

The draft GAAR provisions of the Finance Bill 2013 (the “GAAR”) and the draft GAAR guidance

Response by the IFS Tax Law Review Committee¹ to the draft provisions and Consultation published on 11 December 2012 (the “GAAR Consultation”)

1. Introduction

1.1 The Tax Law Review Committee (“TLRC”) welcomes the publication of the further GAAR Consultation.

1.2 The TLRC’s role is to keep under review the state and operation of tax law in the UK. It does not seek to question Government policy as such but to look at whether particular arrangements achieve the stated policy in a satisfactory and efficient way. With that in mind the comments below seek to indicate how the TLRC perceives the proposals would work within the current system given the target and scope of the measure as explained in the Consultation.

1.3 Although the Government has amended the June 2012 draft legislation in some respects, the current draft GAAR legislation is not significantly altered. Many of the comments that we made in our response to the June consultation apply also to the current draft. In this note we focus on what we consider to be the core issues at the heart of the GAAR: the roles of Parliament, HMRC and the courts in the tax law making process going forward; the function of the Advisory Panel and the taxes to which the GAAR should apply.

1.4 In summary—

1.4.1 The GAAR represents a significant departure from the accepted roles of Parliament, the courts and HMRC in relation to tax law making. This change needs to be fully recognized and understood, not least by Parliament.

1.4.2 The appointment process for the Advisory Panel should be and be seen to be fair and open. The Panel’s role and independence should be guaranteed.

1.4.3 The drafting of the GAAR needs to be further addressed before it is applied to inheritance tax, SDLT and the annual residential property tax.

¹ This response has been prepared without the participation of either Professor Judith Freedman or Professor John Tiley, both of whom are members of the TLRC and were also members of the Aaronson GAAR study group.

2 The roles of Parliament, HMRC and the courts

- 2.1 The GAAR represents a significant departure from the accepted roles of Parliament, the courts and HMRC in relation to tax law making. We do not believe that this is properly acknowledged or satisfactorily dealt with in the legislation as currently drafted.
- 2.2 Until now it has been accepted that Parliament legislates and HMRC administers the tax system set out in that legislation as correctly interpreted. The Bill of Rights provides that no charge on the subject shall be levied by “pretence of prerogative” without the consent of Parliament. From this has followed the presumption that express statutory authority is needed before a tax can be imposed.
- 2.3 Within that framework it can readily be acknowledged that the meaning of particular tax legislation and its application to particular circumstances are often unclear. This may be for a variety of reasons:
 - 2.3.1 the particular factual context to which the legislation applies may be disputed;
 - 2.3.2 the application of the legislation may explicitly depend upon the taxpayer’s intentions or their purpose in entering into particular arrangements;
 - 2.3.3 the meaning of the legislative language may be ambiguous or unclear.
- 2.4 Nevertheless, where such circumstances arise, Revenue and taxpayers usually reach a consensus in most cases as to the meaning and application of the legislation in the particular circumstances that have arisen. Where they are unable to do so, the Tribunals or the Courts may be called upon to give a definitive judgment as to the correct meaning and application of the legislation in question. In doing so, the courts have shown that they do not see their role as limited to strict, literal interpretation of tax legislation: “The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.”²
- 2.5 One reason why the Government now proposes to introduce a GAAR is because the courts do not regard their role as filling gaps or correcting defects or shortcomings in the legislation. In other words, there are limits to the interpretation of legislation beyond which the judiciary will not go.

² Ribeiro PJ’s statement in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKFCA 46 at [35] as adopted by the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson* (2004) 76 TC 446 at 535, para [36].

- 2.6 The GAAR proposes to ‘remedy’ this situation by denying taxpayers the tax advantages to which they would otherwise be entitled if their arrangements cannot reasonably be regarded as a reasonable course of action in all the circumstances.³
- 2.7 In those cases in which the meaning or application of particular statutory provisions is disputed, the GAAR may often provide another string to the Revenue’s bow to enable it to defeat particular tax arrangements where previously the arguments would have focused solely on the correct interpretation or application of the legislation.⁴ Now, under the GAAR, the question can also be posed whether the taxpayer’s arrangements did or did not satisfy the double reasonableness test.
- 2.8 A conclusion that the taxpayer’s arrangements did *not* amount to reasonable tax planning may just mean that the taxpayer is taxed on the basis of the Revenue’s interpretation of the legislation or by reference to how they say it should be applied, rather than by reference to the way in which the taxpayer believed (or was advised) the legislation should be interpreted and applied when they entered into the arrangements.
- 2.9 This truth – or, if you like, the “*practical application of the GAAR*” in such circumstances – should not, however, disguise the fact that the GAAR may operate to impose tax where Parliament has in fact imposed *no tax*, purely by reference to a test of whether the taxpayer’s conduct is perceived to be reasonable tax planning or not.
- 2.10 It is proposed that if legislation has acknowledged “shortcomings” or gaps, HMRC can seek to fill in those shortcomings or gaps by invoking the GAAR against those taxpayers who seek to use them to achieve a tax advantage. Clause 2(2)(c) of the draft legislation and Part B of the Consultation Draft, setting out examples of how the GAAR applies to tax arrangements, frankly acknowledge this.
- 2.11 Parliament no longer need legislate to correct defective legislation (whether or not it in fact chooses to do so). Indeed, it need no longer be particularly concerned with the accuracy of its legislation in the first place. Explicit statutory authority is no longer needed to tax. Taxation may depend upon the particular perception of the taxpayer’s actions.
- 2.12 We do not intend to suggest that in future the Government or Parliament or the Revenue will no longer be concerned with the accuracy of tax legislation or to correct defects. Nevertheless, this change to the way in which the UK tax system operates should not be underestimated.
- 2.13 After the GAAR, the Revenue can assert that notwithstanding the legislative language, the tax outcome for taxpayers should be different. If a taxpayer enters into a

³ For ease of reference we refer hereafter to this test as the “double reasonableness” test or as “reasonable tax planning”.

⁴ It might also be anticipated that the GAAR will deter arrangements that might otherwise have sought to test uncertainties as to the correct meaning and application of particular legislation

transaction where HMRC consider that the legislation should apply although on its face it clearly does not, HMRC can say that the transaction is abusive as defined by the GAAR because, “in relation to the relevant tax provisions ... the arrangements are intended to exploit any shortcomings in those provisions”.

- 2.14 It will therefore be the position that tax, for which on no construction of the existing legislation would the taxpayer be liable, can be imposed *ex post facto* and the body deciding whether to seek that result will be HMRC. If the GAAR is to be applied even-handedly between taxpayers it seems to us that HMRC will be bound to consider in every case whether the GAAR provisions apply and if they consider that they do, they will be bound to apply them.
- 2.15 At the same time, however, the consultation document acknowledges that the same arrangements – both equally contrived or abnormal and designed to exploit shortcoming – but carried out in different circumstances, may lead to different tax results according to the GAAR analysis.
- 2.16 The GAAR also affects the role of the courts. Exploiting gaps and shortcomings in tax legislation is a matter to which the Courts will have to have regard in deciding whether tax arrangements are abusive. So ultimately the courts will have been given the role of filling gaps and correcting shortcomings in the legislation.
- 2.17 Recognising this effect of the GAAR, we have two particular comments to make:
- 2.18 First, Clause 2(2)(c) should be deleted from the draft. We have previously observed that if the legislation is clear but wrong or clear but leaves open gaps, taxpayers should not be required to guess whether Parliament intended something else to have been written or intended that their situation should have been addressed. The responsibility for inadequate or badly drafted legislation should remain with government. It should not be shifted to taxpayers. If a taxing rule does not apply to a transaction, is that a shortcoming or an intentional omission? Unless specific comment or explanation was given when the legislation was introduced, the answer to this question can only be determined by reference to principles of statutory construction, having regard to underlying principles or stated policy objectives.
- 2.19 We do not think it right that the GAAR should offer any support to government that is ultimately the person responsible for defective legislation. Tax avoidance is a product of the tax base and its particular qualities. To include in the GAAR provisions which enable it to be said that relying on shortcomings in the legislation is an “abuse” is a discouragement to tackling the system properly. The adoption of the description “abuse” does not limit the concerns mentioned above because “abuse” is defined by the provisions to mean arrangements which fail the double reasonableness test as judged by reference to the circumstances *including the exploitation of legislative shortcomings*. Similarly the words “artificial” and “contrived” do not limit the scope of the GAAR as a great deal of “sensible and responsible tax planning” includes features that can only be described as both contrived and artificial in the sense that such

planning involves transactions or arrangements that would not ordinarily be undertaken in the absence of taxation.

- 2.20 Second, we continue to believe that the counteraction provisions in Clause 4 are inadequately expressed. In effect, they fail openly to acknowledge that the GAAR may operate to tax in circumstances in which Parliament has imposed no tax charge. In this respect, we think that it is inadequate just to specify the making of “just and reasonable adjustments”. This is particularly the case given the range of taxes to which the GAAR is proposed to apply. At the very least we think it is necessary to make clear that tax is charged by reference to whatever alternative arrangements the Revenue propose to counteract the tax advantages that would otherwise arise from the taxpayer’s arrangements.

3 The Advisory Panel

- 3.1 What is or is not reasonable tax planning is incapable of objective determination. In practice this means that the role of the Advisory Panel is crucial as an independent arbiter and check on the scope and application of the GAAR. While, ultimately, the final arbiters are the judges, in practice few cases may be litigated. Experience in other jurisdictions also suggests that it may be several years before a body of case law (or even one case) is established. The Advisory Panel therefore provides a fundamental safeguard⁵ against the inevitable uncertainty that surrounds the scope and application of the GAAR and guards against its inappropriate extension via non-statutory Revenue guidance over time.
- 3.2 Given the importance of the Advisory Panel, it is vital that it is seen as an independent body. The consultation draft on the GAAR procedure suggests at paragraph 2.2 that the Panel members are appointed by the Commissioners on the basis of the advice of the Chair, but that alone appears insufficient. While the role of the Advisory Panel is not, and is not intended to be, a judicial or quasi-judicial role, it is nevertheless essential that the Panel act in a judicial manner, without fear or favour for Revenue or taxpayer. The recruitment and appointment process to the Advisory Panel needs to be and to be seen as a fair and open process and should support the Panel’s independent status. We would hope to see an open and independent selection process as is used for other public appointments. There should be a clear period of tenure and continuation in office should not depend upon the Commissioners of HMRC. The Chair and Panel members should be paid, possibly at a daily rate similar to that applicable to Tribunal members.
- 3.3 A key aspect of the Advisory Panel will be its composition. As we have previously commented, we think that this may present some difficulties. Ideally, a Panel member from the private sector should have appropriate tax or business experience in the particular sector concerned. The consultation draft on the GAAR procedure appears

⁵ The others are the double reasonableness test and the placing of the burden of proof on the Revenue.

to recognise this by acknowledging the need for “relevant expertise” and for Panel members to be particularly well-placed to offer reasoned opinions. Inevitably, however, such individuals may have a conflict of interest, not directly in terms of their connection with the taxpayer concerned but indirectly in terms of their involvement in tax planning generally.

- 3.4 Many of the tax schemes that have been examined by the courts in recent years have been used in one form or another by many of the major accounting or law firms. It is difficult to see how a Panel member who continues to be associated with such firms could be regarded as an independent member of the Panel, free from considerations of other arrangements that may have been promoted by his firm and the views their firm may have taken on the scope and application of the GAAR. We recognise that in order to get the right levels of expertise on the Panel this issue may be unavoidable. If recognised, however, it can be addressed even though it may necessitate the appointment of a larger number of individuals to the Panel than might otherwise be the case to ensure that there is a suitable number from which to select an appropriate sub-panel on any referral.
- 3.5 We think that the manner of appointment, tenure and payment of Panel members ought to contribute to the perception that Panel members do act independently when carrying out their Panel duties and are not, so as to speak, in the pay of their companies or professional firms.
- 3.6 We comment separately in the Appendix on some issues that arise in relation to the Advisory Panel approved GAAR guidance and on the proposed Advisory Panel procedure.

4 The taxes covered by the GAAR

- 4.1 We have commented previously about the taxes covered by the GAAR and our comments below are not new, save that we believe the same issues arise in relation to the annual residential property tax as well as SDLT and inheritance tax.
- 4.2 In summary our comment is that it is for government to decide which taxes should be covered by the GAAR but the wording of the GAAR for each tax needs to be appropriate. It is not sufficient to leave it to HMRC or the Advisory Panel to produce an explanation of how legislation, which on its face does not fit with the structure of certain taxes, should be modified or interpreted in order to make it fit. For these reasons we believe that more work is needed in this area. The extension of the GAAR to those other taxes should be subject to a separate consultation followed by implementation of more appropriately tailored provisions at a later date. For ease of reference we set out below our previous comments, with some modification to allow for the December consultation.

- 4.3 The scope of the GAAR in terms of the taxes to which it should apply is a matter for Government. Most GAARs apply to taxes on income and profits (including capital gains) but there is no reason in principle or concept why a GAAR should not apply to any tax. There is less need in the case of some taxes because they are by design more robust to avoidance and therefore less vulnerable to artificial and abusive schemes.
- 4.4 The central question, therefore, is not whether a particular tax should be protected by a GAAR. It is whether the particular design of the GAAR is suited to the tax in question. In the present case the majority of the debate surrounding the introduction of a GAAR has been in the context of taxes on income and profits, in particular its effect on business competitiveness. Little consideration has been given to the issues that such a rule might pose for a tax such as inheritance tax.
- 4.5 One of the problems with the application of the GAAR (as drafted) to inheritance tax, stamp duty land tax and the annual residential property tax is that the examples of what should be taken into account ("GAAR criteria") to determine whether arrangements are abusive do not work in those contexts. As we have said before, we think that it is for HMRC and the Government to articulate such GAAR criteria in the legislation rather than to leave the matter at large for taxpayers, their advisers, the Advisory Panel and the Tribunals to guess at.
- 4.6 Considering the example of inheritance tax further to illustrate this, there are various problems with the current drafting. The application of the GAAR to inheritance tax raises another issue derived from the purpose test. The purpose test in this context would seem completely redundant as, almost without exception, any arrangements entered into will have the purpose of, or one of the main purposes of, obtaining a tax advantage.
- 4.7 In addition, the inheritance tax code is extremely complex and unwieldy. It will be significantly more difficult in the context of that legislation to say what is or is not a reasonable course of action. In particular, the interaction of many inheritance tax provisions often lacks any apparent principle or policy objective. The tax is immediately derived from Capital Transfer Tax, which was converted back to an Estate Duty model. The principles and policy of the tax as it has developed over the years may as a result be unclear.
- 4.8 Inheritance tax may well raise issues for the assessment of particular arrangements and the ability to form a judgment on them some time after the event (especially when one or more participants may be deceased).
- 4.9 Finally, we have noted the IHT examples contained in Part B of the GAAR Consultation draft. These do not give us confidence as to the way in which the Revenue anticipates the GAAR applying in this field.

5 Conclusion

- 5.1 We welcome the opportunity to comment on the provisions and would be happy to contribute to any further discussions about the proposals.

IFS Tax Law Review Committee
8th February 2013

Appendix

The Advisory Panel

The following are some more detailed comments on the role and procedure envisaged for the Advisory Panel by the draft legislation.

1. GAAR Guidance

- 1.1 The draft legislation requires that a court or tribunal must take into account HMRC's guidance about the GAAR that was approved by the GAAR Advisory Panel at the time the tax arrangements were entered into. However, it is otherwise silent above the development of such guidance and its approval by the Panel.
- 1.2 We accept that the principal responsibility for producing GAAR guidance appropriately lies with HMRC. Nevertheless we think that the legislation should provide that HMRC may only produce and publish GAAR guidance with the approval of the Panel. HMRC should not be in a position to produce unapproved GAAR guidance that might then be amongst the other materials that a court or tribunal takes into account.
- 1.3 It is unclear from the legislation how the Panel is to approve guidance: whether the Panel must be unanimous in its approval, whether approval can be by a majority of the Panel or whether the guidance will be approved by the Panel Chair in consultation with Panel members. As drafted it appears that the Panel must unanimously approve the GAAR guidance.
- 1.4 Paragraph 2.3.2 of Part C of the Consultation draft states that, "each approval by the Advisory Panel lasts until a subsequent approval is given". This statement is opaque. Is it intended that the entirety of the GAAR guidance should be considered and approved at a particular interval, or added to and amended on an ad hoc basis?
- 1.5 The Advisory Panel should of its own initiative be entitled to withdraw its approval or to require that HMRC review and/or amend the GAAR guidance and resubmit it for re-approval.

2. GAAR Procedure

- 2.1 It would seem sensible to make provision for the 45 day limit in paragraph 4 of the procedural schedule to be capable of extension with the agreement of the designated officer.
- 2.2 We assume that if no representations are made, the reference under paragraph 5 of the Schedule must take place immediately following the expiry of the 45 days specified by paragraph 4. This could be stated explicitly.
- 2.3 We believe that paragraph 6(2) should incorporate a specific time limit (possibly 60 days) at the end of which the designated officer must either refer the matter to the Panel or drop the matter. The time limit might be capable of extension on some specified basis (possibly with the taxpayer's agreement).

- 2.4 We believe that the 14 days allowed for the taxpayer to send representations or comment under Paragraph 9(1) of the Schedule is unreasonably short. At least 28 days should be allowed.
- 2.5 Paragraph 10(1) might require the appointment of a sub-panel within a specified time.
- 2.6 The number of sub-panel members is fixed. It is unclear, however, as to what should happen if an appointed sub-panel member should subsequently become indisposed or if it should turn out that they have a conflict of interest. Provision might, for example, be made for replacements to the sub-panel at any time prior to the sub-panel having delivered its opinion.
- 2.7 The question arises as to how the sub-panel should be constituted if no (or insufficient) currently appointed members of the Advisory Panel have relevant expertise or experience for the matter that has been referred. The question arises as to whether ad hoc temporary appointments might be made for particular referrals.
- 2.8 It is unclear how a sub-panel is intended to deal with a case in which HMRC may be disputing the facts as presented by the taxpayer. As Part B of the GAAR Consultation draft notes, "*whether the GAAR will or will not apply depends on subtle nuances of fact*". On the assumption that the sub-panel will have neither means nor the procedure to resolve such disputes, it is possible that the sub-panel's opinion may have to be given on the basis of particular assumptions, and the opinion may be different depending on the alternative assumptions made. Paragraph 11(3) could recognize that possibility.
- 2.9 It seems likely that the Chair and Panel members may require administrative support for the proper performance of their functions. On the assumption that this will be provided by HMRC, consideration needs to be given to the basis upon which this is done so as not to compromise or to appear to compromise the independence of the Advisory Panel.

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