

# Perspectives on the GAAR report

## Examining the scope: the not so general anti-abuse rule



**Ashley Greenbank,**  
*Partner, Macfarlanes*

As noted elsewhere, the illustrative GAAR attempts to leave the 'centre ground' of tax planning unaffected. So the resulting GAAR is quite narrowly focused. But, it is not a 'general' anti-avoidance rule in other senses too.

The illustrative GAAR only extends to certain taxes: corporation tax, income tax, capital gains tax and petroleum revenue tax. The report suggests that it could also extend to national insurance contributions, although this would require separate legislation.

## Excluding IHT seems odd

There are, therefore, some notable exceptions from the scope of the proposed GAAR.

It would not apply to VAT. This is perhaps understandable. VAT has its own anti-abuse case law, which has been developed through the jurisprudence of the ECJ. If a GAAR were to apply to VAT, the result is likely to be confusion with the case law principles. In a similar way, you might question how the GAAR will interact with principles of purposive construction which apply to the main direct taxes. On this point, the report is clear. The illustrative GAAR would operate as a separate rule after the application of normal principles of statutory construction (including those in the *Ramsay* line of cases) to override the consequences of the application of the normal rules.

The illustrative GAAR does not extend to IHT. The reason given in the report is that limiting the GAAR to the main direct taxes will allow its operation to be monitored before it is extended more widely. On the one hand, excluding IHT seems odd: IHT has not been a scheme free zone in the past. On the other, the application of some of the principles of the illustrative GAAR – in particular list of 'abnormal features' in clause 7 – is not ideally suited to transactions outside the commercial sphere. That said, income tax and capital gains tax apply equally to transactions between individuals outside the commercial context. So why exclude IHT here?

SDLT is also excluded. Once again, this is perhaps not surprising. SDLT has its own mini-GAAR in the form of FA 2003 s 75A. So, it is arguable that the GAAR is not required for SDLT and its introduction alongside s 75A would only lead to confusion regarding the interaction of the two rules. But, if you take that view, the same concern must surely arise in relation to the targeted anti-avoidance rules (TAARs) that exist in many other parts of the tax code.

This latter point highlights the need for the introduction of the GAAR to be accompanied by a rigorous programme to remove TAARs from existing legislation. The report expresses some hope that this would occur – but a commitment from government to engage in such a process would be welcome.

## What type of transaction would be caught?



**David Harkness,**  
*Global Head of Tax, Pensions and Employment, Clifford Chance*

Unfortunately the Aaronson Report does not give examples of arrangements that would be caught by the GAAR, perhaps because most aggressive tax planning has failed in the courts recently. Even where taxpayers have steered a course through the maze of anti-avoidance legislation, the courts have taken purposive approaches which deny the intended tax benefits.

An example is *Tower MCBashback* where the Supreme Court viewed a circular arrangement as having no meaningful substance and denied relief. Other recent cases such as *Prizedome* and *DCC Holdings* involved the courts stretching a purposive approach to legislation to deny the hoped for results.

A recent example of scheme succeeding is 'SHIPS 2' in *HMRC v Mayes*. The Court of Appeal held it effective, despite its highly artificial nature. They did so reluctantly, concluding that Parliament had to tackle such avoidance. The Report refers to SHIPS 2 and presumably the authors would see the GAAR applying to this case.

Some aggressive SDLT planning ideas are still marketed – I can see these would be affected by the GAAR were it to apply to them. But it will not, apparently because the SDLT rules already have their own specific GAAR (although this does not seem to deter those who market such schemes).

The complexity of the tax code means that taxpayers often have to structure to avoid anomalous results arising from ordinary commercial transactions. These arrangements may have no other purpose than to avoid tax – however the tax result they are trying to avoid is one that Parliament likely did not intend. Would the GAAR apply?

## [How would the GAAR apply to] arrangements [which] may have no other purpose than to avoid tax [but] the tax result they are trying to avoid is one that Parliament likely did not intend

For example, in corporate restructurings a company may need its banks to write off debt for the company to continue trading. Yet this is typically taxable for the company and the exemption for debt/equity swaps is often something lenders are unwilling to accept (for accounting reasons). The company has an impossible choice between doing nothing (and becoming insolvent) and writing off the debt (triggering tax the company cannot pay). Many businesses have squared this circle through various forms of tax planning. Would such arrangements be caught by the GAAR? It seems to me not. But the taxpayer would have to rely on

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HMRC or the Courts agreeing that this was a reasonable exercise of choices of conduct under tax legislation.

What about holding real estate in a Jersey SPV to avoid CGT on a future sale? Is the absence of a CGT charge on non-residents a reasonable choice of conduct? Hopefully, yes. Much of the real estate industry would regard it as such (even HMRC did it). But I suspect there are many who would see this as egregious.

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## What's the impact on commercial transactions more generally?



**Heather Self**  
*Director, McGrigors*

Business was deeply sceptical that a workable GAAR was possible, and many companies hoped that the idea would die a quiet death. Twelve months on, Graham Aaronson's draft has received a cautious welcome – so what has happened?

The idea of a GAAR was last looked at in detail some 12 years ago. It foundered on the need for clearances: where there is uncertainty, businesses and advisers will want the reassurance of a clearance. There were fears that HMRC would be swamped with applications, and ultimately HMRC itself did not support the proposal.

Graham Aaronson has taken a radically different approach and has sought to draw the GAAR's boundary at the outer limits of aggressive tax planning. In a complex world, it is crucial that businesses can implement commercial transactions tax efficiently, and the GAAR report makes it very clear that such 'responsible' tax planning will be unaffected. To test this, the CBI Tax Committee engaged actively in the consultation process. We drew up a range of scenarios for testing against the early drafts of the proposals. This helped to provide reassurance that issues such as financing or transfer pricing strategies would be outside the GAAR's ambit, and that existing anti-avoidance legislation such as the CFC rules would apply in priority to the GAAR.

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## One area which remains unclear is how the 'true economic profit' will be measured in a group context

One area which remains unclear is how the 'true economic profit' will be measured in a group context. The report refers throughout to 'the taxpayer', although the illustrative draft legislation applies to 'the arrangement viewed as a whole'. If a transaction does not achieve an 'abusive tax result' in any single company, can the GAAR strike it down if the consolidated tax position does not match the group's economic profit? This may be a hypothetical question, particularly after the introduction of targeted anti-avoidance rules in this area in recent years, but if it were to be tested I would not be optimistic of success before a Tribunal.

## The GAAR proposals in brief

In December 2010, the government asked Graham Aaronson QC, a tax barrister specialising in commercial taxation, to lead a study into whether a general anti-avoidance rule should be introduced into the UK tax system.

In the study group report published last week, Aaronson recommended that the rule should initially apply to the main direct taxes – income tax, capital gains tax, corporation tax and petroleum revenue tax – as well as NICs.

The draft GAAR counteracts 'abnormal' arrangements contrived to achieve an 'abusive tax result'. For this purpose:

- 'abusive tax result' is defined as an advantageous tax result that would be achieved by an arrangement that is neither 'reasonable tax planning' nor an arrangement 'without tax intent'; and
- an abnormal arrangement is 'contrived to achieve an abusive tax result' if the inclusion of any 'abnormal feature' can reasonably be considered to have as its sole purpose, or as one of its main purposes, the achievement of an abusive tax result by (a) avoiding the application of particular [tax] provisions, or (b) exploiting the application of particular provisions, or (c) exploiting inconsistencies in the application of provisions, or (d) exploiting perceived shortcomings in the provisions.

### Safeguards

The following 'safeguards' are proposed to ensure that the 'centre ground' is protected:

- an explicit protection for reasonable tax planning;
- an explicit protection for arrangements entered into without any intent to reduce tax;
- placing on HMRC the burden of proving that an arrangement is not reasonable tax planning;
- an advisory panel to advise whether HMRC would be justified in seeking counteraction under the GAAR;
- giving taxpayers and HMRC the right to refer to material or information which was publicly available when the tax planning arrangement was carried out, to help in determining whether an arrangement should be regarded as reasonable tax planning; and
- requiring that potential application of the GAAR has to be authorised by senior officials within HMRC.

### Counteraction

Where the GAAR applies, the tax result would be determined by:

- computing the tax which is 'reasonable and just' (including, if appropriate, by treating the arrangement as if it had not taken place); or
- in the case of arrangements which have a significant purpose other than achieving the abusive tax result, computing the tax as if a corresponding non-abusive arrangement had been carried out instead.

### Clearances

The illustrative GAAR does not provide for a general system of clearances. However, the GAAR permits taxpayers to expand any application under an existing clearance procedure to include an application of the GAAR.

### Existing anti-avoidance rules

'In time, once confidence is established in the effectiveness of the anti-abuse rule, it should be possible to initiate a programme to reduce and simplify the existing body of detailed anti-avoidance rules,' Aaronson said. 'The Office of Tax Simplification would be the obvious agency to do this. This would lead to a significant improvement in the certainty of operation of the existing body of tax rules.' The report noted that enacting an anti-abuse rule 'should make it possible, by eliminating the need for a battery of specific anti-avoidance subrules, to draft future tax rules more simply and clearly'.

*The full report is available via [lexisurl.com/MuzmG](http://lexisurl.com/MuzmG).*

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The proposed GAAR has a number of key safeguards, of which the most important are the requirement for the burden of proof to be on HMRC and the proposed use of an Advisory Panel. Business's key concern, which Graham Aaronson acknowledges in his report, is that these measures may be watered down in any final legislation. That would send us back to uncertainty and significant compliance burdens, which would make the proposals unworkable. Crucially, uncertainty would also make it harder to convince inward investors that the UK has a stable and competitive tax system.

The Advisory Panel may be difficult to operate in practice – will sufficient experts be available, at relatively short notice? And, finally, if the initial GAAR is workable, will there be too much temptation for its scope to be widened in subsequent amendments?

Graham Aaronson and his Study Group have done a remarkable job in producing an outline which has gained such broad, if wary, acceptance. It is crucial that this precisely targeted medicine to cure 'egregious schemes' does not mutate into a broad spectrum antibiotic against commercial tax planning – if it does, resistance to the proposals will quickly develop.

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## A view from large business



**Ian Brimicombe,**  
*Head of Group Tax and Treasury,*  
*AstraZeneca*

It is important to remember that the brief handed to Graham Aaronson QC was to consider whether a GAAR *should* be introduced into the UK statute book (emphasis added). The question demanded an understanding of the rationale for a GAAR in the context of existing UK law and assuming compelling reasons could be found, the next step was to recommend how such a GAAR would be constructed in order to address the perceived deficiency but not so as to undermine the competitiveness of the UK tax regime.

Five years ago the proposition of a GAAR was firmly rejected by business on the grounds of lack of efficacy, increased uncertainty and the need for a comprehensive clearance system. Instead HMRC acted to deter those who exploited the tax system through a series of targeted anti-avoidance rules, a principles based approach to law development and extensions of DOTAS all administered by a focused Anti-Avoidance Group within its Business Tax division. This approach has largely been successful in stemming the flow of schemes but there remains a smaller number that are troublesome.

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## Business is cautiously optimistic

Both large business and HMRC have long agreed that tax schemes which are devoid of commercial and economic purpose should be countered. Schemes like SHIPS 2, which evolve to step through the statutory language and withstand a purposive interpretation of the law, are still slipping through the courts in favour of taxpayers. However, business' main concern with

anti-avoidance law as currently implemented is that it strikes at too broad a range of transactions, many of which are perfectly acceptable commercial arrangements which have to be carved out in complex and lengthy language. Such collateral damage undermines confidence in the UK tax regime and its competitive standing.

So what could be achieved though a GAAR? A traditional business view of a GAAR as enacted in Australia, Canada and many other locations is that it is ineffective, and business would ask whether this type of sledgehammer is necessary to tackle the residual risk in the UK if it also brings uncertainty coupled with an administrative burden in the context of normal commercial transactions.

The GAAR report sets out to address this concern by limiting its application to the most egregious arrangements identified by certain features that are designed to exclude the centre ground. Additional welcome safeguards are also recommended including burden of proof on HMRC and the Advisory Panel to review counteractions. All such measures are very sensible but the one key question remaining is whether business and HMRC can reach an understanding as to where to draw the line between egregious and centre ground. In my view the report has done all it can to circumscribe the targeted areas but I suspect the balance will only become apparent once a GAAR has been in place for some time and has been tested.

There is no doubt that the approach taken by Graham Aaronson QC and his colleagues is the most appropriate in order to deal with the tail risk of extreme avoidance schemes given the UK context of existing counter measures and its delicate economic state. Business is cautiously optimistic that if the government goes ahead then the GAAR can be structured to achieve its targeted aim to counter egregious cases only.

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## The impact on the tax code: a simplifying GAAR?



**John Whiting,**  
*Tax Director, Office of Tax*  
*Simplification*

Graham Aaronson's GAAR report includes the suggestion that once a GAAR has settled down, it might pave the way towards a simpler tax code. The UK tax code has vast quantities of anti-avoidance legislation. So, if a GAAR is striking down convoluted schemes (and deterring others), does that make much anti-avoidance legislation unnecessary?

The answer to that question should be 'yes', though it won't be an easy or automatic switch. Our reams of anti-avoidance legislation are a mix of specific measures (often lengthy and detailed), more general attacks (think s 703) and those relatively new inventions, the TAARs. Many (including me) have argued that TAARs are mini-GAARs, so introducing a GAAR could logically make TAARs redundant. Indeed, many (including me) would see this as part of the quid pro quo for having a GAAR. If a GAAR can't replace some of the existing anti-avoidance provisions, it is adding to the existing plethora and that can't be good for the certainty taxpayers crave from the tax system.

Unfortunately, I can't see HMRC recommending abolition of

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swathes of TAARs et al until the GAAR was well proven... which would mean we have a long period of 'double heading'. Perhaps that is inevitable, but if the GAAR is to come, it should come with a commitment to use it to abolish a fair swathe of anti-avoidance measures, and to do so in a reasonable timescale. And yes, as Graham suggests, I agree that the Office of Tax Simplification (OTS) would be the logical group to lead the work: we are independent, after all. Perhaps we should start an exercise – and not just about TAARs – in parallel to a GAAR's introduction? That would mean there is no risk of such a review being forgotten, and GAAR thinking and experience would feed into the OTS review.

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## If a GAAR is to come, it should come with a commitment to use it to abolish a fair swathe of anti-avoidance measures

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Another question that might occur is whether a GAAR could mean simpler tax legislation in the future. Insofar as it would preclude any more TAARs, the answer has to be: yes. But that isn't a complete answer and the litmus paper test has to be whether it would mean that the infamous disguised remuneration in FA 2011 could be rendered in a tenth (or less) of the 60+ pages it currently clutters up. There, I feel, the answer is more nuanced: it might allow the draftsman not to strain to cover so many eventualities, but to make that legislation 'simpler' really means using some form of principles-based drafting. After all, the problem with disguised remuneration is the attempt to write things down in exhaustive detail and I am not sure that a GAAR would stop that.

Whether or not the GAAR proceeds, the OTS isn't going to be out of work any time soon ...

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## Are there sufficient safeguards to prevent 'mission creep'?



**Bill Dodwell,**  
*Head of Tax Policy, Deloitte*

Graham Aaronson QC is one of the UK's best tax advocates. We can see those skills as he proposes a general anti-abuse rule, claiming '... a moderate rule which does not apply to responsible tax planning, and is instead targeted at abusive arrangements, would be beneficial for the UK tax system'. He continues 'An anti-abuse rule which is targeted at contrived and artificial schemes will not apply to the centre ground of responsible tax planning...'

Yet we have to recall Mr Aaronson's record as a litigator is mixed. The Supreme Court (and House of Lords) has rejected a great many of his arguments. We need to look closely at the detail and not be swayed by the advocacy.

It's easy to see that the merit in a rule which means the

second hand life policy scheme in *Mayes* fails to provide income tax losses. After all, there were no commercial considerations whatsoever. The problem, though, comes from the suggestion that we all agree what is egregious and should not succeed – and that those judgements remain unchanged over time.

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## I cannot see the [recommended five-year review] offering any help

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We all know that tax is levied to provide goods and services to society – and that there is a benefit to being part of this club. Yet the rules that provide for taxation need to be clear and not imposed subjectively by the tax authority. This is where there is the greatest potential for failure of the GAAR initiative. Even if we can just about reach agreement today on what is reasonable planning and what is not, isn't there a real danger that the tax authority would start to extend the boundaries of their new weapon? Here the safeguards put forward suddenly look a little less clear. There's supposed to be a group of three wise men, including one from HMRC. Yet those from the private sector can hardly be involved in giving tax advice – as conflict of interest, or the perception of conflict, could arise. We all know how easy it is to get out of date and it will surely be a hard role for someone outside tax practice to sit in judgment on proposals put forward by former colleagues. Suddenly the panel could look a lot less wise.

How would new law fit into the range? We all will evaluate a potential GAAR by looking at prior cases where we can understand what many companies and individuals do – and thus assess as reasonable, middle ground planning. But when some new piece of law arrives, it will be extremely important to make sure that a GAAR doesn't step in and immediately limit any form of planning.

Graham Aaronson recommends a five-year review – but I cannot see that offering any help. The chance of a GAAR being withdrawn is very small. This is a tough decision.

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## The GAAR and the Courts



**Adrian Shipwright,**  
*Director, Allington Eames Ltd*

Albert Einstein said 'The hardest thing to understand in the world is the income tax'. The courts have an even harder problem of considering when there is 'tax avoidance'.

Much would be improved if our tax system had a clear underlying policy and purpose. What the GAAR offers is counteraction of 'abnormal arrangements which ... achieve an abusive tax result from the application to the arrangement of the provisions of the Acts, and which are contrived to achieve such a result'.

If the GAAR is introduced then the courts will have to apply and interpret it. Often it will be obvious something is abusive. However, the courts will have to grapple with the hard cases and the legislation presumably itself interpreted purposively. What is its purpose? How is it to be ascertained?

The court will have to consider when an arrangement is abnormal viewed objectively having regard to all the circumstances

and considering its purpose. Presumably this is effectively an officious bystander test and so will not require making 'windows into men's souls'. It will also have to decide what is meant by avoiding the application of a particular provision and/or exploiting the provision or its perceived shortcomings (by whom?). Is choosing something which results in lower tax avoiding the application of a particular provision? Presumably this depends on whether it is 'reasonable tax planning'.

It will be interesting to see what evidence HMRC, who has the burden, will bring to prove an abnormal arrangement. HMRC also has to show the advantageous tax result of the arrangement would be abusive and not reasonable tax planning and what the corresponding non-abusive arrangement is. This is easily stated as a matter of theory but the particular application will not always be easy. This is nothing new but as ever it will be the difficult cases that reach the courts, though the 'safeguards' and the advisory panel should prove a helpful filter. It is to be hoped that court admissible material will be published so that the parties can know what is acceptable. 'Safe harbour' guidance would be welcomed. The problem will be deciding what the comparators are and whether what is done is abusive given that '... the GAAR comes into effect only if the application to the arrangement of the particular relevant tax rules, given their normal purposive interpretation' would be abusive. This echoes the ECJ. It is to be hoped that there will be no real divergence from the European approach so that direct and indirect tax are in line.

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## 'Safe harbour' guidance would be welcomed

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If the result is that egregious tax schemes disappear then the GAAR will achieve its aim but this will be because of the legislation rather than the Courts.

*The views expressed here are the current personal views of the author without the benefit of having heard arguments on the issue. These views may evolve and change over time and are put forward for the purposes of discussion.*

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## Will the proposals help or hinder the UK's tax competitive standing?



**James MacLachlan,**  
*Partner, Baker & McKenzie*

The proposals represent a thoughtful and ingenious response to the government's terms of reference, one of which is to ensure that any GAAR would not erode the UK tax regime's attractiveness to business. Indeed, the study concludes that this is the 'most critical' factor to be taken into account to determine whether a GAAR would be a positive step in today's turbulent economic conditions and financial markets. It seems to me that the proposals go to very considerable lengths to address this issue. Here are some aspects of the proposals which should help (or at least not hinder) UK tax competitiveness.

*Scope:* The proposed form of GAAR is framed as a narrow spectrum 'fiscal antibiotic' (to borrow a judicial metaphor from *Ramsay* case law) and it is hard to envisage that it could often apply in practice. In this regard, it is interesting to note that the only concrete example cited by the study of a contrived and abusive scheme is the 'SHIPS 2' scheme in the recent *Mayes* case. The proposals are complex and one does wonder if they are not a sledgehammer to crack a nut. That, however, should be of no concern to the 'centre ground of responsible tax planning' occupied by the overwhelming majority of businesses in the UK.

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## The proposals go to considerable lengths to address [UK tax competitiveness]

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*Safeguards:* The safeguards to ensure that responsible taxpayers are protected are crucial and will be of significant comfort to business, notably that HMRC should have the burden of proving (on the balance of probabilities) that an arrangement is not reasonable tax planning and the referral by HMRC of potential counteraction under the GAAR to an independent Advisory Panel (for which there is no real precedent in the UK system). On the importance of burden of proof in this context, it is interesting to compare the approach in other countries. In France, for example, there is an Abuse of Law Committee whose function is to determine whether the burden of proof in abuse of law tax litigation should be carried by the taxpayer or the fiscal authorities. Unlike the Advisory Panel, however, the Committee does not publish redacted versions of its opinions or guidelines for the operation of the abuse of law doctrine in the tax context. The proposal to develop a strong body of law and practice around the application of a GAAR in the UK should provide an important measure of certainty to business.

*Longer-term benefits:* The study suggests that the GAAR (apart from its deterrent effect) should bring important, longer-term benefits to the UK tax system, such as a more level playing field for all kinds of businesses and their tax advisers, more predictable interpretation of UK tax laws by the courts, simplification of UK tax legislation generally (eg, by eliminating the plethora of TAARs) and enhanced trust between taxpayers and HMRC. Whether all these benefits can indeed be realised through the introduction of the GAAR is of course uncertain, but, if they can be, then with hindsight the proposals will surely be seen to have helped the competitive standing of the UK's tax regime.

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## How do the proposals compare with overseas GAARs?



**Chris Morgan,**  
*Head of Tax Policy, KPMG*

The GAAR regimes around the world reflect local concerns about tax planning and are quite different in terms of breadth, scope of taxes covered and clearance process.

Graham Aaronson QC's report recommends a GAAR which is aimed only at the most flagrant abuse. Aaronson's view is that as the UK courts already take a purposive approach to interpretation only a very moderate GAAR is needed. The recommendations in theory are very pragmatic and sensible. However, unfortunately, defining what constitutes 'reasonable tax planning' is likely to be extremely difficult in practice.












## A UK GAAR should focus purely on UK tax effects

This contrasts with the approach being taken by the Indian authorities which is at the opposite end of the scale. India's GAAR is proposed to be introduced as part of its Direct Taxes Code from 1 April 2012. It will apply to 'impermissible avoidance

arrangements' which are those entered into with the objective of obtaining a tax benefit and satisfy any one of the following conditions: not arm's length; represents misuse or abuse of certain tax provisions; lacks commercial substance; and not for bona fide business purposes. Also, unlike the UK proposals, the burden of proof will fall on the taxpayer to demonstrate that obtaining a tax benefit was not the main objective of the arrangement.

It is unclear whether an overseas tax effect can be taken into account when determining if the UK GAAR can apply. In many cases outside the UK overseas taxes cannot be taken into account. For example in New Zealand the GAAR can only be used to void an arrangement where New Zealand tax is avoided and in Spain, while the tax authorities have been known to look at activities conducted overseas to determine whether the Spanish GAAR is in point, it can only be applied to a taxpayer deemed to be avoiding Spanish taxes. We consider a UK GAAR should focus purely on the UK tax effects.

### A comparison of different GAAR regimes

Country	When does it apply?	Pre-clearance?	Targeted anti-avoidance rules too?
 UK	'Abnormal arrangements' designed to achieve an 'abusive tax result'.	No (unless a statutory clearance applies)	Yes
 India	To an 'impermissible avoidance arrangement' entered into with the objective of obtaining a tax benefit and one of a number of conditions apply.	No (but final details not yet published)	Yes
 Ireland	Transaction results in a tax advantage and is undertaken <i>primarily</i> to obtain the tax advantage.	No (but can make protective notification)	Yes
 Spain	Under conflict and sham doctrines.	No	Yes
 Canada	Transaction results in misuse of clear policy in the tax act and creates a tax benefit <i>unless</i> undertaken <i>primarily</i> for a bona fide non tax purpose.	Yes – charged for	Yes
 New Zealand	Tax avoidance is a not incidental purpose or effect of the arrangement.	Yes	Yes
 Australia	Obtaining a tax benefit is the <i>sole</i> or <i>dominant</i> purpose of the scheme.	Yes (but limited)	Yes
 South Africa	<i>Sole</i> or <i>main</i> purpose of a scheme is to obtain a tax benefit and the scheme has abnormal aspects such as no commercial substance.	No	Yes
 Germany	Attacks inappropriate structures using an 'abuse of law' concept unless there are sound business reasons for the structure.	Yes – charged for	Yes
 USA	A transaction is treated as having economic substance <i>only</i> if it changes in a meaningful non-tax way the taxpayer's economic position, <i>and</i> the taxpayer has substantial non-tax purpose for entering into the transaction.	No	Yes
 China	Business arrangements are carried out <i>without</i> 'reasonable business purposes'.	No	Yes

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We have long argued that a GAAR should only be introduced in the UK if it is accompanied by a fast and effective pre-clearance regime. Aaronson's report dismisses the need for a clearance system on two grounds: the resource burden and the additional discretionary powers for HMRC which 'would be wrong as a matter of constitutional principle' (although such an objection does not apply if the transaction happens to be one for which a statutory clearance mechanism already exists – a distinction which appears arbitrary and potentially unfair). A clearance regime would undoubtedly place a strain on already stretched HMRC resources but some countries have addressed this issue by charging for a clearance, an option which may be worth exploring here. Such a system has operated in Germany since 2007. The fee is generally based upon the amount of tax at stake and ranges from €121 to €91,000. Alternatively the tax authorities have the option to charge a time based fee (currently €100 per hour). In practice, the fee is rarely a deterrent for taxpayers considering whether to apply for a clearance, more common is the uncertainty over how long the tax authorities will take to respond. A statutory time limit for responding would therefore seem essential.

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## Is a clearance procedure needed?



**Paul Davison,**  
*Partner, Freshfields Bruckhaus  
Deringer*

When the introduction of a GAAR was last seriously considered in the UK in 1998, the question of clearances (among other things) is understood to have proved a stumbling block: the assumption was that a clearance system would be necessary to mitigate the uncertainty created by a GAAR; and the Revenue were wary of the resource commitment that would be required. Graham Aaronson acknowledges that some incremental uncertainty from a GAAR is unavoidable (at least before taking account of any repeal of other anti-avoidance provisions). But he considers that it can be mitigated, by targeting the GAAR appropriately, such that there would be no need for a GAAR-specific clearance system. (Taxpayers could, however, wrap a GAAR clearance up with an application being made under another clearance procedure. The basis for this distinction – that in those circumstances the resource implications are manageable – seems quite thin.)

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## It is far from clear that [the proposed measures] would be sufficient to avoid material uncertainty

It would certainly be better to avoid a clearance system. In addition to the resource, cost and timing implications, Aaronson notes that a Revenue-operated clearance system would increase HMRC's discretionary powers in an undesirable way. Besides, a clearance system does not necessarily reduce uncertainty. Since giving clearance precludes a subsequent challenge, there is a

natural inclination for HMRC to refuse clearance in doubtful cases – which significantly undermines the value of the process. The transactions in securities rules have a clearance mechanism; yet on transactions to return cash to shareholders, where a choice between income and capital is offered, it became common (before the FA 2010 changes narrowed the scope of the rules) for taxpayers to be advised (a) that the anti-avoidance rules should not apply, but also (b) that they should not seek clearance, as HMRC would likely refuse it. A clearance procedure is a poor substitute for legislation expressed in appropriately targeted terms.

So can a GAAR be targeted sufficiently precisely? The illustrative GAAR is deliberately designed to be capable of hitting tax-motivated features of a wider commercial transaction. As a result, the 'reasonable tax planning' safeguard would often be the only substantive safeguard available. This concept would bear a very heavy burden. How is a taxpayer to know what counts as a 'reasonable exercise of choices of conduct afforded by the provisions of the Acts'? It is rare for tax legislation actually to prohibit particular transactions (ICTA 1988 s 765 was one example, now repealed); but it commonly taxes similar transactions differently. Thus the question would ultimately seem to be just whether arranging matters in a particular way with an eye to their tax treatment is 'reasonable' (or can reasonably be regarded as reasonable) in any given case. Aaronson suggests some innovative ways of putting skin on the bones here – a form of statutory guidance, and the Advisory Panel – but it is far from clear that they would (or could) be sufficient to avoid material uncertainty.

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## Are the Advisory Panel proposals workable?



**Chris Sanger,**  
*Head of Tax Policy, Ernst & Young*

A core part of Graham Aaronson's articulation of the GAAR, or more specifically the STAAAR, the Specifically Targeted Anti Abuse Rule, is the creation and operation of an Advisory Panel. As the name suggests out, this panel is only advisory in nature and can be wholly ignored by all concerned, including HMRC and the Tax Tribunal. So given this, what role could the panel play and will they help in making this version of a GAAR workable?

The key role of the panel would be to provide 'a quick and cost-effective way of helping taxpayers and HMRC identify the location of [the limit of the centre ground]'. Any such review would be undertaken by members of the panel, including one from HMRC and two independents. One will have specific experience in the area concerned. This is intended to reduce the risk that HMRC misinterprets the nature of purpose or the transaction.

Whatever your views about the necessity or benefit of the GAAR, an additional safeguard for the taxpayer would seem to be an important extra layer of protection. This should help to keep the GAAR to those areas which are 'egregious' and provide a body of experience that can be used to define what is reasonable tax planning. Furthermore, the work of this panel, if listened to, is likely to be critical in deterring the creep of the GAAR into the centre ground of tax planning.

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Should the Advisory Panel come into existence and its observations be honoured, it will effectively own the definition of 'acceptable tax planning'. That would provide an interesting relationship between the Panel, HMRC and taxpayers in general. Its views could also determine the approach that is taken in relation to the drafting of legislation.

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## The role of the Advisory Panel ... seems to create the same concern as the clearance mechanism

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However, in considering the role of the Advisory Panel, it is worth reflecting on why the Committee chose against a clearance mechanism: 'a general clearance system ... operated by HMRC would give them additional discretionary powers – which would be wrong as a matter of constitutional principle'. This concern presumably also exists around the role of the Advisory Panel – if empowered and regarded as definitive, the control of the central ground will now rest with a group of individuals that are separate from HMRC, the courts and the government. This seems to create the same concern as the clearance mechanism. Only the fact that the Panel can be over-ridden, and, therefore, ignored, seems to make this acceptable.

Therein lies the paradox – for the Panel to be constitutional, it has to be merely advisory and capable of being ignored. However, for the Panel to be effective, it needs to be revered and obeyed. So, yes the proposals for the Panel are workable but they may take a willing suspension of disbelief if they are to operate appropriately.

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## Will consultation make it better?



**Francesca Lagerberg,**  
*Head of Tax, Grant Thornton*

Trying to draft a rule that can walk the tightrope of allowing taxpayers' the freedom to plan legally to take sensible action to pay less tax than they otherwise would and yet stop the sort of scheme that fails the 'smell test', was never going to be easy. The independent GAAR report shows the value of tax professionals and those steeped in the law in helping to arrive at a useful starting point for consideration. But in my view it is a start and not necessarily the final conclusion.

Any proposal that affects taxpayers should be subject to wide scrutiny. There is already a framework for tax policy consultation (issued on Budget Day 2011) and it includes a number of important steps that are monitored by the Tax Professionals Forum. These steps are:

- setting out objectives and identifying options;
- determining the best option and developing a framework for implementation, including detailed policy design;
- drafting legislation to effect the proposed change;
- implementing and monitoring the change; and
- reviewing and evaluating the change.

It also committed the government to full and open consultation at each stage, except in exceptional circumstances. The GAAR therefore should be no different from any other proposal.

In particular now is the time to road test the proposal taking a number of well-known schemes, such as those highlighted in recent cases, and seeing if the rule would catch planning described in the proposal as being 'highly abusive contrived artificial schemes'. Then it should be tested against commercial planning, taken by all to be acceptable, to ensure that it does not unwittingly catch them. Finally, it needs to be tested against planning that is in the 'grey' category, ie, legal, not contrived but a little more aggressive.

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## The best legislation takes time to finalise

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Then one needs to step back and ask questions such as 'is this still an acceptable rule? Does it make the UK less competitive than its neighbours? Will it mean the economy suffers? Does the rule provide enough certainty and enough clarity for all to make it workable and not unacceptably burdensome?'

The best legislation tends to take time to finalise. Consultation will highlight if the GAAR stands up to such close scrutiny or if it needs amendment to help keep the balance on the tightrope highlighted above. HMRC is now expected to listen to views on the proposals and then take a view in the spring on next steps. We can help here. We can provide input on where we think the GAAR as proposed helps and where it hinders UK tax policy.

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## Is the game finally up for scheme promoters?



**David Heaton,**  
*Partner, Baker Tilly*

Some readers will know that, long ago, I originated and promoted a number of NIC avoidance schemes, some of which succeeded because the old DSS took the view that *Ramsay* did not apply to NICs, so I should declare my 'form' in this area before commenting.

That said, as a tax partner in a large firm and current Chairman of the ICAEW Tax Faculty, I have lost count of the colleagues who have been aghast at the claims of 'zero tax' aimed at businesses and their owners by certain scheme promoters, and who have asked when 'somebody' was going to 'do something' about 'it'.

Perhaps that time has come at last. When Graham Aaronson took on the question of whether and how to rid us of these new age turbulent priests, opinion in the profession was divided, as amply evidenced at the ICAEW Tax Faculty's Wyman debate on the possibility and wisdom of introducing a GAAR back in June. In the concluding poll, the majority of the practitioner audience decided that they didn't know whether a GAAR would be a good idea for the UK. In light of Graham's conclusions and proposed approach, I believe there will be audible sighs of relief from the majority of the tax profession, and cause for a major rethink among scheme promoters.

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The relief stems in no small part from the balanced approach taken by the study group, which has recognised the validity and legitimacy of planning to minimise or avoid taxes, and the need to avoid handing HMRC a powerful veto over any and all arrangements.

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## I have lost count of the number of colleagues who have asked when 'somebody' was going to 'do something' about 'it'

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Most practitioners will arguably lose nothing from the proposals if they are adopted, other than perhaps the irritant of clients demanding to know why they haven't been informed of the whizzy scheme sold to their mates at the golf club. Most prefer to save clients from unnecessary HMRC scrutiny, and potentially expensive investigation and litigation, by steering them away from various off-the-peg schemes that most would regard as, in Graham Aaronson's terms, 'egregious'. They should welcome this version of a General Anti-Abuse Rule.

Most practices have concentrated solely on bespoke planning – after all, tax is complex enough, clients always need advice, and arranging your financial affairs so as to fend off the state shovel has always been legitimate. The GAAR proposals offer welcome and rational safeguards to protect that position.

In contrast to the majority, a minority have earned a minor source of commission income from aggressive and provocative schemes and only for a very few have these been a *raison d'être*. It is arguably only the last group whose schemes will be seriously hit, and many mainstream practitioners will be relieved that this is so.

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## Would principles-based drafting have been a credible alternative?



**Heather Gething,**  
*Partner, Herbert Smith*

Principles-based drafting is in my view the best method of counteracting the application of legislation for avoidance purposes.

By principles-based drafting I mean legislation which begins with an umbrella statement as to what is intended to be achieved by the legislation and each subsection thereafter seeks to explain each aspect of the initial statement. For example 'The purpose of this legislation is to tax the profits and relieve the losses arising from loan relationships'.

The draftsman should however resist overly prescriptive rules as the draftsman can never foresee all possible scenarios to which the legislation could apply and he should avoid unintended consequences that can frequently apply where the computation of profit or loss is to be determined by the application of accounting rules. To allow accounting rules to

apply is in large measure surrendering sovereignty of Parliament to the various accounting standards boards. Accounting rules may provide a guide but should never be a master.

Regrettably the rewrite project has resulted in the elimination of these principles from much of the legislation with the new 'Janet and John' style. To correct this would regrettably require some further legislation but it could be done.

Legislation is necessarily prescriptive where taxpayers are required to collect tax on behalf of HMRC. It is not reasonable to impose on collectors the burden of balancing competing interests or weighing up whether what is being achieved is reasonable. Purposive legislation is impossible to achieve where the administrative/collection provisions and the charging provisions are the same provisions. The *Mayes* case exploited this cross-over. It is, however, possible to separate the administration from the charging provisions and to introduce the notion of taxing the profit from the arrangements. The *Mayes* case is used by the GAAR Committee as a guide or reason why the GAAR is needed. As we know hard cases can result in bad law and I fear that this may be the case with the GAAR.

An area of potential weakness for principles-based drafting is where two pieces of legislation drafted independently are applied to a single set of circumstances with apparent unintended tax results. This could be said of the facts in *DCC Holdings*. If the overarching provision imposing the charge to tax on profits of a company or individual is principles based and two sets of provisions applying to a particular taxpayer produce an extraordinary result, the requirement to tax the profit and relieve the loss which fairly result from the application of the legislation could be sufficient to eliminate these unexpected results.

I would venture that the operation of the GAAR in a civilised society requires the principles behind the legislation to be well understood in order to determine whether the safeguards in the GAAR should apply. How else could anyone say whether the use of a provision can be regarded as a reasonable exercise of choices afforded by the legislation without understanding what the legislation was intended to achieve. If the application of the GAAR is not so dependent the GAAR's application would seem to be dependent on the subjective views of the panel, the authorised officer or the judges. The question should not be 'would I do this' but 'can it be said having regard to the words whether this taxpayer is permitted to do this?'

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## To impose a tax-related penalty on unsuccessful planning arising from marketed schemes ... would be sufficient to eliminate the problem the GAAR is aimed at

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As there will inevitably be a lapse of time before the implications of the re-write project are unwound the vast majority of egregious tax planning could be prevented by simply removing the 'no downside risk'. At the moment the taxpayer pays no penalties if the planning is supported by a professional opinion. To impose a tax related penalty on unsuccessful planning arising from marketed tax schemes would be sufficient to eliminate the problem the GAAR is aimed at.

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## Does the proposed GAAR give an unacceptable level of discretion to HMRC?



**Kevin Cummings,**  
*Partner, Berwin Leighton Paisner*

The question of ‘discretion’ afforded to HMRC is of course (ironically) *du jour*. Dave Hartnett currently finds himself in the public dock for having cut deals with a well-known financial institution, a purportedly improper exercise of care and management powers. While many might feel sympathetic to HMRC on this issue, there are genuine concerns that any GAAR (howsoever formulated) would be invoked improperly and indiscriminately and that its potential power would be so irresistible as to morph your average CRM from a *Sméagol* to a *Gollum* in a heartbeat.

But not so, perhaps. If we are to believe Aaronson, only a broad spectrum anti-avoidance rule allows HMRC to wield wide discretionary powers, becoming the final arbiters of the limits of responsible planning. There seems to be some truth in that position and Aaronson’s study group merits some recognition for the extent to which it tackles the risk (perceived or otherwise) of potential

administrative abuse. The (small ‘s’) ‘safeguards’, including the burden of proof on HMRC, an advisory panel with GAAR oversight, meddle-proof guidance notes cast in stone, the need for top level sign-off within HMRC and the right for taxpayers to invoke evidence of HMRC practice as a shield in litigation, appear to be credible checks and balances, if adopted as a package and not subsequently tampered with. And that is even without the technical ‘high hurdle’ that HMRC must be satisfied it can convince a court, by an objective measure, that the path taken by a taxpayer was not a reasonable exercise of choices.

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## [The recommendations] merit recognition for the extent to which they tackle the risk (perceived or otherwise) of potential administrative abuse

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At a practical and technical level, therefore, Aaronson has gone some way to safeguard that a GAAR, if adopted in its current ‘package’ formulation, could realistically be invoked only in *the most extreme of instances*. Only the Supreme Court can be said to have done more to counter perceived tax system abuse – the creative brutality with which it has interpreted statute in recent decisions means that current law leaves, in any event, very little need for Revenue officials to invoke anything beyond the traditional weapons.