrate a satisfactory balance of interests. The Consultative Document fails to give effect to those objectives or to that balance.

CHAPTER 3. SPECIFIC ISSUES ON THE GAAR

Composite transactions

3.1 The TLRC Report and the Consultative Document both envisage that the trigger for the GAAR would be a transaction that has as its sole or main purpose the avoidance of tax and that a list of factors would be used to determine the "purpose". The principal difficulty, and the main difference of approach taken by the Consultative Document, affect multiple step or composite transactions.

The scope of a composite transaction

3.2 Our definition proposed that a multiple step transaction should comprise [31]—

> "A transaction that is carried out in more than one step, to the extent that a subsequent step was planned or envisaged by the time when the first step was taken. In this context it is unnecessary for the precise nature or timing of a subsequent step to have been planned so long as the general nature of such step was planned or envisaged and its implementation was expected."

3.3 The Consultative Document omits the words we have underlined. A transaction is a composite transaction "even if it is not then known what the precise nature of the other step will be or whether it will be taken".[32]

3.4 Both the TLRC Report and the Consultative Document reject the judicial approach that the steps in a composite transaction must be preordained, that is practically certain to happen.[33] The question is whether the steps of a composite transaction need only be planned or envisaged or whether the definition ought also to express some expectation that each step of the composite transaction will occur.

3.5 It is apparent that our formulation requires a higher standard, involving inquiry into what the taxpayer was aiming at and what he was expecting to happen. In either case the inquiry is likely to be conducted with the benefit of hindsight, which may colour the conclusion. But we think that the definition proposed by the Consultative Document sets too low a standard. A simple illustration of its application is the acquisition of an asset by a group company that has a realised loss, the aim being to ensure that the loss is available to offset any profit that may arise should the asset be sold.[34] At this level, all manner of transactions designed to conduct on-going commercial operations on a tax efficient basis are brought within the scope of the GAAR, multiplying further the impact of the Rule and the need for clearances.

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[31] TLRC Report, page 40, illustrative clause 5(d).

[32] Consultative Document, page 19, paragraph 6.7.10.

[33] See TLRC Report, page 41, paragraphs 5.23–5.25.

[34] Without detailed rules giving relief within a group for capital losses this represents basic group tax planning. The use of "bought in" profits and losses is already subject to detailed anti-avoidance rules.

The tax avoidance purpose

3.6 The TLRC Report also considered how the tax avoidance purpose ought to be applied to a composite transaction. We proposed that [35]—

> "Where a transaction is a multiple step transaction, it shall be regarded as a tax driven transaction not only if, taken as a whole, it falls within (a) above but also where the avoidance of tax is the [sole] purpose of any step in the transaction."

3.7 It is appropriate to note that our concept of a "protected transaction" extended to a composite transaction so that [36]—

> "When a transaction is a multiple step transaction, it shall not apply where that transaction (taken as a whole) is entirely or mainly a protected transaction."

3.8 The Consultative Document proposes that the rule should apply to a composite transaction if tax avoidance is one of the main purposes of any step in the transaction.[37] There is no explicit extension of the acceptable tax planning exception on a similar basis to that proposed by our concept of protected transactions.

3.9 We have considered further three aspects of this issue—

> 3.9.1 What should be the test applied to the individual steps of a composite transaction to bring it within the Rule? Is it (a) sole purpose; (b) **the** main purpose, or (c) **a** main purpose?
>
> 3.9.2 Should there be a further test (and if so what), by reference to the entire composite transaction, to determine whether the composite transaction falls with the Rule?
>
> 3.9.3 Assuming any step of a composite transaction satisfies the test, what should be the test, looking at the composite transaction as a whole, to allow the taxpayer to justify it as a protected transaction?

3.10 As regards 3.9.1, we accept that a sole purpose test is a high standard and that it may allow taxpayers in particular cases to devise reasons other than tax reasons for each step. It leaves an appeal tribunal to decide whether the claimed non-tax reasons were indeed real reasons for the step. The proposal in the Consultative Document, on the other hand, is that tax avoidance need only be a main purpose of any step. This would be in the context of a composite transaction that, as a whole, does not have tax avoidance as a main purpose. This is the broadest proposed formulation and its impact may depend on how in those circumstances the GAAR contemplates recharacterising the transaction or any step. Nevertheless, we think that this again sets too low a standard, bearing in mind practical commercial and administrative considerations.

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[35] TLRC Report, page 41, illustrative clause 5(e).
[36] TLRC Report, page 38, illustrative clause 3
[37] Consultative Document, page 19, paragraph 6.7.10.

3.11 As regards 3.9.2, the TLRC Report envisaged that the Rule would apply to a composite transaction that as a whole had tax avoidance as a main purpose, without the need to consider its individual steps. Assuming (as we did) the adoption of a higher standard for individual steps, the Rule would apply to counteract those steps even if the transaction as a whole did not have tax avoidance as a main purpose. The principal issue then is what degree of recharacterisation the Rule allows.

3.12 As regards 3.9.3, it should always be open to the taxpayer to show that the composite transaction as a whole is mainly or predominantly or substantially a protected transaction. This would be notwithstanding that a step within the composite transaction had tax avoidance as its sole purpose.

Protected transactions

3.13 The TLRC's illustrative clause proposed that the GAAR not apply to a transaction if the taxpayer could show that it was a "protected transaction". This was to be a transaction that satisfied one of three tests [38]—

> 3.13.1 A transaction that can reasonably be regarded as encouraged by legislation.
>
> 3.13.2 A transaction that falls within an exception to, or an exclusion from, other anti-avoidance provisions (that is to say, other provisions having the main purpose of preventing or counteracting the avoidance of tax).
>
> 3.13.3 A transaction that otherwise does not conflict with or defeat the purpose of the legislation.

3.14 The Consultative Document rejects 3.13.1 as insufficiently precise. In the context of a general rule, this does not seem a particularly serious criticism. 3.13.1 contains echoes of the distinction between tax avoidance and tax mitigation that the courts have begun to formulate. Lord Nolan in his speech in *IRC* v *Willoughby* said ([1997] STC 995 at page 1003h)—

> "The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option."

3.15 The Consultative Document adopts 3.13.3 in its definition of "acceptable tax planning".[39] It rejects 3.13.2 as such, pointing out that we envisaged that a GAAR would plug gaps left by specific anti-avoidance provisions and that avoidance

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[38] TLRC Report, pages 43–44, illustrative clause 5(g).

[39] Consultative Document, pages 15–16, paragraph 6.5.10.

schemes frequently exploit the terms of existing tax avoidance provisions. We acknowledge this point but it raises the issue of Parliamentary intention and on which side should the onus of showing it lie.

3.16 The Consultative Document incorporates our proposed 3.13.2 in modified form in the definition of "acceptable tax planning", so that the fact that [40]—

> "(a) the purpose of a transaction is to take advantage of a relief or allowance provided by the tax legislation, or
>
> (b) that a transaction is specifically excepted from an anti-avoidance provision,
>
> is an indication, but not a conclusive indication, that it is acceptable tax planning."

This is helpful but it should suffice that the taxpayer can point to an exception that indicates Parliament's intention not to tax in the circumstances. The Inland Revenue would then have to show why the exception is not relevant in the circumstances or ought not to apply in the taxpayer's case. This conflates 3.13.2 and 3.13.3.

3.17 As a practical measure to limit the occasions on which a clearance application under the GAAR will be required, we think that this qualification of "acceptable tax planning" will be little used. Taxpayers will need to seek clearance to ascertain whether the Inland Revenue accepts that the transaction falls within (a) or (b) above. We accept that any taxpayer that seeks to rely on our concept of a "protected transaction" may prefer to seek a clearance before proceeding. But the deficiency of the proposed GAAR is that it puts the entire burden on the taxpayer to claim exemption from the GAAR based on the definition of acceptable tax planning.

3.18 There may be a degree of overlap between the three limbs of our definition of a protected transaction. In addition, 3.13.3 explicitly refers to Parliament's purpose, which was the overriding requirement of illustrative clause 1. Existing anti-avoidance provisions, however, frequently incorporate overlapping language, in an effort to cover every eventuality.

3.19 In this case, we believe that the overlapping language serves to emphasise the character of the action that falls outside the scope of the GAAR and what it counters. It offers taxpayers the opportunity, once the Inland Revenue has established a prima facie right to tax, to show that the relief from tax that is sought and the methods used to secure that relief, ought not to be countered by the GAAR.

3.20 The limited version proposed in the Consultative Document, coupled with the other changes it makes, provides a less satisfactory outcome. In the end, the results of any changes to limit the safeguards we proposed will have to be measured by their impact on commercial transactions and the necessity for GAAR clearances.

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[40] Consultative Document, top of page 16.

CHAPTER 4. TAX CONSEQUENCES OF THE GAAR

Guiding principles

4.1 Recharacterisation of a transaction that falls within the GAAR presents a number of difficulties. We do not underestimate the importance of the recharacterisation rules but we think that it is probably inadvisable for the legislation to be over-prescriptive. What is needed is a clear statement of the guiding principles under which recharacterisation proceeds. In this respect we think that the principles should deal satisfactorily with such matters as double taxation, third party rights, the consequences for third parties of recharacterisation [41] and the enduring consequences of transactions that are subject to the GAAR.[42]

Negating the tax avoidance

4.2 In broad terms, a GAAR can approach its task in two ways—

> 4.2.1 It can set out to identify those transactions that were designed with a tax benefit in mind and reverse or negate that benefit.
>
> 4.2.2 It can take a transaction and ask whether the same result could have been achieved with different (less favourable to the taxpayer) tax consequences.

In either case (but to a greater extent in 4.2.2) the recharacterisation rule plays a part in identifying the transactions that fall within the GAAR because it illustrates what amounts to tax avoidance.

4.3 As a broad principle the permitted recharacterisation should bring the taxpayer within a specific charge to tax and ought to reflect a transaction which (absent tax considerations) would and could have been carried out. The Consultative Document states that [43]—

> "A GAAR should make it clear that the recharacterisation which it imposes should apply only for the purposes of countering the tax avoidance which the transaction was designed to achieve."

This places the Consultative Document closer in intention to 4.2.1 but we think that the practical effect of its proposals places it into 4.2.2.

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[41] The Consultative Document appears to suggest the contrary on page 21, paragraph 6.8.9.
[42] We think that the Consultative Document overstates matters when in paragraph 6.8.11 it expresses concern that the GAAR might itself become a tool for tax avoidance! The example in that paragraph does not appear to us to provide a good reason for excluding from the power of recharacterisation a power to ignore or modify the enduring consequences of the actual transactions where it is appropriate to do so.
[43] Page 21, paragraph 6.8.8.

4.4 The Consultative Document uses the expression "corresponding normal transaction" and defines this as "the transaction to achieve the commercial purpose that would have been adopted if tax avoidance was not a consideration".[44] But this needs to be read in conjunction with a proposed definition of tax avoidance that includes "not paying tax, paying less tax or paying tax later than would otherwise be the case".[45]

4.5 The words "not paying tax" and "paying less tax"[46] suggest that a corresponding normal transaction can be any transaction that achieves the taxpayer's commercial purpose and attracts a tax charge or a higher tax change than that arising in the actual transaction undertaken. This is extraordinarily broad and in its proposed formulation we think that it may be defective.[47] The timing issues that arise from "paying tax later than would otherwise be the case" also make it very difficult to say what the corresponding normal transaction may be and the same can be true of a composite transaction that includes within it an intentional omission.

4.6 As we noted in paragraph 2.9, it may be difficult to escape a broad definition of "tax avoidance". The main problem appears to be that the proposed formulation fails to recognise that tax avoidance as defined encompasses both acceptable and unacceptable tax planning. Thus, the permitted recharacterisation can proceed on the basis that not even prudent tax planning is allowed. In this respect we think that there needs to be a clear relationship between the proposed counter-action and the tax avoidance purpose that brought the transaction within the GAAR.

4.7 It is particularly important that there is a satisfactory limitation on the scope of the Revenue's power, as a taxpayer may not be inclined to appeal on the question of recharacterisation if it has accepted that the GAAR applies. As a procedural matter we think that a GAAR assessment should be required to state what the Inland Revenue claims is the corresponding normal transaction.

Composite transactions

4.8 The Consultative Document addresses the issue whether a composite transaction should be recharacterised as a whole or whether recharacterisation of individual steps (or a subset of steps) should be possible. Once a composite transaction is within the Rule, we think that the Rule should allow the recharacterisation of individual steps or subsets of steps, provided this respects the overall commercial objective of the composite transaction.

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[44] Consultative Document, page 22, paragraph 6.8.12.
[45] Consultative Document, page 14, paragraph 6.5.2.
[46] Less than what?
[47] We accept that the Consultative does not purport to express matters in legislative language and we note that the draft Finance Bill clause in the Consultative Document issued by HM Customs & Excise uses marginally different language.

CHAPTER 5. ADMINISTRATION OF THE GAAR

Procedure for invoking the GAAR

Content of a notice invoking the Rule

5.1 The Consultative Document accepts our view that the Board should invoke the Rule.[48] It rejects our suggestion that the legislation should set out the content of the notice invoking the Rule and other details.[49] The Consultative Document suggests that as an administrative matter the Board would specify the transaction to which the GAAR was said to apply and with what effect.

5.2 We think it unnecessary for the legislation to prescribe every aspect of a notice invoking the GAAR. We continue to believe, however, that its essential features, such as those mentioned in the Consultative Document, ought to be part of a statutory requirement.

Disclosure of a notice

5.3 The Consultative Document also rejects our proposal that the Board should give details to a recipient of the notice of any other persons affected by their exercise of the GAAR in respect of the same transactions. Our proposal was in the context of a requirement to give notice to every person whose tax liability would be affected by the application of the GAAR to the same transaction. The objection to such disclosure is that this would breach the Board's duty of confidentiality.

5.4 We accept that due respect should be accorded to taxpayer confidentiality. But our proposal should be viewed in context, i.e. in the context of a notice to persons involved in a transaction proposed to be counteracted under the GAAR. In those circumstances, we think that each taxpayer concerned should be informed who else has received notice and to what effect.

Internal review

5.5 The Consultative Document rejects our proposal for an internal review of the Board's decision to invoke the Rule.[50] The Consultative Document indicates, however, that the authority of the Board would be delegated to a section of the Inland Revenue's Head Office.[51] Given the delegation, we see no reason to change our view that the taxpayer be entitled to seek an internal review of the GAAR section's decision to invoke the Rule and its basis for proceeding.

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[48] Consultative Document, page 25, paragraph 7.1.

[49] TLRC Report, page 45, illustrative clause 6 and Consultative Document, page 25, paragraphs7.1 and 7.2.

[50] TLRC Report, page 46, illustrative clause 7 and Consultative Document, page 25, paragraph 7.3.

[51] Consultative Document, page 25, paragraph 7.1.

Dedicated appeals procedure

5.6 Illustrative clause 8 of the TLRC Report also incorporated a dedicated appeals process against the issue of a notice invoking the GAAR.[52] The Consultative Document rejects this.[53] We see no reason for changing our view on this aspect of our proposals. We think that the appeal would be made in all cases to the Special Commissioners and that their jurisdiction should be extended to allow them to take account of any general consents or other published GAAR material in reaching their decision.

Clearance applications

Restricting clearance applications

5.7 We are concerned that several proposals in the final Chapters of the Consultative Document are concerned to find administrative means of restricting the number of clearance applications. As the TLRC Report and this response make clear, achieving a manageable demand for clearance applications is a function of a sensibly targeted Rule. We do not regard it as a matter to be managed solely through administrative expedients.

The grounds for refusing clearance

5.8 The Consultative Document accepts our view that a GAAR must incorporate a clearance procedure.[54] The Consultative Document indicates that "a clearance would be refused in cases where it appeared that the GAAR might reasonably apply".[55] Given the breadth of the proposed GAAR, we are unsure that this formulation means a great deal. We assume that clearance would be refused only in those cases where on the available information, the Board would expect to invoke the GAAR (without prejudice to its right to decide otherwise in the light of the actual transaction).[56]

5.9 The Consultative Document indicates that a general explanation would normally be given in refusing a clearance. It reserves the right to refuse an explanation if it is thought that the clearance procedure is being used to test schemes.[57] In this

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[52] TLRC Report, page 47.
[53] Consultative Document, page 25, paragraph 7.3.
[54] Consultative Document, page 26, paragraph 8.1
[55] Consultative Document, page 26, paragraph 8.2.
[56] See the Board's practice in relation to s. 707 clearance applications, SP3/80, 26th March 1980.
[57] Consultative Document, page 36, paragraph 15.2. See SP3/80 in relation to s. 707 refusals. The Consultative Document suggests that the right to refuse an explanation would be subject to "the same controls" as apply in relation to a refusal to give a clearance. We think it rather unclear what precisely is intended here. If there is an appeal against the refusal the outcome may be the giving of clearance or a confirmation of the refusal. In the latter case, presumably the appeal body can give reasons if it wishes. We assume that an appeal is not envisaged solely against the refusal to give an explanation.

respect, requests for rulings on general provisions of the taxing Acts and clearances under specific anti-avoidance provisions differ from clearances under a GAAR. We think that the latter offers little scope to test schemes and that this makes it an unlikely eventuality. Only in exceptional circumstances should no explanation be given for refusing a clearance.

The use of an external clearance body

5.10 The Consultative Document indicates that clearances would be handled by a specialist section within the Inland Revenue but suggests that it might possibly use a separate clearance body outside the Inland Revenue.[58] We think it better that the matter be left to a specialist section of the Inland Revenue. This does not preclude the recruitment to the section of appropriately qualified persons from outside the Inland Revenue (as has been done in the case of the Tax Law Rewrite Project).

Insurance applications

5.11 The Consultative Document notes that some countries with rulings systems may refuse to give a ruling where the point of law at issue is considered clear. This is designed to discourage "insurance" applications by professional advisers.

5.12 We think that this suggestion is misconceived. A refusal to respond on these grounds would be tantamount to a clearance (and would be wholly misleading if the refusal were intended to indicate that the GAAR clearly applied). In any event, it appears a particularly inappropriate policy for GAAR rulings where the need to resolve the uncertainty created by the generality and scope of the legislation is paramount. We think that the Inland Revenue ought to be obliged to respond to all GAAR clearance applications.

Time limits

5.13 The TLRC Report proposed a response time for clearances of 30 days but the Consultative Document notes that few countries have so short (if any) deadlines.[59] It makes the suggestion that any time limit ought to be an administrative target rather than a statutory requirement and that any statutory requirement would need to specify a longer period.[60]

5.14 We appreciate that GAAR clearance applications may be longer and more complex than those involved in existing anti-avoidance clearance provisions. It may be appropriate, therefore, to specify a longer response period, for example 60 days, but we think that a period ought to be laid down in statute. This would not prevent the Inland Revenue from working to a shorter period as an administrative target.

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[58] Consultative Document, page 26, paragraphs 8.2 and 8.3.
[59] Consultative Document, page 33, paragraph 13.3.
[60] Consultative Document, page 34, question 11.

5.15 No statutory period will be ideal for many commercial transactions that may move at some pace. The changing detail of a commercial transaction may also make it necessary to confirm previous clearances. In this respect, we wonder whether the Consultative Document intends that a transaction must be carried out "precisely" as described in the clearance application.[61] Taken literally, this offers the company's professional advisers no latitude at all to decide whether, for example, a change to the transaction is a non-material change, requiring no clearance reconfirmation.

5.16 The real solution to this issue, however, is to frame the Rule so that it impinges as little as possible on commercial transactions. Companies and their advisers can then proceed with ordinary commercial transactions knowing that in most cases the GAAR is irrelevant to the transaction. Subject to that, we consider it an overriding requirement that the clearance section has whatever resources it needs to administer the GAAR properly.

Informal clearances

5.17 The Consultative Document suggests that an applicant might be able to make an informal approach to discuss particular aspects of the transaction with the clearance section in a non-binding way.[62] This seems entirely sensible but it seems unlikely to eliminate the need for a formal clearance application, if only to confirm any informal indication that the GAAR does not apply.

Information requirements

5.18 The Consultative Document makes proposals for the type of information that a taxpayer would have to supply in seeking a clearance. It suggests that this include [63]—

5.18.1 An analysis of the possible tax treatments of the transaction

5.18.2 A technical analysis that is sufficiently detailed for the Inland Revenue to understand fully the facts and the point at issue, including references to the relevant statute and case law.

5.19 We think that these requirements go further than is appropriate in the case of a GAAR clearance. The fundamental aspect of a transaction that may fall within the GAAR, is the need to consider hypothetical alternatives and the potential recharacterisation that might follow from an application of the Rule. In particular, in a commercial transaction, it seems unreasonable that a clearance may be invalid for lack of full disclosure because, for example, the application fails to disclose and discuss a way in which the company can achieve the same commercial end in a less tax efficient manner.

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[61] Consultative Document, page 26, paragraph 8.2.
[62] Consultative Document, page 34, paragraph 13.6 and question 12.
[63] Consultative Document, page 35, paragraph 14.3.

5.20 An alternative approach would be to require an applicant to state why it was making the application and to offer a description of the transaction bearing in mind the factors that are used to determine the purpose of the transaction,[64] but without having to describe alternative transactions or possible recharacterisations.

5.21 We agree with the suggestion in the Consultative Document that the details of clearance applications should be a matter of administrative practice, subject to the general requirement of full disclosure,[65] rather than a matter of statutory rule.[66]

Charging for clearance applications

5.22 The Consultative Document proceeds on the assumption that some charge will be made for clearance applications.[67] It justifies doing so on the basis that a "GAAR would not apply to most commercial transactions" and that it would only apply "to complex, and in the main fairly large transactions".[68] We regard neither of those statements as being truly accurate or a justification for charging.[69] We also think that the fact that "seeking a clearance would not be compulsory" also provides no justification for charging. Professional indemnity reasons (if not the client's desire for certainty) are likely to make clearance applications compulsory.

5.23 The Rule is enacted for the protection of the revenue and many applications will be in respect of commercial transactions for which clearance will be granted as involving only acceptable tax planning. In those circumstances some of us are strongly opposed to any idea that a charge be made for a clearance application. A taxpayer should not have to pay to confirm that his transaction is entirely acceptable for tax purposes. Others of us, however, feel that some charge can be accepted, if it secures the resources to administer the system properly and guarantees a satisfactory response time for commercial transactions. None of us, however, supports the idea of *ad valorem* charging arrangements.

Publication

5.24 The Consultative Document discusses the issues of publishing both specific clearance applications (in anonymised form) [70] and "general consents", to exclude transactions that would fall within the rule but for which clearance would be given.[71] We support both forms of publication and in relation to the latter, think that specimen general consents ought to form part of any consultation on the wording of GAAR legislation. We envisage that the general consents would be binding upon the Inland

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[64] Consultative Document, page 17, paragraph 6.6.4.
[65] As established in the *MFK Underwriting Agencies* and *Matrix Securities* cases.
[66] Consultative Document, page 35, question 13.
[67] Consultative Document, page 37.
[68] Consultative Document, page 37, paragraphs 16.1 and 16.2.
[69] As appears from this response, the proposed GAAR will affect large numbers of commercial transactions and, without any de minimis rule, the size of the transaction is no guide to the application of the GAAR.
[70] Consultative Document, page 31.
[71] Consultative Document, page 32.

Revenue until amended or withdrawn but that specific anonymised clearance applications would only provide non-binding guidance.

Appeals against clearance refusals

5.25 The TLRC Report suggested a paper-based appeal from a clearance refusal, similar to that currently available under s. 138 Taxation of Chargeable Gains Act 1992.[72] The Consultative Document says that such a system "might reduce the effectiveness of the GAAR". It also suggests that [73]—

> "The tax treatment of a transaction for which a clearance was sought and refused, on the grounds that it involved avoidance, could be settled by a single tribunal. That would be incongruous, since a completed transaction for which no clearance was sought could be considered at several levels in the appeals system."

We reject these and the other reasons given by the Consultative Document against our proposal. The consequences of a referral to the appeal tribunal are no different to those that flow from the granting or refusal of a clearance by the Inland Revenue.

5.26 We also reject the suggestion that the existence of a paper-based appeal would encourage clearance applications and appeals against refusals as a way of short-circuiting the normal appeal route.[74] We think that it would be a rare case for a taxpayer to proceed with a transaction having been refused a GAAR clearance by the Inland Revenue and for that reason the right to have the clearance application considered by an independent appeal body has importance.

5.27 We do not envisage that an appeal against the refusal of a clearance would go so far as involving every stage of the ordinary appeal in a consideration of a hypothetical transaction. We also think it unnecessary for the Inland Revenue to have an appeal right against the granting of a clearance by an independent body. If the clearance creates no binding precedent (even assuming publication), it can only be the tax involved in the particular case that is of concern.[75] If, despite that, the concern is that a clearance in a particular case might expose a loophole in the general taxing Acts, the solution is to correct those Acts, rather than rely upon the refusing or appealing clearances under the GAAR.

5.28 We see no reason therefore to alter our proposal for a paper-based single stage review of a clearance refusal. We have no objection to the appeal body being entitled to call for additional information or to hear representations in private by both parties, if it chooses.

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[72] TLRC Report, page 48, illustrative clause 9.

[73] Consultative Document, page 29, paragraph 10.7.

[74] Consultative Document, page 30, paragraph 10.7.

[75] Paragraph 10.4 suggests that complex and difficult legal issues could be settled at a low level of non-judicial authority. It is unclear to us why this need be so when it involves a decision by an administrative body on the particular facts of a case.

CHAPTER 6. OTHER MATTERS

Parliamentary scrutiny

6.1 The TLRC Report proposed that the Board of Inland Revenue be required to report each year to Parliament on the operation of the Rule.[76] We were mindful that the operation of a GAAR was akin to the Inland Revenue exercising a power to tax, or at least a power to say what it thought Parliament had intended to tax. As such, we thought that it appropriate to require a report by the Inland Revenue to Parliament giving details of how it had exercised that power. We reaffirm that view.

Self-assessment

6.2 We understand that the Inland Revenue envisages that the GAAR would form part of the corporation tax self-assessment system. It is unlikely that a company would undertake a transaction to avoid tax and negate the tax advantage in its return. This might arise if a transaction went wrong. The practical effect, however, is to open a taxpayer to the risk of interest on any tax subsequently found to be due following the application of the GAAR. It could also involve penalties if the Revenue alleged that the taxpayer's action amounted to the making of an incorrect return.

6.3 The TLRC Report considered the issue of interest and penalties under the GAAR.[77] We noted there that a specific penalty regime for GAAR cases may signal a particular view as to the type of case that falls within the Rule.[78] We expressed no final view on the matter in the TLRC Report and as the Consultative Document is silent on the issue, we express no final view here.

6.4 We think it unfortunate that this issue may go by default. The breadth of the proposed Rule suggests that there should be some discussion of the self-assessment issues that arise. The risk of interest and penalties may affect taxpayer and professional views of the Rule and further fuel the demand for clearances. Specific consideration of the matter might address what criteria were thought appropriate for an interest charge (and the date from which it runs) and what factors might lead to self-assessment penalties.

Effective date and transitional provisions

6.5 The Consultative Document is silent on the effective date of any GAAR and how (if at all) it would affect transactions or planning commenced before the Rule was enacted. This should be clarified in any further round of consultation, if the government decides to take its proposals further.

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[76] TLRC Report, page 49, illustrative clause 12.
[77] TLRC Report, Chapter 6.
[78] TLRC Report, paragraphs 6.19 and 6.20.