

The GAAR study

Response by the IFS Tax Law Review Committee¹ to the Consultation Document “A General Anti-Abuse Rule” published on 12 June 2012 (the “GAAR Consultation”)

1 Introduction

- 1.1 The Tax Law Review Committee (“TLRC”) welcomes the publication of the 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 GAAR Consultation.
- 1.3 We start by commenting on the target and scope of the measure as explained in the GAAR Consultation. We then respond to the list of consultation questions summarized in Chapter 9 of the Consultation document.

2 The Target and Scope of the proposed GAAR

“Contrived, artificial and abusive”

- 2.1 The Introduction and Chapter 2 of the GAAR Consultation set out the background and intended target and scope of the proposed GAAR. In summary, the principal aims of the measure appear to be as follows—
 - 2.1.1 To target “artificial and abusive” tax avoidance
 - 2.1.2 To provide certainty and fairness for taxpayers
 - 2.1.3 To maintain the attraction of the UK as a location for business investment and activity

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.

- 2.1.4 To minimize the costs of the measure for business and for HMRC
- 2.2 The Aaronson report concluded that the introduction of “a broad spectrum general anti-avoidance rule” would not be beneficial for the UK tax system. In particular, such a measure would carry a real risk of undermining the ability of business and individuals “to carry out sensible and responsible tax planning”. Such tax planning “is an entirely appropriate response to the complexities of a tax system such as the UK’s”.
- 2.3 The Aaronson report was therefore clearly focused on the introduction of a rule that was limited to schemes that could be regarded as ‘contrived’, ‘artificial’ and ‘abusive’, so that the rule would be limited in its application, would not confer unwanted discretion on HMRC and could be justified without the need for any clearance procedure.
- 2.4 Our understanding is that the Government accepted and adopted these criteria and that they provide the policy framework against which the current proposed legislation should be judged.
- 2.5 In considering whether the current proposals meet these policy objectives, it must be borne in mind that the proposed GAAR necessarily retains the central feature of any GAAR, whether of a broad or limited spectrum character, namely that it seeks to deny the ordinary tax consequences of a taxpayer’s arrangements.
- 2.6 A GAAR has no application where under ordinary tax law (purposively construed in accordance with the *Ramsay* principle) the arrangements fail to confer the tax advantage that the taxpayer seeks. The fundamental characteristic of any GAAR, therefore, is to define the circumstances in which otherwise successful tax planning is rendered ineffective and, that being so, in what way the tax advantage that would otherwise accrue is to be counteracted.
- 2.7 Having regard to the policy objectives underpinning the current proposals, this involves defining one of two things:
- 2.7.1 The legislation could seek to describe the characteristics that define what is regarded as “contrived”, “artificial” and “abusive” in this context.
- 2.7.2 Alternatively, the legislation could seek to describe the characteristics of “sensible and responsible tax planning”.
- 2.8 The fundamental problem with the first of these approaches is that a great deal of “sensible and responsible tax planning” includes features that can 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. This is implicit in the Aaronson

report's recognition that "sensible and responsible tax planning" is an appropriate response to the complexities of the UK tax system. Those 'complexities' force taxpayers to do things that they would not otherwise do in ways that they would not otherwise contemplate for the purpose of reducing or avoiding particular tax burdens or tax consequences.

- 2.9 The GAAR Consultation recognizes this in so far as it does not attempt to define either what is contrived or what is artificial. Instead it concentrates on the quality of "abusive". The claim, however, that Clause 1(1) of the draft legislation makes clear at the outset that the purpose of the GAAR is to counteract abusive arrangements is in our view of little relevance or effect because "abusive" in this context is no more than what the legislation defines as "abusive". We do not agree with paragraph 3.5 of the GAAR Consultation, therefore, that Clause 1(1) "should make it easier for taxpayers and their advisers to consider and interpret the provisions that follow" or "help them to conclude quickly that the GAAR has no application". The ease of interpretation and application can only be determined by reference to the following provisions and not by reference to Clause 1(1).

"Tax arrangements"

- 2.10 In this respect, there is little to limit the application of the GAAR by reference either to the definition of "tax arrangements" or of "tax advantage". "Tax arrangements" include arrangements that have a tax advantage as "one of their main purposes". Tax will almost inevitably be 'one' of the main purposes of most tax planning (whether reasonable or abusive) and a more limited formulation (such as "sole or main purpose") would therefore seem more in keeping with the policy objectives of the measure. The critical aspect of "tax arrangements", however, is how one identifies an arrangement and, in particular, whether an "arrangement within an arrangement" is an arrangement for these purposes.
- 2.11 The GAAR Consultation acknowledges in relation to Clause 7 that an arrangement may be a transaction or a step within a larger arrangement. Paragraph 3.8 of the GAAR Consultation suggests that "incidental steps" taken to minimize a tax liability arising from an arrangement will not usually constitute a main purpose. If, however, the incidental steps are themselves regarded as an arrangement, the main purpose (possibly the sole purpose) of that "arrangement within an arrangement" will be the tax advantage that those steps confer on the broader arrangement. We think, therefore, that the scope to ignore "incidental steps" is likely to be rather limited and that the main purpose test therefore provides little or no protection as a feature of the GAAR against the GAAR's potential application.

- 2.12 This conclusion appears to receive some confirmation from paragraph 3.9, which accepts that certainty must be sacrificed to an extent to eliminate the possibility that “abusive” schemes might escape counteraction. A particular example might be the sale by a company of a business. We assume that the choice by controlling shareholders to procure the sale of a company’s business (possibly followed by a distribution of the proceeds) rather than to sell their shares would be classified as reasonable tax planning, even though the tax consequences of the two courses may be very different and tax may be an important aspect of any choice. As part of the sale of the business, however, it might be agreed that the sale of the assets subject to SDLT takes place in a particular way to avoid the application of SDLT. The purpose of the arrangements overall is to sell the business; it is only the purpose of a particular part of the arrangements to avoid SDLT.

“Tax advantage”

- 2.13 The concept of tax advantage, as paragraph 3.18 of the GAAR Consultation acknowledges, is intended to have a very wide meaning. We note that the Consultation dispenses with the concept suggested in the Aaronson Report that the tax advantage should be “substantial”. However, we think that the consideration should be given to ignoring any tax advantage that is merely incidental to the arrangements as a whole.
- 2.14 As we observed in paragraph 2.11, the scope for “incidental steps” is likely to be limited by the fact that such steps, even if incidental to a larger arrangement, may themselves amount to an arrangement that falls to be assessed under the GAAR. We recognize the need for this approach given the possibility of wrapping “abusive” arrangements within “commercial” arrangements as an obvious way of seeking to side-step the scrutiny of the GAAR. A more sensible approach to consider may be whether, in the context of the arrangement as a whole, the tax advantage conferred by the “arrangement within an arrangement” is a significant or substantial tax advantage or only incidental to something larger.

“Reasonable tax planning”

- 2.15 Absent some restriction on the definition of “arrangements” and “tax advantage” it seems to us that the limitation on the GAAR depends almost entirely upon the definition of “abuse”. In this regard, the GAAR seeks to define abuse by reference to a concept of “reasonable tax planning” rather than by identifying the characteristics of what amounts to “abusive” tax arrangements.
- 2.16 In terms of the scope and application of the GAAR, therefore the practical consideration that it presents is that all tax planning must pass a “GAAR

check". In other words, all tax planning must be capable of description as "reasonable tax planning". While the scope and application of this test is limited in legal terms by the "double reasonableness standard" and by the fact that the burden of showing that the tax planning fails this standard is placed on HMRC, in reality we think that taxpayers will ordinarily require some assurance in respect of most tax planning arrangements that they can be viewed as 'reasonable' steps to mitigate or minimize their taxation liabilities.

- 2.17 While Clause 2 of the draft legislation requires that the "reasonableness" of any tax planning is to be determined by reference all the circumstances, including three specified circumstances, this appears to add relatively little to the test. This is because in most cases whether a course of action is reasonable or not is something that has to be tested by the circumstances of the case. In particular, the inclusion of "the relevant tax provisions" (including the factors referred to in clause 2(3)) may be of relatively limited value when it is borne in mind that the relevant tax provisions operate to confer the tax advantage (possibly after the application of a TAAR) that the GAAR is seeking to deny. Furthermore the value that attaches to the "indicia" provided by clause 2(4) is qualified by clause 2(5).
- 2.18 We think it clear, therefore, that as with any GAAR, the current proposals will inevitably create uncertainty for any tax planning activity. This uncertainty is only likely to be resolved in the medium term by the 'extra-statutory' guidance as to what is thought to be 'reasonable' tax planning. In the ordinary course of matters many years are likely to elapse before any significant body of case law on the GAAR accumulates and even then it cannot be certain to what extent any body of case law will be of general application rather than limited to the particular facts of the case. One appropriate approach to the production of the initial guidance may therefore be to review past tax avoidance cases in which the taxpayer has succeeded against the Revenue's arguments to identify whether they represented reasonable tax planning or not, what characteristics identify them as 'abusive' and how they might be counteracted under the GAAR.
- 2.19 A key element of the Aaronson proposals underpinning the principles that we summarized in paragraph 2.3 above was the adoption on a statutory basis of an Advisory Panel and the use of the Panel to produce the GAAR guidance. We are disappointed that the opportunity has not been taken to develop the idea of the Advisory Panel further at this stage of the GAAR Consultation. It is an aspect of the GAAR proposal that requires care and attention and early consideration to ensure that the structure, composition and operation of the Panel that is eventually adopted commands general

support and will work as intended, in particular to provide the assurance that this proposal does not confer unwanted discretion on HMRC.

- 2.20 We understand that it is the Government's current intention that HMRC should produce interim guidance with the next draft of the legislation in December and that HMRC's interim guidance may be used in piloting the legislation through Parliament. Furthermore, the current proposal envisages that the GAAR would take effect from April 2013. All of this will inevitably occur before any Advisory Panel can be appointed and produce its guidance. Any interim guidance is bound to be seen as HMRC's guidance. While HMRC must inevitably have its own view on the GAAR, we think that this way of proceeding tends to undermine the idea of the Advisory Panel and its role in the implementation and operation of the GAAR. To secure its independence the Advisory Panel must be free to accept or reject or elaborate the interim guidance as it thinks fit as and when it is appointed. Further consideration should be given to this manner of proceeding and if appropriate to deferring the effective date of the GAAR until the Panel has been formed and is in a position to issue its guidance.

Our general assessment of the proposals

- 2.21 Our general assessment of the proposals relative to the Government's stated policy aims and intended target and scope of the proposed GAAR is therefore as follows—
- 2.21.1 The proposed GAAR requires that all tax planning arrangements qualify as 'reasonable tax planning'. The 'targeting' at abusive arrangements is largely achieved through the 'double reasonableness test' and by placing the burden on HMRC to show that no person could reasonably believe that the planning was a reasonable course of action. In legal terms this is a high standard. In practical terms, however, most taxpayers are likely to require some comfort that their planning is reasonable and will have to rely on the published guidance for that assurance.
- 2.21.2 The GAAR inevitably increases the uncertainty that attaches to any tax planning. This derives from the fact that it will no longer suffice to conclude that particular tax provisions secure a particular tax result: that result must be achieved in a way that can be regarded as reasonable.
- 2.21.3 The implication of the GAAR is that different taxpayers may be subject to different outcomes according to whether the GAAR operates to disapply or not the basic provisions of the tax code. Whether that is fair or not may depend on the circumstances of the

case. There will inevitably be unfairness if the GAAR is unevenly applied between taxpayers.

2.21.4 In the absence of any formal clearance procedure there may also be unfairness if some taxpayers are in a position to obtain a formal or informal assurance that their tax planning is unaffected by the GAAR while other taxpayers are unable to get that assurance for similar planning. We remain of the view that in the case of transactions which incorporate a statutory clearance procedure and where HMRC is asked under those provisions to consider whether a transaction is part of avoidance arrangements, a taxpayer should also be able to ask HMRC to confirm that the GAAR will not be invoked in respect of the arrangements or any element of them.

2.21.5 Whether or not and to what extent the GAAR affects the attraction of the UK as a location for business is likely to depend upon the degree of certainty and assurance that inward investors are able to secure for any tax planning. The standard of the published guidance and the procedural safeguards that are put in place to control the application (or threatened or perceived application) of the GAAR are also likely to be important.

2.21.6 There will be some cost inevitably and unavoidably involved in the introduction of this measure. It becomes one further element on which taxpayers must be satisfied before concluding that any tax planning arrangements have the desired effect.

2.22 Any provision dealing with avoidance will have some areas of uncertainty. It is important that there is not a mismatch of expectations. As far as the public's expectation of the GAAR it should be understood that it will not deal with many of the matters which have occupied the media headlines in recent times.

2.23 In addition, it will take some years for the provisions to bed down and for HMRC and the taxpaying community to judge how well the provisions are working. The GAAR will not provide a "quick fix" to the problems surrounding tax avoidance. Before, the question facing taxpayers was how the legislation taxed varying choices of action. Now the question shifts to one of whether the action taken cannot reasonably be regarded as a reasonable course of action notwithstanding that it would otherwise achieve the particular tax outcome prescribed by the Act.

3 The GAAR Consultation Questions

3.1 ***Question 1 - Do you agree that the GAAR should be limited to the taxes and duties set out in clause 1(3) of the Draft GAAR initially? Are there any particular issues relating to how the GAAR would function in relation to the taxes (including NICs) that are proposed to be included?***

3.1.1 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.

3.1.2 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.

3.1.3 We think that it would be wrong to believe that the application of the GAAR to inheritance tax (or, indeed, to any part of the personal tax system as compared to the business tax system) will have no impact on the competitiveness of the UK tax system. The possibility that the rule may impact on tax planning strategies by individuals ordinarily based outside the UK who are thinking of coming to the UK or who are considering whether to invest in UK assets may raise competitiveness issues.

3.1.4 In relation to its application to UK persons ordinarily within its scope, however, a GAAR raises issues that are specific to IHT and which will need further consideration. First, the context of inheritance tax is not a commercial one and those involved in IHT planning are not usually dealing with each other at arms' length. The indicia of abusive arrangements in Clause 2(4) are therefore inappropriate for a tax such as inheritance tax. Indeed, indicium (d) is likely to be found in every transaction that is relevant to the tax and provides no assistance in deciding whether an arrangement is abusive or not.

- 3.1.5 The position of family settlements and trusts in inheritance tax planning may also raise particular issues for the application of the GAAR to inheritance tax. This is not only in terms of identifying what is reasonable tax planning or an abusive arrangement but also in terms of the application of the GAAR to existing structures and determining the appropriate counter measures in any particular case.
- 3.1.6 Separate indicia may therefore need to be developed to take account of the different nature of the tax and to provide some indication of what are or are not regarded as the features of reasonable tax planning and of abusive arrangements in this context. Whether or not the proposed indicia in Clause 2.4 are thought to be adequate or clear, the attempt to set them out for income and capital gains taxes is an important feature of the current draft legislation and their existence will offer some guidance to those who will have to interpret the legislation (even though Clause 2.4 is qualified by Clause 2.5). It does not seem in keeping with the underlying policy of the proposals to apply the basic GAAR test of 'reasonable tax planning' to a tax but without providing any indication at all of what is considered 'unreasonable' or 'abusive'. It seems fair to suggest that it is for HMRC and the Government to articulate such indicia in the first place rather than to leave the matter at large for taxpayers, their advisers, the Advisory Panel and the Tribunals to guess at.
- 3.1.7 The application of the GAAR to inheritance tax also 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.
- 3.1.8 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. This impacts not only on the usefulness of the provisions contained in Clauses 2(3)(a) and (b) but also on the usefulness of Clause 2(3)(c).
- 3.1.9 Finally, the 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). This may be a particular consideration for the

transitional arrangements for the introduction of the GAAR (see paragraph 3.7.3 below).

3.1.10 For these reasons we believe that more work is needed in this area. Rather than distract the process and drafting of the legislation for the GAAR to apply to other taxes, we believe that the extension of the GAAR to inheritance tax should be subject to a separate consultation followed by implementation of a more appropriately tailored provision at a later date.

3.1.11 We also consider that there are specific issues to be addressed in the context of SDLT. The main purpose of the transactions to which SDLT applies will be to buy or sell the underlying asset(s). Transactions involving the avoidance of SDLT are unlikely to be entered into for a tax benefit per se. In some cases the indicator in Clause 2(4)(d) may be relevant but otherwise the indicators in Clause 2(4) are not appropriate. Again, consideration should be given to the development of separate indicia to provide some indication in relation to SDLT as to whether the arrangement represents reasonable tax planning or is an abusive arrangement in the context of this tax. Again, it seems fair to suggest that it is for HMRC and the Government to articulate such indicia rather than to leave the matter at large for others to guess at.

3.1.12 In relation to both IHT and SDLT consideration may also have to be given to whether or not it is appropriate to retain, or to retain without modification, existing broadly formulated anti-avoidance rules, such as section 75A Finance Act 2003 in relation to SDLT.

3.2 **Question 2 - *“Do you agree that the GAAR should be capable of counteracting UK tax advantages obtained under double tax agreements?”***

3.2.1 In principle we see no reason why the GAAR should incorporate a specific exclusion for UK tax advantages obtained under a double taxation agreement. Whether and to what extent particular tax planning can be regarded as a reasonable course of action may depend upon the particular treaty provision. Similarly, the consistency of applying the GAAR in any particular treaty context may depend upon the terms of the treaty in question. If there is doubt on the matter the point may ultimately be tested in the Courts. It therefore seems unnecessary for us to express any view on the matter.

3.3 Question 3 - “Do you agree that (1) the proposed “main purpose” rule serves as a useful filter, when coupled with the concept that arrangements must also be “abusive” and (2) a specific exclusion for arrangements without tax intent is not required? If you think a specific exclusion is required, please explain why.”

3.3.1 As we have explained in our opening remarks, we do not believe that the main purpose test will operate as much of a filter given the broad definition of arrangements. Any feature of a larger arrangement that is designed to produce a tax advantage may well be an arrangement in itself and therefore have as a sole or main purpose the production of a tax advantage.

3.3.2 We would also note that the Clause 2(1) adopts an objective test: i.e. whether having regard to all the circumstances, “it would be reasonable to conclude”. The GAAR Consultation suggests that in the light of this “filter” a specific exclusion for arrangements without tax intent is not required. A filter based on a taxpayer’s intent in entering into the arrangement, however, is subjective in nature, depending upon the taxpayer’s intent rather than on what a reasonable person would conclude about the purpose of the arrangement having regard to all the circumstances of the case. The GAAR Consultation therefore does not compare like with like.

3.3.3 This represents a departure from the proposals in the Aaronson report which envisaged a specific exclusion where transactions were entered into solely for business, investment, family or philanthropic reasons without any thought being given to the possibility of achieving an advantageous tax result.

3.4 Question 4 - “Do you agree that the proposed “double reasonableness” test operates as intended to counteract only artificial and abusive schemes (such as those described in Annex B)?”

3.4.1 We believe that the scope of the double reasonableness test is less clear than the GAAR Consultation suggests. In particular, as our introductory comments indicate, the test in practice is not really whether the arrangement is “artificial and abusive” but is likely to be whether any arrangement (or any feature of a larger arrangement) represents reasonable tax planning; the concept of “artificial” is not a feature of the draft legislation at all and “abusive” is merely defined in terms of what can reasonably be regarded as reasonable tax planning.

3.4.2 Judicial clarification is likely to be many years away and will therefore be of no assistance to determining the immediate

application of the GAAR, for which the published material will be the principle source of guidance.

- 3.4.3 We are not wholly convinced that all the schemes described in Annexe B of the Consultation are caught by the test. The *Mayes* decision illustrates the difficulty of being able to discern the purpose of particular legislative provisions as a guide to reasonable tax planning. The *D’Arcy* decision illustrates the difficulty of knowing when a taxpayer may or may not legitimately take advantage of a lacuna that exists in the legislation, in particular a gap left between two sets of statutory provisions. Both cases raise the question whether *any* arrangement that seeks a tax advantage based on such provisions is abusive or whether *some* arrangements may be regarded as reasonable (so that the tax advantage made available under the general law is undisturbed) while *others* are not so regarded (so that the tax advantage made available under the general law is denied).
- 3.4.4 The indicia in Clause 2(4) offer some indication of what type of arrangement may be regarded as reasonable or not but clause 2(5) to some extent operates to negate their benefit. As we have already noted, however, there are no readily applicable indicia if the GAAR is to apply to IHT and SDLT.
- 3.4.5 We understand the reasons for moving away from the concept of a choice of action afforded by the legislation. However, the responsibility for inadequate and badly fitting legislation should remain with government. It should not be shifted to taxpayers, leaving them with the task of discerning when they can rely upon the black letter law interpretation and when they must go behind that interpretation to discern some underlying purpose or meaning that would make it unreasonable to take advantage of poor or ill-fitting legislation. The draft GAAR puts the burden on the taxpayers of considering what is reasonable. When there are no identifiable principles underlying particular provisions this will be difficult. If a taxing rule does not appear to 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. It is not clear that the provisions in Clause 2(3) address this issue sufficiently. The word “exploit” in Clause 2(3)(c) suggests that the intention is that relying on opaquely drafted legislation is itself an indicator that the

arrangements are abusive regardless of how clear it is what principles should apply. We do not think it right that the GAAR should offer any support to government that is ultimately the person responsible for defective legislation.

3.5 Question 5 - “Do you agree that the counteraction provision in the draft GAAR is appropriate?”

3.5.1 As a basic approach it is difficult to disagree with the proposed adoption of a “just and reasonable basis” as the underlying principle for counteraction. We believe, however, that it is wholly inadequate to leave the matter there. Some clarity may be needed as to whether a “just and reasonable” response should represent a reversion to the “reasonable tax planning” outcome or a “no tax planning” outcome. It also has to be assumed that under the generally applicable tax provisions, absent the GAAR, the taxpayer will be entitled to whatever tax advantage the arrangement confers on him.

3.5.2 We think that the final legislation will need to confer extensive powers on HMRC to raise assessments, to deny repayment and to make whatever other appropriate adjustments are needed to achieve whatever is the “just and reasonable basis” in the circumstances. The proposed manner of counteraction must be separately appealable.

3.5.3 Although Clause 4(2) recognizes that counteraction may extend to any other tax to which the GAAR applies, it is unclear to what extent counteraction is limited to negating any tax advantage sought or by substituting some other form of arrangement which may operate to impose new charges to tax or relieve existing charges to tax and substitute others, whether of a tax within the GAAR or not. Consideration will also be needed of the powers needed to make consequential adjustments in the tax positions of other taxpayers apart from the taxpayer for whom a tax advantage is denied under these provisions. In this respect without special provision time limits may operate to prevent the reopening of closed years.

3.6 Question 6 - “The Government is continuing to develop its analysis regarding the appeals processes in relation to counteraction and consequential adjustments under the GAAR, and welcomes views which may inform detailed proposals to be published later in the year.”

3.6.1 The TLRC notes that the draft provisions do not set out the procedural steps which would be needed for the GAAR to be applied and look forward to seeing and commenting on these in due course.

3.7 *Question 7 - “The Government would welcome views on the options set out regarding commencement, how transitional arrangements should be dealt with, and whether there should be different rules for different taxes where appropriate.”*

3.7.1 Apart from the situation of inheritance tax (see paragraph 3.7.3 below) providing that the GAAR will apply to arrangements not completed before the effective date appears to have the benefit of the greatest clarity (it being recognised that there may still be argument as to what constitutes the relevant arrangements).

3.7.2 The more difficult case relates to arrangements that have been completed (i.e. fully put in place) before the effective date but where tax advantages continue to be derived from the arrangements after the effective date. On balance we do not believe that the GAAR should operate to negate any such tax advantages given that this would potentially allow unrestricted reconsideration of arrangements that have been fully put in place before the effective date.

3.7.3 This point may be particularly relevant to inheritance tax. In particular, we assume that the death of an individual after the effective date would not be regarded as the completion of arrangements entitling HMRC to invoke the GAAR in respect of arrangements fully made before the effective date. Inheritance tax raises difficult questions about the timing of the application of the GAAR to the tax. Many transactions will have been put into effect many years ago and may have been designed to continue for many years. The basic premise of the GAAR is to look at the purpose of the taxpayer at the time they enter into transactions and to judge whether those transactions are abusive, by reference to the prevailing practice and understanding at the time. We therefore suggest that the GAAR should only apply in the case of inheritance tax to arrangements first entered into after the effective date. Even with this there will be complex questions to address concerning the time at which arrangements are considered to be entered into bearing in mind that transactions entered into after the effective date may be part of wider arrangements entered into before that date.

3.8 *Question 8 - “The Government welcomes views on clause 5(1) of the Draft GAAR.”*

3.8.1 We regard Clause 5 as an essential element of the GAAR. As Clause 6 indicates, the GAAR only operates when general tax law would entitle the taxpayer to whatever tax advantage the arrangement

confers. The burden is and should be on HMRC to show why the general law should be displaced in the context of the taxpayer's arrangements and why in that context the proposed counteraction is just and reasonable.

3.9 *Question 9 - "Do you agree that it is appropriate for particular weight to be given in the legislation to the GAAR guidance and the opinion(s) of the Advisory Panel on the arrangements?"*

3.9.1 Our comments in relation to the Aaronson report suggested that it would be most appropriate for the Advisory Panel guidance and opinions to be stated explicitly in the legislation to be matters which the Tribunal could take into account. We continue to believe that it is vital that the Tribunal and the courts are expressly enabled to take these materials into account. We therefore support the wording in the Clause which states that the courts "must" take those materials into account.

3.10 *Question 10 - "The Government welcomes comments on whether particular issues arise in relation to Self Assessment (where the relevant taxes operate within a Self Assessment regime) or within the existing administrative rules for those taxes that do not operate within a Self Assessment regime."*

3.10.1 We do not understand how the GAAR can easily sit within the existing self-assessment regime. The GAAR is predicated on the basis that the taxpayer's arrangements achieve the tax advantage in question as a matter of general tax law. Apart from the inherent improbability that any taxpayer would self-assess for the GAAR, it is unclear on what basis he would be entitled to do so. His return should be in accordance with the general tax law because it is only on the basis that HMRC choose to assert and can prove that the GAAR disapplies the tax advantage conferred under general tax law that a different result will apply. It is also for HMRC to justify its "just and reasonable" counteraction and not for the taxpayer to guess at this as part of his self-assessment.

3.10.2 We assume that HMRC will identify those arrangements for which it might wish to assert that the GAAR applies in the same way as it identifies arrangements the efficacy of which it wishes to challenge under general law. Indeed, the Consultation suggests that the GAAR may represent an alternative to challenges under existing anti-avoidance provisions and the application of the *Ramsay* principle.

3.10.3 To the extent that HMRC may require specific notification of arrangements to which the GAAR may potentially apply, the DoTAS

rules represent the obvious mechanism. It would be unusual if an arrangement in respect of which HMRC would wish to consider invoking the GAAR was not an arrangement in respect of which notification was required under the DoTAS rules.

3.10.4 The particular relevance of self-assessment to the GAAR, on the basis that for a taxpayer to self-assess the GAAR is counter-intuitive, is likely to be whether there are circumstances in which a *failure* to self-assess the GAAR can attract a penalty notwithstanding that the self-assessment is correct as a matter of general law absent the GAAR. The GAAR Consultation says nothing on this aspect of the proposals, which will need clarification.

3.11 ***Question 11 - "The Government invites comments on the general proposal that the GAAR should as far as possible operate within existing administration rules for the taxes involved; and on what adaptations may be necessary to existing administrative rules to ensure that the GAAR operates with as little as possible additional administration cost and burden for taxpayers, advisers and HMRC. Is there a case for having a new type of assessment given the cross-regime range of the GAAR?"***

3.11.1 Please see our answers to Questions 5 and 10.

3.12 ***Question 12 - "The Government invites comments on whether time limits should be set for each of stages two, three and four and if so what those time limits should be."***

3.12.1 We believe each of the proposed stages will require detailed consideration. As a general matter, however, we think that basic time limits should be specified for each stage but it will also be necessary to build in appropriate flexibility to deal with the variety of cases that may be involved.

3.12.2 We note that it is contemplated that the Advisory Panel "would deliver an opinion, not a judicial decision". While this states the obvious, in that the Advisory Panel is not a Tribunal or other judicial body as such, we assume that the Advisory Panel will be bound to address the same question as the Tribunal if the matter were to proceed to a judicial determination. In other words, the question for the opinion of the Advisory Panel (as also the question for the decision of the Tribunal) is whether the taxpayer's arrangements can reasonably be regarded as reasonable tax planning or not. The Advisory Panel's consideration of that question may be more 'broad brush' and less 'judicial' in approach and its conclusion may be arrived at with less consideration and evidence than that of the Tribunal but we do not understand that the Panel will be seeking to

answer some entirely different question about the arrangements or apply some different test to the arrangements to determine whether they are regarded as 'abusive' or not.

3.12.3 The suggestion that the Advisory Panel should only be entitled to seek further information or clarification by passing the matter back to HMRC seems inappropriate and may unnecessarily extend the entire process. We do not think that it is necessary to confer formal information powers on the Advisory Panel but it should surely be open to the panel to request that either party provide further information or clarification to enable the Panel to deliver its opinion. In most cases we think that it would be to the parties' advantage to provide the information voluntarily, either to secure the opinion that they seek or at least to avoid any qualification to the Panel's opinion. Indeed, the taxpayer is likely to see it as critical to obtain a favourable opinion from the Advisory Panel (and therefore do whatever is necessary, hoping to avoid further action by HMRC).

3.13 ***Question 13 - "The Government welcomes comments on the proposals relating to the Advisory Panel."***

3.13.1 We believe that Aaronson saw the Advisory Panel as a fundamental element of his proposals, which needed to be embedded in the GAAR proposal and its operational processes on a clear statutory foundation. We therefore think it unfortunate that so much of the development and the detail of this element of the proposals have been left to a later stage. It requires detailed and careful consideration of the way in which it is envisaged that it will work, sooner rather than later. We offer some preliminary comments and will consider the matter further when more detailed proposals are made known.

3.13.2 Pending further details, we comment as follows:

- (i) We consider below some issues on the appointment and possible composition of the Advisory Panel. It is important that the recruitment of the Advisory Panel is seen as a fair and open process.
- (ii) The Advisory Panel should be permitted to take oral evidence as well as written. This may only be necessary in exceptional cases and should not be a matter of right in any case, but we see no reason to limit the manner in which the Advisory Panel can choose to act when it considers it appropriate to do so. Often initial discussions about a commercial transaction will take place informally and will

not be documented. Those discussions may not touch upon tax issues but will be important evidence about the commercial context of a transaction. At a later stage there may be more documentation and at that time tax may be mentioned frequently. Looked at alone the written papers may convey an unrealistic impression of the extent to which tax planning dominated the discussions.

- (iii) A clear process should be set out; for example, requiring something like a Statement of Facts and a Counter-Statement of Facts so that the Advisory Panel can see clearly what is and what is not agreed.
- (iv) Where the Advisory Panel is composed of different members at different times consistency of decision making will be made more difficult. There is probably no complete solution to this, save requiring that the Advisory Panel should have regard to previous decisions and should explain the reasoning if a conclusion that is reached appears inconsistent with a previous decision.

3.13.3 A key aspect of the Advisory Panel will be its appointment and composition and we think that this presents some significant difficulties. On the assumption that the members of any particular panel have to be selected from a list of potential members there will need to be satisfactory arrangements to determine who makes the selection and on what basis. As HMRC is necessarily one of the parties to the procedure we have some difficulty in understanding how HMRC can be represented on the Advisory Panel. We assume that a decision whether or not to apply the GAAR would be taken at a relatively senior level within HMRC. This would suggest that any HMRC panel member would have to be of equivalent seniority or at a more senior level but nevertheless independent of any of the processes within HMRC that are ordinarily involved in arriving at a decision to invoke the GAAR. The better conclusion would therefore be for the panel not to include HMRC representation, although this need not preclude former or retired members of HMRC from membership.

3.13.4 There are also potential difficulties with other possible members of the Advisory Panel. Ideally a Panel member from the private sector should have appropriate tax or business experience in the particular sector concerned. Such individuals, however, may well 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. Many of the tax schemes that have been examined by the courts in recent years have been marketed 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.

3.13.5 Membership of the Panel may also be seen as conferring an advantage on the individual concerned (or his firm) where he is engaged in continuing tax practice.

3.13.6 We think that it would be more satisfactory if the Panel could be composed of individuals who reflected neither the interests of HMRC nor those of the taxpayer and his advisers, but who nevertheless had the appropriate experience to express an opinion on whether the particular arrangements could be regarded as reasonable tax planning or not. We recognise, however, that such an 'independent' Panel may be infeasible.

3.13.7 A more novel approach to the formation of the Panel in any particular case might be to adopt the course used in many arbitrations where the parties agree on the appointment of an independent Chairman and are otherwise entitled to nominate one other member from a panel list.

3.14 ***Question 14 - "The Government would welcome views on the proposals for producing and updating the guidance."***

3.14.1 We think it important that the guidance is, and is seen to be, the guidance of the Advisory Panel and not HMRC. If, as we believe should be the case, the Advisory Panel is placed on a statutory basis, it should be for consideration whether it should have a dedicated staff for the production of its guidance and the administration of its case work. The question is whether this should or can satisfactorily be handled from within HMRC. Subject to such considerations, if as a matter of resources and practicalities the material has to be drafted within HMRC, it must be clear that the Advisory Panel is able to accept, reject, elaborate or modify any or all of the draft. This may mean that two sets of guidance develop: the guidance of the Advisory Panel and that of HMRC. HMRC may take views about the interpretation of the GAAR rules which the Advisory Panel does not accept.

3.14.2 There should be Advisory Panel approved guidance at the time at which the GAAR takes effect. However, under the current proposals

the Advisory Panel would not have been formed at that date. We commented at paragraph 2.20 above on our understanding that it is the Government's current intention to produce interim guidance that will be available with the next draft of the legislation in December. We do not regard this as satisfactory because the interim guidance is bound to be seen as HMRC's guidance. Furthermore, if the guidance is to be seen as truly that of the Advisory Panel, the Advisory Panel must be free to accept, reject, modify or elaborate HMRC's interim guidance as and when it is appointed.

3.14.3 Ultimately, the initial decision whether to apply the GAAR or not will always lie with HMRC. We think it more satisfactory, therefore, if any initial guidance is explicitly HMRC's guidance. This is consistent with the fact that the Government is promoting the current legislation and that it is HMRC as the relevant Government department that will apply the legislation if passed by Parliament. It is quite legitimate for the Government and HMRC to explain to Parliament their understanding of what the legislation will achieve, even though the legislation incorporates the concept of an Advisory Panel with a specific role of rendering opinions as to whether particular arrangements constitute reasonable tax planning or are abusive tax avoidance.

3.14.4 The Advisory Panel would produce its own guidance once it has been appointed following Royal Assent. This would maintain a degree of independence which we think will be lost if the Interim Guidance is presented to Parliament as having in some way the anticipated imprimatur of an Advisory Panel that has not yet come into existence. To achieve proper implementation of the GAAR we believe that consideration should be given to deferring the effective date until after Royal Assent so that the Advisory Panel can be formed and issue its guidance in time.

3.14.5 The Advisory Panel must be seen to be independent of HMRC. It should therefore have its own website setting out its procedures and guidance. Subject to the suggestion at paragraph 3.13.7, HMRC should play no part in the appointment of any particular advisory panel.

3.15 ***Question 15 - "HMRC would welcome comments or evidence that can improve the TIA assessment of impacts, costs and yield of the GAAR proposals."***

3.16 We have no comments to make or evidence to offer.

4 Conclusion

- 4.1 We look forward to receiving further draft provisions regarding the operation of the Advisory Panel and the procedures to be followed when applying the GAAR; and we look forward to contributing to any further consultations in this area.

14th September 2012