CITY OF LONDON LAW SOCIETY REVENUE LAW COMMITTEE

COMMENTS ON THE GAAR DRAFT LEGISLATION AND GUIDANCE

These comments are made further to the meeting held between members of the CLLS Revenue Law Committee and Carolyn Comben and Rakhim Mirzayev of HMRC held on 29th January 2013.

Comments on the draft legislation

We understand based on what was said by HMRC at our meeting that significant drafting changes to the draft legislation are unlikely to be made in practice now. We nevertheless make a number of drafting points on the draft legislation. Where relevant, our points could be reflected in the Guidance if changes are not to be made to the draft legislation.

1. As a general point, it would be helpful to include a clearer general policy statement for the GAAR at clause 1 emphasising that it is aimed at "egregious" arrangements. Clause 1(1), which we understand is intended to describe the purpose of the GAAR, currently uses terms which are defined later in the draft legislation and so does not act as an interpretational aid. On a related note, it would be helpful if all future new tax legislation included clear policy statements as this would assist in determining whether the GAAR may apply in the future to such provisions.
2. The 'double reasonableness test' in clause 2(2) refers to 'tax provisions'. It is felt that more clarity is needed here – will the GAAR only apply to enacted legislation and statutory instruments or will it extend to other published materials such as established statements of practice (on the basis that they have been in existence for so long that they may be viewed as tantamount to legislation in practical terms)? This could be addressed in the Guidance.
3. What is a "shortcoming" (clause 2(2)(c))? It is suggested that something should only be considered a "shortcoming" where there is a clear policy objective underpinning the relevant legislation which is not being met. Equally where it is not possible to discern the policy behind a given provision – which we would not expect to be particularly unusual – if the wording of the legislation is unambiguous it should be assumed to correctly reflect policy. This could be addressed in the Guidance.
4. More generally we consider that the degree of ambiguity in the legislation on which a taxpayer seeks to rely is an important factor in considering how egregious a given scheme might be. If the law is entirely clear in its operation, it must be less offensive to rely on it than where a taxpayer adopts a strained interpretation to support the analysis he looks to uphold. Ideally we would like to see this principle added to the law (we think it is important enough that it should be one of the clause 2(2) circumstances that the court must consider), but failing that it could be included in the Guidance.
5. Similarly we think a useful indicator of abusiveness would be if no transaction would have taken place absent the expectation of the tax advantage. This would distinguish between pure tax plays (such as the shares as debt and *Working Wheels* examples in the draft Guidance), and cases where the taxpayer is doing something anyway but finds a way to reduce his tax, where he would prima facie be entitled to plead *Duke of Westminster* in aid but may find that the GAAR now penalises him if his allegedly *Duke of Westminster* compliant structuring is in fact egregious (as would have been the case in the *Huitson* example). A pure tax play is far more likely to meet the criteria for the GAAR.
6. The statutory indications of when arrangements may be considered to be abusive (clause 2(4)) do not sit naturally for all the taxes covered by the GAAR including, notably SDLT and inheritance tax because they refer to concepts such as income, profits or gains and deductions / losses etc.
7. The reference to indication of HMRC acceptance of practice in clause 2(5) is felt to be too narrow. HMRC has clearly implicitly accepted many arrangements over the years without

any formal published reference to them. Relatedly, we consider that something being established practice should be enumerated as something which might indicate non-abusiveness independently of whether HMRC has accepted it (as per the original Aaronson suggestion). Again, these points could be addressed in the Guidance.

8. It is suggested that the list of "non-abusive" factors (clause 2(5)) should be extended. What about implicit acceptance of a state of affairs by HMRC or where legislation has been changed reflecting a policy shift (eg. revised Section 703 transactions in securities rules (now Chapter 1 of Part 13 ITA 2007)?

9. The reference in clause 4(6) should be to "all taxation purposes" , as we do not believe that the GAAR can, or that it is intended to, change the legal reality of a transaction undertaken.

10. In clause 6(2), it is stipulated that a Tribunal or Court *must* take into account the Advisory Panel ruling and in clause 6(3), it provides that the Tribunal or Court *may* take into account, amongst other things, guidance in the public domain. It is suggested that the two paragraphs should have the same emphasis: that the Tribunal or Court should be allowed to consider (and if appropriate, ignore) the Advisory Panel opinion. The FTT and the Courts are (usually) capable of determining for itself what evidence is relevant or not in any given fact finding task.

11. We have concern over "public domain" test in clause 6(3). Finding all "public" HMRC materials can be a challenge particularly if to be assessed at the time of the transaction. HMRC are likely to have more detailed knowledge generally than taxpayers and some taxpayers may be aware of HMRC's position on something because they have specifically previously cleared it with HMRC. There is also a general concern that HMRC release information to certain select groups in advance of the information becoming more generally public.

12. The 14 day timeframe in paragraph 9 of Schedule 1 is clearly too short and therefore unfair and a more realistic timetable should be stipulated. The Advisory Panel procedure should also be subject to time limits (even if indicative only).

13. There is real concern if HMRC and indeed the Advisory Panel are not time bound in any way. It is considered that the existing rules which allow taxpayers to effectively force HMRC's hands are not adequate when applied to the GAAR because of the uncertainty created and the fact that some taxpayers may be looking for a ruling from the Advisory Panel before deciding how to file their own tax returns.

14. The premise of paragraph 11(3) of Schedule 1 is that a 'tax advantage' has been obtained. We would welcome the Advisory Panel also being able to consider whether or not there is a "tax arrangement" and a "tax advantage".

15. There is general concern over paragraph 13 of Schedule 1 in that it should be drafted much more narrowly. As it stands, the provision allows a designated HMRC officer to effectively go on a "witch hunt" by issuing a GAAR notice where he or she *merely considers* that a tax advantage *may have arisen* to the taxpayer. If the concern here is that HMRC should not be prevented from applying the GAAR as an additional argument in cases where it believes that it can defeat a scheme on general principles (in which case no tax advantage would have arisen) we would prefer that this be made explicit.

16. We suggest including a provision which expressly provides that a taxpayer may choose to sidestep the Advisory Panel and instead put its case, including on the application of the GAAR, to a Tribunal or Court in the ordinary way. As the Advisory Panel process was included to protect the taxpayer, the taxpayer should be free to exclude it as there may be circumstances where the taxpayer may consider going to the Advisory Panel to be unhelpful or an unwelcome extra cost. For example, differing rules of evidence will apply before a Tribunal which the taxpayer may feel is preferable for a proper and detailed examination of their case (the Advisory Panel will have limited fact finding powers).

17. It is implied that the Advisory Panel will have terms of reference. We assume that these will be public (included as part of the Guidance or otherwise). It would be helpful to see a draft of these as soon as possible.

18. We strongly consider that the legislation should provide generally for all opinions (majority and any minority) of the Advisory Panel to be published (anonymised as appropriate) and only the Advisory Panel should be able to rule against publication on confidentiality grounds. If this was expressly legislated for, it could supersede HMRC's existing duties of confidentiality and so concerns that those might otherwise be breached would fall away.

General comments on the draft Guidance

1. It is considered important for the Guidance to state more clearly that aimed at "egregious" schemes only and that the whole tone of the Guidance should more clearly reflect this.

2. In terms of the examples given in the Guidance, it is felt that they:

   - lacked sufficient analysis to be truly helpful when applied to other scenarios, especially where apparently similar situations lead to different conclusions[1];

   - in consequence, do not allow taxpayers and their advisers to extrapolate how the GAAR may apply to their own facts and therefore the examples combined with the rest of the Guidance are not sufficient enough to ease concerns about lack of certainty;

   - are too far in the '9s and 10s' on the scale of abusiveness, or obviously low on the scale and that more examples were needed closer to the "middle ground" (ie structures that we would acknowledge involve an element of planning but which are every day/common transactions and structures). Some of the examples at the bottom end of the scale would be better excluded as they provide no assistance in drawing the line where the GAAR does or does not apply[2];

3. As discussed at our meeting, we suggest more examples be included. As advisers we feel constrained in suggesting more every day type transactions and structures to HMRC. However, we did discuss at our meeting with HMRC the use of Luxembourg companies and Eurobonds in international structuring and the indication was that these types of arrangements are likely not to be considered abusive. A good source of further possible scenarios/examples could also be cases where HMRC have lost on technical grounds (even if the law has subsequently be changed, the examples could consider what the position would be under the GAAR absent that change).

4. As indicated above, we would recommend that some of the most innocent examples be removed, since the implication that they are even worthy of serious analysis adds unhelpful colour and contributes to the overall impression of a GAAR that has potential application beyond only egregious schemes. Alternatively, some such structures might be dismissed briefly rather than being subjected to the line-by-line forensic approach (as now drafted) which very much implies that there is a GAAR question to be answered in those cases.

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1 For example, why is it a shortcoming in the shares as debt scheme that a 209(2)(c) ICTA 1988 (now section 1000 CTA 2010) distribution can be paid without the write down being disqualified, but not a shortcoming in the late paid interest structure that paying a penny of interest to the Cayman Islands would enable a more advantageous treatment for an unlimited amount of interest paid elsewhere? HMRC's quoted current guidance on the latter contradicts the analysis in the GAAR guidance in stating that this result could not have been the intention of Parliament.

2 For example, although the example on late paid interest rules (pages 46 to 49 of the draft Guidance) is generally helpful in that it is an example of something which is perhaps more towards the middle of the scale of tax planning than other examples of where the GAAR does not apply, the reasoning is somewhat difficult to follow. In particular, the example states (at paragraph 6.2.2.5) that HMRC has in the past indicated its acceptance of similar arrangements and cites as evidence for this an extract from the Corporate Finance Manual in which HMRC states its view that such arrangements are contrary to the spirit of the law

5. It is felt that the Guidance on the meaning of 'established practice' was largely unhelpful because it simply repeated the legislation. See our comments at paragraph 6 above.

6. Further detailed guidance is needed on the meaning of 'reasonably held view' and 'conflicting views'. Paragraphs 5.2.2.1 and 5.2.2.2 are very brief.

7. Further detailed guidance is needed on the 'main purpose' test. HMRC has previously published a detailed consultation on the test yet in the GAAR guidance (para 4.4) the discussion is extremely brief! Some examples would be very helpful (both where test met and where not met).

8. It would be helpful if HMRC were to confirm (and for the Guidance to reflect) the extent to which the history behind a section matters to whether the GAAR will apply. For example, section 703 ICTA 1988 was reformed. Is this evidence that the behaviour addressed in the deleted provisions is now considered to be acceptable to HMRC? Similarly, it would be helpful if the Guidance could make it clear that where HMRC has specifically looked at an area of legislation and has decided against making changes that this would indicate HMRC's acceptance of a particular practice (the consultation on the quoted eurobond withholding tax exemption would be an example of this).

9. Is there anything that HMRC has accepted in a pre GAAR world that it may want to revisit in a post GAAR world? If yes, please include in the Guidance.

10. We agree with the conclusion which HMRC has now apparently drawn in relation to the Advisory Panel that if a single Sub-Panel member is of the view that what a taxpayer has done is a reasonable course of action, then only in the most exceptional circumstances could the GAAR be applied (the reasoning being that conclusions reached by Panel members must be assumed to be reasonably held views, so in those circumstances the double reasonableness test would be failed by HMRC). We think it would be very helpful if this conclusion was stated in the Guidance, perhaps with some additional colour around what circumstances HMRC might consider exceptional enough to override the general rule.

11. We consider, and we think in the course of our discussions you agreed, that the point of challenge in the life of a scheme is relevant to the GAAR analysis. This is specifically around the question of established practice/HMRC acceptance of some kind, however that test is finally pitched. The Guidance should make it clear at what point in time we are considering the application of the GAAR to each example (ie immediately after first implementation, or today); given that many of the examples relate to schemes which have been blocked by specific law the implication cannot be taken that it is always today we are looking at. For instance, whilst as we stated at the meeting we disagree fundamentally with the conclusion that the IHT gift with reservation of benefit structure could be attacked with the GAAR given its long and well publicised history, we can see that the analysis would differ if you were testing the structure against the GAAR immediately after the relevant law was enacted (whether or not that different analysis lead to a different conclusion).

In summary, the legislation together with the Guidance needs to draw in much clearer terms the boundaries between what is reasonable and unreasonable tax planning. In our view, the current drafts do not achieve this.

The CLLS Revenue Law Committee would be pleased to discuss our concerns and comments further with HMRC and/or the Interim Advisory Panel.

5th February 2013