COUNTERING TAX AVOIDANCE IN THE UK: WHICH WAY FORWARD?

Tracey Bowler

Tax Law Review Committee

THE INSTITUTE FOR FISCAL STUDIES

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Part 1: Introduction, Background and Executive Summary

1 Introduction

1.1 This is a discussion paper written for the Tax Law Review Committee of the Institute for Fiscal Studies considering the ways in which tax avoidance has been tackled and could be tackled in the UK.

1.2 The paper reviews the use of the anti-avoidance techniques employed over the past 11 years. It considers the extent to which the goal of preventing UK tax avoidance has been achieved in relation to the main direct taxes (income tax, corporation tax and capital gains tax) and stamp duty on land transactions.

1.3 The background to the paper and an executive summary can be found in Part 1. In Part 2 of the paper, some underlying issues are addressed. These are issues relevant to a consideration of existing approaches to anti-avoidance as well as possible new ones, such as what is meant by tax avoidance. In Part 3, the paper moves on to consider the existing techniques for countering avoidance: first, legislative; second, judicial; and third, administrative. In relation to the review of the existing legislative approach, there is a detailed analysis of two areas of tax law in Appendices A and B: that dealing with the taxation of employee shares and securities; and the changes to the operation of stamp duty and the introduction of stamp duty land tax. There is also a review of the different forms of Targeted Anti-Avoidance Rule (TAAR) in Appendix C. In relation to the review of the judicial approach to avoidance, consideration is given to whether steps could be taken to bolster this way of tackling the problem.

1.4 In Part 4, there is a review of possible other techniques: the use of a General Anti-Avoidance Rule (GAAR), an anti-abuse law and alternative ways of drafting legislation, as well as a consideration of how other jurisdictions have approached the issue. In the context of looking at the use of a GAAR, the Finance Acts since 1997 have been reviewed in Appendix D, considering the extent to which a GAAR would have resulted in less of that legislation being enacted. A summary of the techniques used in various jurisdictions is set out in Appendix E. The conclusions of the paper are set out in Part 5.

2 Background

2.1 The Chancellor of the Exchequer announced in the October 2007 Pre-Budget Report that there would be a review designed to find out how anti-avoidance legislation can best meet the aims of simplicity and revenue protection. Over the past 11 years, the government has used various methods to counter tax avoidance with varying degrees of success. The government has recognised that the complexity of tax law has increased to the point where the burden for taxpayers in complying with the law has become a real issue. Anti-avoidance legislation plays a large part in contributing to this complexity. In addition, it is clear that highly complex legislation does not necessarily achieve the purpose of stopping avoidance: the more detailed the rules, the more opportunity there may be for those wishing to do so to find and exploit loopholes. Then yet more complexity is added in response, and so the process continues. The introduction of rules requiring taxpayers and their advisors to give advance disclosure of certain tax avoidance arrangements has contributed to this process.

2.2 It is unrealistic to expect any tax system to exist without tax avoidance. That should not be the aim of anti-avoidance measures. Instead, it is a case of finding the right balance so that taxpayers can carry on their business and lives without undue restriction (and at times can be incentivised by the tax system to act in a particular way) but also so that the need for government to raise sufficient revenues is met. In so doing, it is for government to decide what acceptable tax planning/ mitigation/avoidance is.[1]

2.3 For the UK to remain internationally competitive for business, it needs a tax system that is sufficiently clear for business to be able to operate within with confidence, that is stable so that long-term decisions can be made without significant risk of tax change and that is fiscally comparable to its competitors' tax systems so that financing and transactions can take place without significant additional tax cost. However, the tax environment has become increasingly unstable, with significant changes to the tax system each year, and the general approach to avoidance has resulted in legislation that is increasingly difficult for taxpayers (and HMRC) to navigate. Headlines castigate the volume of tax legislation; however, it is not just the volume that is the problem, but also the complexity of the legislation and the uncertainty and instability that are involved in constant change.

[1]See further at paragraphs 4.15 and 4.16 below.

2.4 The legislative activity suggests that over the past twenty years there has been a significant increase in tax avoidance, both in the UK and internationally.[2] In the UK, various methods have been used to tackle the problem. One approach to avoidance has focused on getting better information for HMRC to tackle the avoidance; hence the disclosure rules that were introduced in 2004.[3] This has had the result that the corporate appetite for mass-marketed tax avoidance 'products', where the transactions are entered into simply to generate tax benefits, appears to have reduced considerably.[4]

2.5 However, bespoke structures are still being generated by or for corporate taxpayers. Taxpayers usually maintain that they are simply looking at ways to minimise their tax bill in relation to commercial transactions they undertake, as opposed to entering into a transaction solely to generate a tax benefit. Commercial transactions, executed in a tax-efficient (but possibly artificial) manner, highlight the difficulty in deciding where a transaction moves from being one of tax mitigation to one of tax avoidance. This is explored in Section 4 of this paper, which looks at what is meant by 'tax avoidance'.

2.6 So far as individual taxpayers are concerned, there is no evidence that the appetite of high-net-worth individuals for tax avoidance has diminished, even though anti-avoidance legislation has closed down many opportunities. This remains a cause for concern by HMRC.

2.7 In 1998, the government published a consultation document on the introduction of a General Anti-Avoidance Rule (GAAR).[5] The TLRC considered the possible drafting of such a provision.[6] However, no further steps have been taken by government to promote a GAAR. Instead, the use of general anti-avoidance language has spread to many discrete parts of the tax code. The overall effect may not be significantly dissimilar from adopting a GAAR.[7]

2.8 Following the 2006 Review of Links with Large Business, HMRC has taken initiatives to reduce the demand for tax avoidance products by

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[2]See J. Freedman, 'Defining taxpayer responsibility: in support of a general anti-avoidance principle', *British Tax Review*, 2004, vol. 4, pp. 332–57 and Law Administration, South African Revenue Service, *Discussion Paper on Tax Avoidance*, November 2005 (http://www.sars.gov.za/uploads/images/0_Discussion_Paper_on_Tax_Avoidance.pdf).

[3]Part 7 Finance Act 2004.

[4]While no specific study has been undertaken, this is the general impression of members of the TLRC.

[5]Inland Revenue, *A General Anti-Avoidance Rule for Direct Taxes: A Consultative Document*, October 1998.

[6]Tax Law Review Committee, *Tax Avoidance*, IFS Commentary no. 64, 1997 (http://www.ifs.org.uk/comms/comm64.pdf).

[7]The advantage, from HMRC's perspective, is that it has been able to expand significantly the use of general anti-avoidance language within the tax code but without having to concede any statutory pre-transaction clearance procedures. The inability of taxpayers to pre-clear transactions may be seen as making the UK tax system less competitive than others. Although not specifically related to anti-avoidance legislation, HMRC has taken steps to expand the scope of its non-statutory rulings procedures.

'rewarding' those who are assessed as low risk in relation to their tax planning by applying a lighter touch to their relationship.[8] This action may have some impact on the products market but will not remove the appetite for tax avoidance, a caution that is supported by a recent report by the Oxford University Centre for Business Taxation.[9] Such an administrative approach to the tackling of avoidance and the OUCBT report are considered further in Section 10 below.

2.9 The disclosure rules have contributed to an increasingly fragmented and reactive system, and both the government and taxpayers appear to recognise that this is not a sustainable approach going forward. Two main overlapping legislative approaches have been increasingly used as a result of the disclosures: providing extremely detailed and complex rules attempting to cater for every situation; and employing Targeted Anti-Avoidance Rules (TAARs). Both these approaches have generally been carried out on a reactive basis: as and when HMRC becomes aware of unacceptable tax avoidance, the legislation is modified or a TAAR is introduced. As a result, the tax legislation has become extremely long and complex.

2.10 The Tax Law Rewrite has added significantly to the length of the legislation and, in recasting the legislative material, has formulated even more of tax law as a series of detailed rules to be followed, often having little that is discernible in the way of principle or purpose underlying them. For example, in the case of income tax, Section 1 Income and Corporation Taxes Act 1988 previously stated that income tax is imposed on all property, profits or gains described in Schedules A, D, E and F. Now the section provides a list of seven parts of the legislation where the income tax charge may be found, along with a catch-all – 'any other amounts which, under the Income Tax Acts, are charged to income tax'. Any sense of purpose conveyed by the previous words has gone and a list is found in its place.

2.11 Length and complexity may not be ideal, but they would be acceptable if the result were a clear, efficient tax system where the line between what is within particular tax rules and what is not was clearly explained. That line is not clearly defined presently and, for the reasons explored in Section 4 below when looking at the definition of tax avoidance, may never be wholly clear. However, the answer to the question of whether a transaction will be viewed by HMRC as

[8] See HMRC, *HMRC Approach to Compliance Risk Management for Large Business*, 2007 (http://www.hmrc.gov.uk/budget2007/large-business-riskman.pdf).

[9] J. Freedman, G. Loomer and J. Vella, 'Alternative approaches to tax risk and tax avoidance: analysis of a face-to-face corporate survey', OUCBT, Working Paper no. WP08/14, 2008 (http://users.ox.ac.uk/~mast1732/RePEc/pdf/WP0814.pdf).

unacceptable tax avoidance often only becomes clear when legislation is introduced to counteract the tax avoidance. The impression can then be given that HMRC is changing its view of what is and what is not acceptable. There may be several reasons for this. HMRC may simply not be aware of the extent of the particular transactions. The transactions may start off as relatively infrequent with little revenue impact and only over time become sufficiently well used and costly to warrant legislative action. The problem, though, has been the perception of a reactive approach and one that lacks principle.

2.12 While this paper focuses on what can be done in the UK to address UK tax avoidance, it must also be recognised that cross-border tax avoidance is an increasing phenomenon. In a world in which there is significant mobility of capital, goods, services and people, cross-border avoidance cannot be ignored. Solutions therefore need to take this into account. In one way, cross-border avoidance is one of the most difficult areas to address: one method of reducing the scope for avoidance is to reduce the tax boundaries between goods, transactions or activities that are close substitutes;[10] the borders between tax jurisdictions form one boundary that cannot be eliminated (absent global coordination of tax systems) where identical or similar goods, transactions or activities are taxed in different ways and at different rates on either side of the boundary.

2.13 The most difficult examples of cross-border avoidance involve what is referred to as cross-border tax arbitrage, defined by one commentator as 'taking advantage of inconsistencies between different countries' tax rules to achieve a more favourable result than that which would have resulted from investing in a single jurisdiction'.[11] This area of tax avoidance raises many difficult issues, not least whether this is really avoidance at all.[12] Consider an example where a structure is put in place to enable two different taxpayers to take a deduction for the depreciation on an asset by virtue of one jurisdiction giving a deduction to the economic owner of the asset and one giving a deduction to the legal owner of the asset. In each jurisdiction, the deduction is legitimately obtained under the relevant tax laws, but, by using two jurisdictions, those rules in combination could be said to have been abused.

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[10]See further Section 5 below.

[11]H. D. Rosenbloom, 'International tax arbitrage and the "international tax system"', David R. Tillinghast Lecture on International Taxation, *Tax Law Review*, 2000, vol. 53, issue 137.

[12]See further 'Eizenstat on global taxation standards', report of an address to the Coalition of Service Industries and Tax Council, Washington, 26 July 2000 (http://usinfo.org/wf-archive/2000/000727/epf409.htm).

2.14 The whole nature of this type of tax avoidance, if that is what it can be called, is different from that of domestic tax avoidance. Specific anti-arbitrage provisions were introduced in 2005[13] but these have not stopped cross-border tax avoidance and, indeed, were only designed to address the UK end of the problem. Subject to applying those provisions, the judiciary has little scope to limit the cross-border arbitrage. GAARs and anti-abuse laws would also be difficult to frame in such a way as to enable cross-border arbitrage to be caught by them. It is beyond the scope of this paper to look at more radical methods of dealing with the use of tax rules in cross-border contexts, such as changes to the scope of Double Tax Treaties. Setting such types of approach aside, we are therefore left with an area where disclosure and information-sharing with other jurisdictions[14] giving rise to reactive legislation may be the only sensible approach.

2.15 Tax avoidance activity will no doubt be affected by the current economic conditions. Some activity will be curtailed, whether because there are simply fewer transactions taking place or because taxpayers become more risk averse or concerned about reputational risk. Other activity may increase: if taxpayers are struggling to realise profits, they may more easily be tempted to take part in transactions that will increase their profit as a result of the tax saving involved. Taxpayers with tax losses and no immediate prospect of profits may look to ways of transferring the benefit of their losses to those with profits. Individual taxpayers may be expected to continue to look for ways to exploit the continuing differential individual tax rates applicable to income and capital. How this balance – between tax avoidance activities being limited by current economic conditions and being increased by them – will turn out is a matter for future review.

[13]Sections 24–26 Finance (No. 2) Act 2005.

[14]Such as the Joint International Tax Shelter Information Centre formed between the UK, US, Australia and Canada.

3 Executive summary

3.1 ‘Tax avoidance’ is a highly subjective and political term and covers an enormous range of actions. It is no longer sufficient to distinguish between avoidance (a legal action) and evasion (an illegal action). The terminology has been complicated and politicised by the use of terms such as ‘acceptable’ and ‘unacceptable’ tax avoidance, begging the question: ‘Acceptable to whom?’. Yet it is clear that tax avoidance is a major factor in what has become known as ‘the tax gap’, i.e. the gap between what the authorities collect in revenue and what they think they should be collecting. It is suggested that tackling tax avoidance should be considered in this light as an important element in reducing the tax gap.[15] To do this, the causes of avoidance continually need to be identified. The way in which the avoidance is then dealt with will be determined by the nature of the avoidance and the costs. Those costs are not only the lost revenues arising from the avoidance, but also the costs of the anti-avoidance measures to taxpayers, the tax authorities and the economy as a whole.

3.2 Tax avoidance is a function of the tax base. In other words, it reflects the difficulty of describing in legislative terms what it is that Parliament wants to tax. In particular, it is often the case that boundaries within the system create opportunities for ‘avoidance’. To the extent that boundaries depend upon objective factors that cannot be distorted, there may be less scope for avoidance. However, if close substitutes are taxed differently, the system encourages taxpayers to choose the one that involves a lower tax cost. To the extent those boundaries are reduced, so the scope for tax avoidance is reduced. As a minimum, this involves reviewing where the boundaries exist in the current system and addressing the extent to which those boundaries can be justified and what the costs of those boundaries are. Political preferences and practical administration are likely to ensure that certain boundaries will remain within the tax system, and some boundaries, such as national boundaries, will always remain. Therefore other approaches also need to be considered after boundary minimisation.

3.3 However, this paper concludes that there is no ‘golden bullet’ in terms of a legislative, administrative or judicial approach that will solve the ‘tax gap’ problems caused by tax avoidance. Instead, a range of methods needs to be employed. Some already are employed by the government: for example, administrative measures such as the

[15] The government released estimates for 2005 which indicated a range of between £10 billion and £40 billion, albeit recognising that these are subject to a wide margin of error: see http://www.hmrc.gov.uk/research/measuring-tax-gap.pdf.

disclosure regime and the 'Risk Rating Approach' and legislative measures such as TAARs. Sometimes, all that is necessary is a specific change in the law to correct a flaw in the rules. However, these methods alone have been shown over the past 11 years to be inadequate, and, at times, have been counter-productive. Each one can fulfil a function as an anti-avoidance tool, but their use needs to be carefully focused so that, once the mischief has been identified, the tool is appropriately targeted. Other methods, as yet untested in the UK, such as a GAAR and alternative approaches to drafting of tax legislation (such as 'principles'-based drafting), can also perform specific functions.

3.4 This paper shows that each approach needs to be evaluated in terms of its appropriateness to deal with the tax avoidance occurring. So, TAARs need to be appropriately 'targeted' and not gradually become a GAAR distributed through the tax legislation in many pieces. Principles-based drafting may be a useful tool, but only when there is a satisfactory underlying principle that can be formulated. A GAAR may have a role to play as a line in the sand and as an aid to construction by the courts, but overseas experience and the review in this paper of the Finance Acts introduced over the past 11 years suggest that a GAAR is no more the solution than any of the other approaches.

3.5 In using these anti-avoidance tools, important issues concerning the relationship between HMRC, the taxpayers and Parliament are raised and these are addressed in the paper. In particular, the more the UK moves away from detailed prescriptive legislation in the form it has historically used, the more important become the questions as to where that missing detail goes and how it can be relied upon by taxpayers. If the detail is not in the legislation, the expectation is that it will be in HMRC guidance, but the ability of taxpayers to enforce such guidance is seriously limited at present. Until such issues surrounding non-legislative rule-making are addressed, the concern is that there will be continued resistance among taxpayers to the government adopting new anti-avoidance approaches and an increased feeling that the UK tax system is insufficiently certain for taxpayers to operate efficiently within it.

3.6 There is a range of anti-avoidance tools available to the government, as the paper illustrates. Avoidance, however, is invariably a symptom of some underlying problem in the tax system. The key therefore is to identify clearly the cause of avoidance and, having done so, to focus on how the anti-avoidance tools can be deployed in the most effective and efficient manner to address the problem and not just its symptom. Too often, anti-avoidance legislation tackles the symptoms, so that the problem merely emerges in due course in a different form. In dealing with any avoidance, however, it is important to consider not only the immediate objective of countering avoidance but also how different methods can operate effectively in balancing the needs of the taxpayer, HMRC and government.

Part 2: Some Underlying Issues

4 What is tax avoidance?

4.1 Defining what is meant by tax avoidance is far from easy. It can be distinguished from tax evasion, which is the illegal means to reduce tax liabilities such as making false statements on tax returns. This paper is not concerned with tax evasion. Tax avoidance, in contrast, is a legal means of reducing the tax payable, the question being whether the action works technically or not.

4.2 However, increasingly the distinction between tax avoidance and tax evasion has been blurred, at least by the tax authorities, and tax avoidance has been treated with some of the disapproval previously reserved for tax evasion.

4.3 This still leaves the question of just what it is that so much effort has gone into to counteract. Highly structured tax schemes with numerous steps included for no apparent commercial purpose may quite easily be recognised as tax avoidance, but these are increasingly not the real problem: large companies have become aware of the reputational risk involved in such schemes. This may be for a variety of reasons, two of them being HMRC pursuing such schemes more aggressively and the impact of the disclosure regime meaning that schemes are often counteracted relatively quickly.

4.4 Instead, the problem has shifted for most taxpayers to issues where taxpayers are carrying out commercial transactions but choose to do so in a way to minimise tax. It is clear from the study undertaken by the Oxford University Centre for Business Taxation that, generally, corporate tax managers can be expected to consider that minimising tax costs in such situations is not a matter of reputational risk.[16]

4.5 Is it tax avoidance if a company raises finance by equity rather than debt because it already has surplus losses and cannot realise the value of deductions for interest? Is it tax avoidance if an individual disposes of shares standing at a loss at the end of a year to set against the gains on other assets realised during the year? At one time, the answer to both these questions would have been a clear no, but the goalposts appear to have moved. We may have assurance that the capital gains tax anti-avoidance rules do not cover the latter example, but the question remains, not least because of the questions for taxpayers in relying on HMRC guidance, discussed further in Section 7 below. The problem

[16] Page 4 of J. Freedman, G. Loomer and J. Vella, ‘Alternative approaches to tax risk and tax avoidance: analysis of a face-to-face corporate survey’, OUCBT, Working Paper no. WP08/14 (http://users.ox.ac.uk/~mast1732/RePEc/pdf/WP0814.pdf).

with examples such as these is that they distract attention from tackling the more aggressive forms of tax avoidance. This paper looks at tackling tax avoidance in different ways, but it is suggested that focusing on what is the real mischief that the government wishes to tackle is a necessary first step.

4.6 More difficult examples highlight some of the other issues. Is it tax avoidance where a company that wants to buy equipment does so through a structure that generates a double tax deduction for the company's group, if this is the clear outcome that the legislation produces, even if one can assume that it is not what Parliament intended? The company's main purpose is a commercial purpose of buying equipment and financing the purchase at as low a cost as possible.

4.7 The transactions entered into by financial institutions raise other problems. The boundaries between a tax-efficient commercial transaction and a transaction designed solely to generate tax benefits can be far more difficult to discern.

4.8 Commentators spend much time debating what tax avoidance is, and that debate changes over time as governments seek to maximise their exchequer receipts in particular areas of the tax system. The OECD suggests that tax avoidance is 'the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow'.[17] The lack of precision in this attempt at a definition highlights the problems in identifying just what it is that we seek to stop in tackling tax avoidance. In addition, any reference to the intent of the lawmakers is fraught with difficulty when that intention can be far from clear in the context of highly technical provisions.[18] Also, while the lawmakers' intention is cast in stone on enactment, it can be difficult for those considering Parliament's intention to ignore current attitudes, which may have changed over time.

4.9 In the context of income tax, Lord Templeman offered the following definition in the *Challenge Corporation* case:[19]

'Income Tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without

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[17]OECD, Centre for Tax Policy and Administration, *Glossary of Tax Terms*, http://www.oecd.org/document/29/0,3343,en_2649_34897_33933853_1_1_1_1,00.html.

[18]See, for example, the SDLT (stamp duty land tax) provisions discussed in Appendix B below.

[19]*Challenge Corporation Ltd v. Commissioner of Inland Revenue* [1987] AC 155.

involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.'

4.10 However, even this appealing definition would soon be seen to be incapable of fully encapsulating all the nuances of what is and is not tax avoidance. An exemption from tax (and therefore taking steps to fall within it) may not depend upon any expenditure. An example of this problem arises in relation to income-shifting. In cases of income-shifting, one person shifts income that would otherwise be theirs to another person who can benefit from a reduced rate of tax on the income. The classic example of this arises in the context of husbands and wives owning a company between them and shifting income from the more highly taxed spouse to the other who pays a lower rate of tax.[20]

4.11 Looking at Lord Templeman's definition, it can be seen that the higher taxed spouse *does* give up income, but that person's actions can still fall within what HMRC considers to be 'tax avoidance'. If such income-shifting is tax avoidance, we are left with a situation where giving up investment income and gains by sharing savings and/or the underlying assets giving rise to those savings is not avoidance, but giving up the right to labour income is avoidance. It is hard to imagine a definition of tax avoidance that could encompass such distinctions.

4.12 An alternative to Lord Templeman's definition may be to consider what forms tax avoidance takes and agree on where the line between acceptable and unacceptable tax avoidance lies. Lord Walker of Gestingthorpe suggested the following categories of case:[21]

'1. Using a relief;
2. Finding a gap;
3. Exploiting or abusing a relief;
4. Anti-avoidance karate (turning anti-avoidance measures to a taxpayer's advantage and using them to produce a tax saving);
5. Unnatural assets or transactions (developing assets or transactions such as dividend stripping, purely to manipulate the tax rules);
6. Pre-ordained transactions;
7. Dodgy offshore schemes.'

4.13 However, even this has its limitations, which Lord Walker recognises. For example, when does the use of a relief become abuse or

[20]The government proposed legislation earlier this year in the Budget to counter such income-shifting, but only in specific and limited circumstances. In the light of considerable adverse comment, that draft legislation has now been withdrawn pending further consultation.

[21]'Ramsay 25 years on: some reflections on tax avoidance', an address to the Chancery Bar Association, 23 March 2004.

exploitation? Some lay people may argue that even using reliefs in an entirely legitimate and legislatively sanctioned way is, in a sense, a form of tax avoidance. On the other hand, every structure with an offshore element is not automatically ‘dodgy’: Lord Walker seemed to be contemplating the more evasive type of structures where the offshore element is there to hide activity. This may, however, verge on evasion rather than avoidance. In relation to gaps, he points out that in one sense every form of tax planning involves finding a gap; and at what point is a transaction preordained?

4.14 What Lord Walker’s list does illustrate is that the grey area surrounding the definition of what is tax avoidance will always be unclear at its edges. This leads to the untidy conclusion that tax avoidance is a concept not capable of precise definition. HMRC may often appear to consider tax avoidance to occur where it is sought to reduce the tax burden of individuals, businesses and other entities below the level envisaged by the government. The problem is that the envisaged level is usually unclear.

4.15 When discussion then turns to a distinction between acceptable and unacceptable tax avoidance, the definitions become even less clear. The very word ‘acceptable’ raises the question: ‘To whom?’. Depending upon the perspective of the person asked – taxpayer or tax collector – the answer may vary considerably. Ultimately, it should be a question of what is acceptable to government as the body responsible for the raising of taxes, but this is of little practical help as a day-to-day matter for taxpayers and HMRC.

4.16 From the point of view of providing a clear workable tax system within which taxpayers can confidently operate, identifying the boundaries between acceptable and unacceptable tax avoidance is important. However, from the perspective of a taxing authority, it may be thought better to keep such boundaries wide and fuzzy, thereby deterring taxpayers from participating in activities that potentially reduce the receipt of revenue. The problem with such an approach is that some taxpayers will not tolerate insufficient clarity. In today’s globalised economy, they will relocate to a less risky location. This has been seen recently in the formation of a new holding company in Ireland for the pharmaceuticals company, Shire, and the asset management group, Henderson, among others, with the reasons given including the uncertainty surrounding, and perceived problems of, proposed changes to the taxation of foreign profits and other potential tax changes.[22]

[22] Even if not going so far as to relocate, 23 of the respondents in the OUCBT study expressed exasperation with the complexity and unpredictability of current anti-avoidance law with all but one asserting that this hindered the competitiveness of the UK economy.

5 Boundaries

5.1 Rather than seek to define tax avoidance and then counter it, an alternative is to tackle the underlying source of the avoidance. To the extent the number of boundaries within the tax system can be reduced, so the scope for avoidance can be reduced. If close substitutes are taxed differently, the system is encouraging taxpayers to choose the one that gives them less tax cost. This has been particularly apparent in the context of financial instruments, where the same economic transaction can take numerous forms which may have significantly different tax treatments.

5.2 The review of the Finance Acts introduced over the past 11 years in the context of a GAAR in Appendix D highlights the sources of the avoidance. As will be seen in that review, the avoidance is usually generated by unsustainable boundaries in the system. If an economic activity can take more than one form and the tax treatment depends upon the form and not the substance, then taxpayers will often use the form that minimises their tax bill. It is a matter of tax policy as to where the boundaries should be, but it is clear that to the extent boundaries are put into the rules with differing tax results for the same economic activity, those boundaries will give rise to avoidance costs.

> ‘Progressive rates of taxation encourage income-splitting techniques; tax expenditures in favour of activities deemed worthy of encouragement lead to the creation of tax-inspired shelters; … administrative necessities such as limiting the taxing exercise to a particular period encourage manipulations of the timing of deductions and receipts of income streams.’[23]

5.3 So there will always be an element of ‘tax avoidance’ if there are unsustainable boundaries in the tax system and policymakers would be wise to remember this whenever creating a boundary: in particular, can it be adequately policed?

5.4 Some boundaries will always remain: for example, national boundaries and boundaries in time. Other boundaries will remain as policy matters. This paper considers how successful current approaches have been in tackling tax avoidance and whether alternatives may be more successful in tackling it. The criteria applied in this process ask whether the boundaries are clearly identified for the taxpayer, HMRC and the courts in order to enable the tax system to be operated on a clear and efficient basis and at the same time minimise tax avoidance. While

[23] J. Waincymer, ‘The Australian tax avoidance experience and responses: a critical review’, in G. Cooper (ed.), *Tax Avoidance and the Rule of Law*, International Bureau of Fiscal Documentation Publications, Amsterdam, 1997.

fuzzy boundaries may offer some deterrent advantage for revenue authorities, it is not suggested that intentionally making the tax system blurred and uncertain is an appropriate way to tackle avoidance.

6 Consequences of avoidance

6.1 There is also a separate question as to what should happen when a taxpayer does engage in tax avoidance. In the context of the taxation of employee shares, it is clear that the government moved from seeing anti-avoidance legislation as a way of ensuring that the 'correct' tax was paid for the economic activity entered into, to seeing it also as a way of punishing those who took part in the avoidance. So, for example, the scope of Section 447 of the Income Tax (Earnings and Pensions) Act 2003 was extended by paragraph 18 Schedule 2 of Finance Act 2005 to give HMRC the power to tax dividends paid by small companies as employment income, with the consequent National Insurance contributions, as well as under the dividend rules, unless the taxpayer can show that there is no tax avoidance motive. When this was pointed out to HMRC by the Tax Faculty,[24] HMRC refused to accept that the double charging was unacceptable. HMRC's response was that there should not be any special consideration given for such cases. To do so would mean giving a blessing to avoidance schemes, as even if the schemes were caught there would be no adverse consequences.

6.2 It is recognised that often a taxpayer will enter into a transaction feeling they have little to lose: the potential tax saving just needs to be set against any additional costs of the structure of the transaction. If it fails to avoid tax, the taxpayer has only suffered those transaction costs; the tax paid is the same as it would have been without the structure and interest payments to HMRC will not be penal. There is therefore a question as to whether some form of penalty should be imposed to deter avoidance. If yes, then this should be by way of an explicit penalty and not at the expense of the coherence of the tax system by imposing double charges.

6.3 There is an argument that if the penalties for avoidance are high enough, that will be a deterrent, but this is only acceptable when the underlying rules and rules determining the penalties are sufficiently clear that taxpayers can be confident as to whether their actions will give rise to penalties.

[24] Paragraph 37, TAXREP 29/05.

7 Non-legislative rule-making by HMRC

7.1 In the course of reviewing the current approaches, the problems surrounding non-legislative HMRC rule-making will be seen to be notable. In addition, non-legislative rule-making is likely to be a matter that needs to be addressed in the context of alternative approaches. The reason for this is that as pressure grows to reduce the complexity and detail of the legislation, so the need for extra-statutory guidance increases. Already, certain TAARs have required considerable amounts of guidance, and if principles-based drafting were to be employed, more non-legislative rule-making could be expected. Taxpayers and their advisors can be expected to demand that the detail of how the provisions will be operated by HMRC should be somewhere if that detail is not apparent from the legislation. However, non-legislative rule-making raises difficult questions regarding the powers of HMRC and the relationship between HMRC and taxpayers.

7.2 What is meant by non-legislative rule-making? First, it may be rule-making by HMRC or HM Treasury where explicit discretion or power to make rules by secondary or tertiary legislation is given. Second, non-legislative rule-making by HMRC may arise where primary legislation is complex and unclear. It can be in various forms, such as the HMRC Manuals, explanatory statements on the introduction of rules and Tax Bulletins. Increasingly, the legislation has been supplemented by these 'rules'. This has been seen particularly in the context of the introduction of some of the TAARs. Where the TAARs are insufficiently targeted, the response has been to give taxpayers assurances outside the legislation as to how they will work.

7.3 One particular example was the introduction of the capital gains tax TAAR in Section 16A of the Taxation of Chargeable Gains Act 1992. The TAAR was simply written and short. Its main provisions were:

> 'For the purposes of this Act, "allowable loss" does not include a loss accruing to a person if—
> (a) it accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements, and
> (b) the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.'[25]

7.4 However, the width of this relatively simple provision meant that HMRC needed to publish 17 pages of detailed Explanatory Notes to

[25] S16A(1) TCGA 1992.

explain how the legislation would be applied.[26] So, considering the example of the person who sells shares standing at a loss in order to set the loss against a gain on another disposal, the Explanatory Notes explain that this transaction will not be prevented, albeit that the legislation could be used to prevent this.

7.5 There are several problems with this approach. First, the Explanatory Notes are not themselves subject to the scrutiny and care in drafting given to legislation. By their nature, Explanatory Notes are not drafted in the precise way required for legislation.

7.6 Second, HMRC does not have the power to legislate: taxation can only be imposed by the legislature[27] and while HMRC may decide upon its own interpretation of the legislation, that interpretation is not binding on taxpayers save to the extent confirmed by the courts. 'HMRC's role is to administer the UK's tax and customs systems.'[28]

7.7 Third, the ability of taxpayers to rely on the guidance depends upon the type of transaction involved: if it is a single transaction entered into in reliance on specific guidance, the taxpayer can rely on the guidance (although enforcement may be cumbersome, for the reasons explained below). In contrast, if the taxpayer is seeking to rely on guidance in relation to a continuing state of affairs, the taxpayer is exposed to changes in that guidance. An example of this is considered in paragraphs A.41–A.46 of Appendix A below in the context of the changing approach of HMRC to the taxation of private equity 'ratchets' in the context of the employee share rules.[29]

7.8 To enforce guidance, the taxpayer must seek judicial review. Judicial review is a process that is costly and time consuming and which is not easily achieved. In order for a taxpayer to seek judicial review, an application for leave to apply for judicial review must be made within three months of the decision that is being challenged. The application is made to the High Court by a form setting out the grounds of the application and an affidavit setting out the factual background. Clearly, three months is an extremely short deadline even for the well-advised taxpayer. If the judge considers that the papers show an arguable case,

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[26] HMRC Guidance, *Capital Gains Tax – Avoidance through the Creation and Use of Capital Losses*, 19 July 2007 (http://www.hmrc.gov.uk/cgt/cgt-recent-developments.pdf).

[27] Article 4 Bill of Rights 1689.

[28] http://www.gls.gov.uk/about/departments/hmrc.htm.

[29] See also *R v. C&E Commissioners ex parte F & I Services*, discussed further in paragraph 7.15 below.

leave to apply for judicial review is granted, but after this initial tight timescale matters may then move very slowly.[30]

7.9 Consequently, a major drawback of judicial review at present is that it is effectively unavailable to most potential applicants: they do not know about it, cannot understand it, cannot afford it, or find the prospect of going to the High Court too daunting. This situation would be improved if the new Tribunals, which will handle tax appeals from 2009, have jurisdiction to review the exercise of discretionary acts by HMRC and review the application of HMRC guidance.

7.10 In addition to the procedural and costs issues, the ability of taxpayers to use judicial review in the context of non-legislative rule-making is not always clear. It is beyond the scope of this paper to set out in detail the present state of the law with regard to the use of judicial review in relation to the exercise of powers by HMRC. However, certain points are addressed below, as the limits of challenge may be increasingly important as new ways of tackling avoidance are explored by the government.

7.11 In the context of this paper, the key issues limiting the ability to challenge by way of judicial review concern the application of judicial review to situations where HMRC has issued guidance to taxpayers generally regarding the application of legislation.

7.12 First, there are situations where HMRC guidance appears to differ from the conclusion that would be reached just by reading the legislation. An example of this arises in connection with the wide-ranging capital gains tax TAAR found in Section 16A TCGA 1992, where the legislation could be read to apply much more widely than HMRC maintains is the case in its Explanatory Notes. Where the HMRC treatment is recognised by HMRC as being a concession from the strict reading of the law, then there is the system of extra-statutory concessions. Even these raise issues of enforcement. The judiciary has frequently indicated that it is uncomfortable with the concessions system: for example, 'One should be taxed by law and not be untaxed by concession'.[31]

7.13 That said, extra-statutory concessions have been upheld by the courts (although they are not enforceable in cases of avoidance[32]). At the same time, the courts have decided that the power to grant them should only

[30] Current delays in the Administrative Court are understood to be more than 12 months.

[31] Walton J in *Vestey and Others v. IRC (No. 2)* [1979]3 WLR 915.

[32] *R v HM Inspector ex-parte Fulford Dobson* [1987] STC 344.

be exercised as part of HMRC's duty of care and management. This was made clear in the case of *R (on the application of Wilkinson) v. IRC*,[33] where the Court of Appeal held that the Inland Revenue had no power to grant a concession to overrule an unequivocal piece of legislation unless this could be said to 'facilitate the overall task of collecting taxes'. As a result of this case, the government announced that the power to make concessions from the strict application of tax law is not as wide as had previously been thought and consequently the concessions are being reviewed to determine those that are not within HMRC's powers of 'collection and management'. Section 160 of the Finance Act 2008 gives the Treasury power to make any existing concession statutory by order. In so doing, it defines an existing concession to include a statement of any sort – whether it is described as an extra-statutory concession, a statement of practice, an interpretation, a decision, a press release or in any other way – that provides a concession that a taxpayer would not, or may not, be entitled to under the law. This power of the Treasury only applies to existing concessions. Going forward, HMRC's administrative powers have been limited by the *Wilkinson* case.

7.14 More difficulty is posed by statements made by HMRC that explain the legislation and are not considered by HMRC to deviate from the legislation. What if a taxpayer considers that HMRC's guidance is wrong in law? The taxpayer could rely on making their argument through the courts, but that raises enormous cost issues and risk issues for the taxpayer. Alternatively, the taxpayer could seek judicial review on the basis that the HMRC treatment as shown by the guidance was 'ultra vires'. However, in order to seek judicial review, the taxpayer also needs to show that they have sufficient interest in the matter to qualify them to make the application. These are high hurdles (albeit not impossible, as cases such as *R v Department of Social Security ex parte Overdrive Credit Card Ltd*[34] show) and it must be asked whether many taxpayers would feel confident of passing these hurdles or be prepared to spend the money in order to do so. If the answer to that is that very few would, then effectively HMRC is legislating by default.

7.15 The other potential source of problems in HMRC guidance is the guidance changing. Usually, the reason given for a change in guidance is that HMRC has been advised that its guidance is wrong in law. Again, judicial review is potentially available, but the case of *R v. C&E*

[33] [2002] BTC 97.

[34] [1991] BTC.

Commissioners ex parte F & I Services[35] held that while a taxpayer could rely on the legitimate expectation generated by guidance, that expectation is limited to circumstances where reliance has been placed on the changed statement. In that case, a VAT clearance for a voucher scheme was withdrawn following a change in view of the Customs and Excise as to the operation of the law. The taxpayer had incurred expense on the introduction of the scheme. It was stated by Lord Justice Sedley that 'the law recognises no legitimate expectation that a public authority will act unlawfully. It is only where the expectation is of a particular exercise of managerial discretion that the court will begin to examine its legitimacy.'[36]

7.16 Consequently, this paper maintains that the more tax rules are dealt with by way of non-legislative methods, the more exposed taxpayers become to these limited forms of redress. Government should only permit the increased use of non-legislative rule-making if the problems highlighted here are adequately tackled. Ways of tackling the problems are suggested in paragraph 13.21 below.

[35][2001] BTC 5266.

[36]At page 5283.

Part 3: Current Approaches Used to Counter Tax Avoidance

8 The legislative approach

8.1 Legislation used to counteract tax avoidance can be seen as falling into two groups: the first is the legislation that changes the way the tax system deals with a particular transaction or arrangement; the second is legislation that introduces TAARs – specific anti-avoidance rules – which are bolted on to existing legislation or are included in new legislation.

System rule change

8.2 When legislation is introduced to change the way in which the tax system treats a particular transaction, it has often been the case that the rules are changed incrementally, tackling one hole or problem after another rather than addressing whether the fundamentals underlying the particular area need to be altered. Those fundamentals are often giving rise to distinctions or boundaries in the tax rules, which feed the tax avoidance planning. Piecemeal changes do not address the underlying problems and can sometimes increase the potential for tax avoidance.

8.3 Legislation has not always taken a piecemeal approach (consider, for example, the dramatic changes arising from the abolition of advance corporation tax in 1998), but historically this has been the preferred method for tackling tax avoidance.

8.4 In order to see more clearly what the problems with the historical approaches to tax avoidance have been, two areas of tax legislation that have undergone considerable change in the last 11 years are analysed in detail in Appendices A and B. These areas deal with the taxation of employee shares and securities and the changes to stamp duty arising in connection with the introduction of stamp duty land tax (SDLT). Those areas are primarily ones where the anti-avoidance approach has been one of changing the rules applying to the relevant transactions and arrangements. Many issues are raised by the ways in which this was done, but in summary it can be said that it has not been an efficient process in either case for taxpayers and HMRC, and it has not been as effective at countering tax avoidance as government may have hoped.

8.5 Why has this approach failed to satisfactorily counteract tax avoidance? One of the main reasons is that the legislation has been reactive rather than proactive. Structures seen as giving rise to avoidance have been responded to in a piecemeal fashion and the result has been complex and unwieldy systems that still leave loopholes. In addition, the width of many of the anti-avoidance provisions does mean that arrangements with no tax avoidance motive can be affected. This then means that HMRC statements and concessions need to be relied upon in order to make the system workable for those treading the ‘ordinary and straightforward path’. Accordingly, the issues surrounding non-legislative rule-making addressed in Section 7 above gain increasing significance.

8.6 In the context of stamp duty, the changes in rates of stamp duty meant that there was increased incentive for taxpayers to avoid the charges, and the disparity in rates for different transactions encouraged taxpayers to use one form of transaction instead of another in order to save tax. Such boundaries will always increase the risk of what the government may view as unacceptable tax avoidance and will therefore carry tax avoidance costs whether through that tax avoidance or through the process of including measures to deter it.

8.7 Often, changes have been made hastily, with little consultation. In the context of the introduction of SDLT, the consultation process seemed to be overridden by the desire to do something to counteract the perceived abuse. It is therefore particularly welcome that the government is consulting widely in connection with the latest anti-avoidance approaches to be explored.

8.8 In the context of reviewing the existing statutory approaches to tackling UK tax avoidance, it is appropriate to consider not only whether the legislation has been successful in its anti-avoidance aim, but also whether this approach results in legislation of the standard that taxpayers can reasonably expect.

8.9 At the most basic level, legislation should uphold the rule of law. Much could be written as to what exactly this means, but it is generally accepted that the rule of law requires that ‘legal rules “should be capable of guiding one’s conduct in order that one can plan one’s life”. In other words, legal rules should meet a variety of criteria, including that they should be prospective, not retrospective; [and] that they should be relatively stable’.[37]

8.10 More specifically, the OECD has carried out work addressing regulatory reform and the table below sets out the recommended checklist. This has in turn been recommended by the House of Lords,

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[37] House of Lords Select Committee on the Constitution, *Relations between the Executive, the Judiciary and Parliament*, Report with Evidence, 26 July 2007 (http://www.publications.parliament.uk/pa/ld200607/ldselect/ldconst/151/151.pdf). The quote within the quote comes from a paper commissioned from Professor Paul Craig, Professor of English Law at the University of Oxford.

in its Sixth Report on the Constitution,[38] as the standard that should be applied to legislation.

OECD regulatory checklist[39]

- Is the problem correctly defined?
- Is government action justified?
- Is regulation the best form of government action?
- Is there a legal basis for regulation?
- What is the appropriate level (or levels) of government for this action?
- Do the benefits of regulation justify the costs?
- Is the distribution of effects across society transparent?
- Is the regulation clear, consistent, comprehensible, and accessible to users?
- Have all interested parties had the opportunity to present their views?
- How will compliance be achieved?

8.11 Often, tax avoidance legislation brings into sharp focus the question of correct definition of the problem and the need for clear, consistent, comprehensible and accessible legislation.

TAARs

8.12 Appendix C sets out the main provisions of many of the TAARs used in the past 11 years. One possibly surprising feature is the variety of forms of TAARs used. This in itself increases the complexity and uncertainty of the legislation, quite apart from any question as to whether any particular TAAR performs its anti-avoidance role efficiently. Having a plethora of different forms of wording gives rise to arguments over whether small differences cause the provisions to operate differently and means that, as and when the TAARs are litigated, a decision of a court as to the interpretation of one TAAR will have reduced significance for a differently worded TAAR.

8.13 To some extent, the problem of inconsistent wording seems to have been recognised by HMRC during the course of its current anti-avoidance review. In the Budget of 2008, it was stated that HMRC is considering whether there might be scope for greater alignment of provisions that include the concept of 'unallowable purposes'.[40] Such a step would be welcome, but it still leaves numerous other forms of TAAR; further steps to align the approaches taken would be desirable.

[38] 31 March 2004; http://www.publications.parliament.uk/pa/ld200304/ldselect/ldconst/68/6810.htm.

[39] *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation*, OECD/GD, Paris, 1995 (http://www.olis.oecd.org/olis/1995doc.nsf/LinkTo/NT000009E6/$FILE/PME5205.PDF).

[40] Paragraph 3.8 of HMRC, *Simplifying Anti-Avoidance Legislation: A Progress Report on the Anti-Avoidance Simplification Review*, 12 March 2008 (http://www.hmrc.gov.uk/budget2008/aa-simplification.pdf).

8.14 More important for the efficiency of the tax system is the fact that a plethora of TAARs, all with their own tests, can give rise to real costs for taxpayers in determining whether their commercial transaction falls foul of the TAARs. Most TAARs include the taxpayer's motives for entering into a transaction as a key feature. If a TAAR carries an 'unallowable purpose' test, there are complex questions of construction to be deliberated over by the taxpayer, such as working out which part or parts of commercial arrangements the TAAR applies to. The test will also contain elements requiring there to be a 'tax advantage' or tax benefit, and the taxpayer is left to come to a conclusion as to what their transaction should be compared with in order to determine whether such advantage or benefit has been obtained.[41] Often most difficult, though, is the need to weigh up at what point taking into account the tax treatment of a transaction (which inevitably is nearly always done) becomes so much a feature of the transaction that it can be said to be the main purpose, or one of the main purposes, of the transaction.

8.15 Notably, these more general motive-based TAARs were considered by a majority of the participants in the OUCBT report as being too vague or too opaque such that they threaten to capture legitimate commercial transactions.[42]

8.16 It will not make the tax system simpler, more effective or more attractive to business to have additional widely drafted anti-avoidance provisions limited predominantly by a tax avoidance purpose test rather than by clearly identifying the mischief concerned. Indeed, if widely drawn TAARs continue to proliferate, there will come a point when the tax system effectively has a GAAR, but one with variations of test applying to one transaction.

8.17 Some may argue that widely drawn TAARs[43] are acceptable if there is a clearance system under which the taxpayer can seek certainty of tax treatment for a particular transaction.[44] However, this raises significant cost issues for HMRC, particularly as taxpayers tend to seek 'comfort' clearances in all cases where a clearance system can potentially apply

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[41]Lord Hoffman has provided some insight into the construction of tax advantage and tax benefit tests in the cases of *Commissioner of Inland Revenue v. Hit Finance Limited* and *Commissioner of Inland Revenue v. Tai Hing Cotton Mill (Development) Limited* concerning the application of a tax benefit test in Hong Kong's GAAR. It is yet to be seen whether Lord Hoffman's approach will be built on in the UK.

[42]Section 3.2.1 of J. Freedman, G. Loomer and J. Vella, 'Alternative approaches to tax risk and tax avoidance: analysis of a face-to-face corporate survey', OUCBT, Working Paper no. WP08/14, 2008 (http://users.ox.ac.uk/~mast1732/RePEc/pdf/WP0814.pdf).

[43]Or what some commentators describe as mini-GAARs.

[44]While HMRC has established a new Clearances Service for large business as of April 2008, it has also stated that it will not issue clearances where 'tax avoidance' activities are involved: paragraph 3.27 and annex C of HMRC, *Giving Certainty to Business through Clearances and Advance Agreements*, 20 June 2007. Quite how this position will affect the operation of the new clearances is not yet clear.

rather than in just the situations where the matter is really in doubt. Setting out guidance as to HMRC's view regarding the application of the TAAR will not reduce *such* clearance applications. An alternative would be to include statutory safe harbours.[45] This operates well in the context of Treasury Consents, but if used more generally it would be necessary to bear in mind that a list of this sort will only assist taxpayers where they can structure their transaction to fall squarely within a safe harbour and will often raise questions as to why other similar transactions are not in the safe harbours.

8.18 All this leads back to the conclusion that TAARs need to be well targeted in order to be an effective and efficient method of tackling avoidance. In particular, in considering the costs of implementing different forms of TAAR, it is not just a question of what tax receipts may be exposed for the government if one particular TAAR is introduced rather than another. It is also a question of what costs will be imposed on taxpayers in seeking to operate within the system; and what costs will be imposed on the tax authorities in operating the system, whether as a result of clearance demands, litigation of uncertain provisions or other administration of the system. These costs can outweigh the expected amount of lost revenues when a poorly targeted TAAR is compared with a well-targeted TAAR.[46]

8.19 In addition, some of the more broadly worded TAARs may not be as effective as HMRC would seek to maintain. Some commentators point out that when there is a transaction that is carried out for commercial reasons but that happens to have tax planning measures built into it, the courts have seemed reluctant to isolate the tax avoidance elements from the overall commercial transaction.[47]

8.20 TAARs also often throw up the problems of non-legislative rule-making commented upon in Section 7 above. Take, for example, the capital gains tax TAAR contained in Section 16A TCGA 1992 and considered in paragraph 7.3. It is a simply written, concise provision, but the simplicity of the words does not mean that the provision is effective in identifying the mischief at which it is aimed. Seventeen pages of Explanatory Notes are used instead of detailed legislation. This may be seen as a more flexible approach for HMRC, giving it scope to adapt its interpretation of the provision as circumstances and tax planning change, but it is that very flexibility which makes

[45] Such as those listed under the Treasury General Consents 1988.

[46] This exercise is not limited to considering what type of TAAR to use. It is necessary in comparing any of the approaches to dealing with a particular form of tax avoidance.

[47] See, for example, page 1940 of *Tiley & Collison's UK Tax Guide*, 2006/07.

taxpayers feel exposed to uncertainty and change because of the problems discussed in Section 7.

8.21 The effectiveness of TAARs and the clarity of the system are not improved by putting provisions into secondary rather than primary legislation. This may make the process of reaction to schemes and, indeed, to consultation seem easier at first sight, but it is the extent to which the TAAR is clearly and appropriately targeted which determines its effectiveness. A clear example of the problems that can arise with hasty secondary legislation is described in paragraphs B.21–B.27 of Appendix B below.

8.22 However, the continuing problem with TAARs is that they are reactive and do not help to make the system clearer and more accessible. There will be circumstances when a well-targeted TAAR achieves the aim of preventing a particular form of avoidance. An example of one TAAR that is generally perceived as being appropriately targeted is that contained in Sections 184A–F Taxation of Chargeable Gains Act 1992. However, when the mischief cannot be clearly and accurately identified, more broadly worded TAARs and mini-GAARs raise problems of construction for taxpayers and consequently increase costs for them. They also bring the implications of non-legislative rule-making into focus. In such situations, another approach may be at least as successful in deterring the avoidance and cause less harm to the coherence and clarity of the tax system.

9 The judicial approach

9.1 In recent years, there has been a notable change in the emphasis of the judicial approach to tax avoidance. As in all areas of law, the jurisprudence is developing. This is not to deny the validity of older cases such as *Furniss v. Dawson*[48] and *Ramsay*,[49] but recent cases have shown that the application of the ‘doctrines’ arising from those cases does not simply rely upon determining whether there is a preordained series of transactions and steps inserted with no commercial purpose (other than the avoidance of a liability to tax). Instead, cases such as *Macniven v. Westmoreland*[50] and *Barclays Mercantile Business Finance Limited v. Mawson*[51] emphasise the need to apply the parliamentary purpose of the relevant legislation to the reality of the transactions undertaken by the taxpayer. Some may argue that this has always been the case. However, it has now been clearly enunciated in these cases. In the *Barclays Mercantile Business Finance* case, the House of Lords stated that ‘The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description’.[52]

9.2 At one level, it has always been the role of the judiciary to look to the purpose of a statute, but recent cases have emphasised the importance of this role as opposed to the more mechanistic view of the approach to avoidance which had been perceived previously. Indeed, Lord Hoffman wrote after the case: ‘The primacy of the construction of the particular taxing provision and the illegitimacy of rules of general application has been reaffirmed by [*Barclays Mercantile*]. Indeed it may be said that this case has killed off the *Ramsay* doctrine as a special theory of revenue law and subsumed it within the general theory of the interpretation of statutes.’[53]

9.3 Lord Hoffman stated clearly in the case of *Macniven v. Westmoreland* that no overriding judicial anti-avoidance principle has been developed by the courts: ‘the courts have no constitutional authority to impose

[48] [1984] AC 474 (HL).
[49] *WT Ramsay Ltd v. IRC* [1982] AC 300 (HL).
[50] 2001 UKHL 6.
[51] 2004 UKHL 51.
[52] Paragraph 32.
[53] Page 203 of ‘Tax avoidance’, *British Tax Review*, 2005, no. 2, pp. 197–206.

such an overlay upon the tax legislation'.[54] *Ramsay* is, instead, an application of the principle that the courts are required 'to ascertain what Parliament meant by using the language of the statute'.[55] An overriding anti-avoidance principle, whether in the form of a GAAR or in other form, is for Parliament to provide by legislation.

9.4 However, there are limits to this purposive approach, particularly where highly technical anti-avoidance legislation is concerned. Two recent cases decided within weeks of each other have highlighted the issues involved. In the first case – *Revenue and Customs Commissioners v. Limitgood Ltd*; *Revenue and Customs Commissioners v. Prizedome Ltd* – the issues concerned the application of restrictions on the use of capital losses where the ownership of companies had changed. Anti-avoidance legislation has been introduced since 1993 aimed at stopping a group from buying a company or group with realised allowable losses ('pre-entry losses'), or assets that could be sold at a loss, in order to shelter the acquiring group's gains. In this case, Limitgood and Prizedome were sold to another group (the 'GL group') and, in the course of being sold, crystallised a £113.9 million pre-entry loss. Shortly afterwards, the GL group was acquired by another company (which, together with another recently acquired subsidiary, formed the 'GH group'). The question was whether the £113.9 million of pre-entry losses had become available for set-off against gains arising in the GH group on assets owned by companies that also joined the GH group at the same time as Limitgood and Prizedome had done. The answer depended upon the construction of detailed rules prescribing which group a company was treated as belonging to at which time.

9.5 Mr Justice Blackburne allowed the Revenue's appeal from a majority decision of the Special Commissioners. It was accepted by Counsel for the companies that the arrangements had been contrived in order to obtain the tax relief sought. Mr Justice Blackburne looked to the object or purpose of the legislation restricting the use of pre-entry losses and to the purpose behind specific rules regarding the identification of groups. He decided that the object of those specific provisions was to put losses accruing to companies in a group that is subsequently taken over by another group, on the same footing as losses accruing to a single company that is subsequently taken over by a group. He then asked whether that purpose could be achieved when applying the detailed rules. He concluded that it could and therefore construed

[54] Paragraph 29.

[55] Ibid.

references in those rules accordingly, rejecting what he called the more literal approach of Counsel for the taxpayers.

9.6 Shortly afterwards, the Court of Appeal considered the case of *Revenue and Customs Commissioners v. Bank of Ireland Britain Holdings Ltd*.[56] Again the court emphasised that 'if it is presented with two alternative constructions, the construction which gives a result which is in line with the policy of the Act should be preferred to a construction which gives a result so bizarre that it could not possibly have been intended'.[57] However, the problem in this case was that the answer depended upon two separate pieces of legislation with no common purpose, where highly technical and specific rules did not take into account the situation involved.

9.7 Bank of Ireland Britain Holdings Ltd, a UK-resident subsidiary of the non-UK-resident Bank of Ireland (BI), entered into agreements with BI and an overseas third party regarding preference shares in an overseas subsidiary of the third party (X). Those agreements resulted in a tripartite repo transaction: the third party agreed to sell the shares in X to BI and under a related agreement was required to buy them back following the exercise of a put option by BH (BH and BI also having entered into put and call agreements regarding the shares). Under the manufactured dividends legislation, a deemed manufactured dividend was deemed to be paid by the third party, but the question was whether the payment was deemed to be made to BH or to BI. The scheme sought to take advantage of a mismatch between two independent sets of legislation within the manufactured dividends provisions, 'each of which is replete with deeming provisions'.[58] At the level of the High Court, Mr Justice Henderson stated: 'there is no suggestion that the transactions had any independent commercial purpose and the inference that this was a carefully designed tax avoidance scheme is … irresistible'.[59] This was a scheme full of the hallmarks of what many would classify as clearly unacceptable avoidance, such as circularity and 'dodgy offshore companies'.

9.8 In this case, the judgments in the Court of Appeal and the High Court are both illuminating. In applying the purpose of the legislation, Mr Justice Henderson came to the conclusion that the scheme worked: BH could claim a deduction for a deemed manufactured dividend without

[56] [2008] EWCA Civ 58.

[57] Paragraph 38.

[58] Paragraph 2 of Mr Justice Henderson's judgment, [2008] STC 253.

[59] Paragraph 9.

being taxable on a deemed receipt. Mr Justice Henderson looked at the purpose behind the repo legislation: namely, to recognise that repos provided funding in a way commercially similar to a secured loan. ‘It is intelligible that Parliament should have decided to tax repos in accordance with what is usually their underlying economic substance.’[60] Precisely because of that, the legislation taxes the deemed return on that ‘loan’ in the hands of the ‘lender’, but here the payment was made not to that lender (BI) but to a third party (BH). However, Mr Justice Henderson was left with the fact that the wording of the relevant legislation was ‘clear and unambiguous’: the deemed loan was from the deemed lender – BI – notwithstanding the actual payment to BH.

9.9 The Court of Appeal confirmed Mr Justice Henderson’s decision. Lord Justice Lawrence Collins set out its reasons. He made clear that the starting point was the ordinary meaning of the relevant section’s words. The section did not contemplate or deal with assignment. It was accepted that the scheme was relying on a mismatch in terms in different sections but Lord Justice Lawrence Collins did ‘not consider that there is any legitimate process of interpretation which will solve the Revenue’s problem’.[61] Regardless of how circular the transactions were or how much they were motivated by tax avoidance, there was no overriding anti-avoidance principle which could be applied. The courts can only look at what has in fact taken place considering all the elements of the transaction and apply the statutory rules to that set of facts. In this case, there had in fact been the assignment and the legislation did not deal with that situation.

9.10 It is to be welcomed that recent cases have made clear the importance of determining what the purpose of statutory provisions is and to apply them accordingly. Interestingly, this approach appears to be one which is also being adopted in other common-law jurisdictions such as Australia and Canada.[62] However, the recent UK cases referred to above highlight some of the difficulties faced in applying current legislation to tax avoidance. The courts in the *Bank of Ireland* case were clear as to what the purpose of the repo/manufactured dividend rules was but that did not help them to counter what was undeniably a tax avoidance scheme. When left to apply the legislation as written,

[60]Paragraph 28.

[61]Paragraph 44.

[62]See J. Freedman, ‘Converging track? Recent developments in Canadian and UK approaches to tax avoidance’, *Canadian Tax Journal*, 2005, vol. 53, no. 4, pp. 1038–46, and C. Evans, ‘Barriers to avoidance: recent legislative and judicial developments in common law jurisdictions’, UNSWLRS 12, University of New South Wales Faculty of Law Research Series, 2007.

there was no scope to insert terms to counteract the scheme. In contrast, in the *Limitgood and Prizedome* case, the court could both see the purpose of the provisions and interpret those provisions in accordance with that purpose in such a way as to counteract the avoidance. In each case, statutory construction was paramount.

9.11 In Section 13 of the paper, consideration is given to possible new legislative drafting methods, including the extent to which purpose statements would be of assistance within the provisions themselves. The courts have shown themselves to be prepared to determine the purpose of statutory provisions without purpose statements within the sections, but whether purpose provisions are included or not, if detailed technical legislation gives rise to a particular result as a consequence of the way in which it is drafted, knowing the purpose of the legislation will not enable the courts to ignore the result of the words used. In addition, it may be that the result most in line with the purpose of the legislation may itself lead to tax avoidance in some cases; see, for example, Mr Justice Henderson's reasoning in the *Bank of Ireland* case that the purpose of the manufactured dividends rules led to BI being the recipient of the manufactured dividend and not BH.

9.12 Bearing these conclusions in mind, is there anything more that can be done to bolster the ability of the courts to counter avoidance? Purpose statements in the legislation would appear otiose. The courts have shown that they are capable of understanding the purpose of legislation. In addition, for the reasons considered below in Section 13, the inclusion of purpose statements may even be counterproductive. The real problem arises when the legislation is so technical and prescriptive that the courts are not left room to manoeuvre to achieve the purpose of the legislation. Such situations are also not likely to be helped by a GAAR. Often, the taxpayer will be relying on a safe harbour built into the anti-avoidance rules, and a GAAR (at least in the form considered in this paper) would need to allow for such safe harbours.

9.13 Instead, the courts would be assisted by legislation that is less detailed. It would be worth considering what the result in the *Bank of Ireland* case would have been if the repo legislation had not been interwoven by pages of complex deeming provisions but had been boiled down to a principle that repos would be treated as bank loans. However, this is no more a golden bullet than any other method of tackling avoidance. Structures may be developed seeking to rely on a principle rather than detailed provisions. Other methods of tackling avoidance would also be needed, but their use may be facilitated by the use of principles where these are themselves capable of being encapsulated by legislation. A GAAR or TAARs could operate more clearly and such an approach would enable the tax system to develop its coherence and prevent the type of ‘black-letter’ avoidance involved in the *Bank of Ireland* case.

10 The administrative approach

10.1 In November 2006, HMRC launched the Varney Review, which was intended to find ways to improve the relationship between HMRC and large businesses. One of the results has been the 'Risk Rating Approach' under which companies are allocated a risk rating by HMRC. This rating determines how much intervention the company can expect in its tax affairs and the nature of the working relationship between HMRC and the company.[63]

10.2 HMRC sees this as an administrative way to incentivise taxpayers to increase their transparency about the transactions they undertake and to curtail tax avoidance activities. However, while company tax managers may wish to be seen as open and transparent, this does not necessarily mean that they will alter their behaviour.[64] This seems to be particularly the case when the company tax manager believes that HMRC's view as to what is unacceptable is not in line with the legislation.[65]

10.3 In addition, companies can be expected to carry out a cost–benefit analysis. If a company does not consider the benefits of reduced HMRC intervention and a better working relationship to outweigh the costs in terms of tax savings arising from more aggressive tax planning, the company is unlikely to alter its behaviour.[66]

10.4 While this administrative approach may be one additional tool that can be used to combat tax avoidance, other approaches will be needed if these reservations remain prevalent. Indeed, in order to alter the attitude of corporates who resist the incentives being offered by HMRC, the tax system needs to be seen by them as clearer and more consistent. At the moment, the argument is there, for those who wish to use it, that it is not the taxpayer's fault if they are simply relying on the complexity and inadequacies in the system to save tax in relation to their commercial transactions.

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[63]A report that includes and analyses a survey of companies on the initial implementation of this approach is J. Freedman, G. Loomer and J. Vella, 'Alternative approaches to tax risk and tax avoidance: analysis of a face-to-face corporate survey', OUCBT, Working Paper no. WP08/14, 2008 (http://users.ox.ac.uk/~mast1732/RePEc/pdf/WP0814.pdf).

[64]A view supported by research carried out for HMRC: A. Coulter and L. Joyce, *Research to Support the Implementation of Proposals in the Review of Links with Large Business*, HMRC Research Report no. 58, December 2007 (http://www.hmrc.gov.uk/research/report58.pdf).

[65]Section 2.3.2.1 of J. Freedman, G. Loomer and J. Vella, 'Alternative approaches to tax risk and tax avoidance: analysis of a face-to-face corporate survey', OUCBT, Working Paper no. WP08/14, 2008 (http://users.ox.ac.uk/~mast1732/RePEc/pdf/WP0814.pdf).

[66]This is confirmed in Section 2.5, ibid.

Part 4: Other Approaches to Counter Tax Avoidance

11 A GAAR

11.1 Ten years ago, there was a consultation by the government on the possibility of introducing a GAAR. Much discussion focused on how a GAAR could be drafted in order to catch tax avoidance appropriately and it was generally felt that a GAAR would need a clearance procedure if it were to work effectively. This paper does not revisit the questions of the drafting of a GAAR, but asks whether a GAAR in the form suggested by the TLRC in 1997 (with or without clearance procedures) would have done a better job of tackling tax avoidance than the approaches in fact used.

11.2 In considering the use of a GAAR, a review of the Finance Acts from 1997 to 2008 has been undertaken and the results are set out in Appendix D. The review asks whether a GAAR would have meant that legislation enacted in those Acts would have been unnecessary. It looks at not only provisions that purport to be anti-avoidance but also those that have an anti-avoidance effect by changing the underlying rules. It does not include oil tax, levies or customs duties, VAT, insurance company rules or the pension rules contained in Finance Act 2004. At the end of the appendix, there is a summary table showing how many 'anti-avoidance' provisions (as used in its widest sense in this paper) are derived from which 'source', how many TAARs were included and how many provisions could have been dealt with by a GAAR.

11.3 The analysis is *a* view of the legislation. There are many provisions about which there could be considerable debate as to the extent to which a GAAR would assist, but the purpose of the review is to draw attention to the extent of anti-avoidance legislation and the limits of a GAAR.

11.4 The review also considers whether provisions are driven by an underlying structural feature of the tax system, such as the capital/income distinction. Those features are described as the 'source' of the tax provision. It is a matter of policy as to what boundaries should operate in the tax system, but the review seeks to draw out where the tensions that give rise to avoidance lie.

Points arising

11.5 A GAAR may assist with countering some transactions but will not always provide the answer. It is one tool that could be considered further.

11.6 However, looking to the TLRC suggested draft GAAR (set out in Appendix D) and seeking to apply it to each of the pieces of legislation, it can be seen how blunt a tool a GAAR can be. At times, it seems clear that a GAAR should not apply, but in fact coming within the 'protected transaction' definition is extremely difficult. Often, this is because the taxpayer can rely on a clear provision or exception in the legislation, but this is not an exception to an anti-avoidance rule (as required by the TLRC definition). At other times, the GAAR would not apply when the transaction has all the hallmarks of a tax avoidance transaction, but it could be argued that it is protected because it could be said to be encouraged by the legislation, or a specific safe harbour within the legislation can be relied upon. A GAAR will not prevent taxpayers legitimately relying upon exemptions, reliefs or differential tax rates expressly built into the system.

11.7 As one progresses through the legislation, it is clear that the avoidance goalposts have moved. What HMRC now considers avoidance is much wider than what was previously considered to be. Where the taxpayer takes steps to maximise reliefs or structure a transaction to fall within one type of tax treatment rather than another, this is now often seen as unacceptable tax avoidance by HMRC rather than as acceptable tax mitigation. For example, the measures introduced in Section 27 of Finance Act 2007 appear to counter transactions such as 'bed and spouse' transactions (where a taxpayer sells shares and their spouse buys them back to get around the bed-and-breakfast rules), which were previously considered legitimate tax planning.

11.8 Clearly, this makes the operation of a GAAR difficult when its purported aim is to reflect the intention of Parliament in legislating in a particular way. As Parliament's view changes, should the operation of the GAAR look to the intention at the time of the legislation or at a later time? Certainty and fairness principles would direct looking at the time of the legislation, but HMRC would then be driven to seek changes in the legislation rather than rely on the GAAR, and the benefits of the GAAR would be reduced.

11.9 Take, for example, the question of the use and value of losses. Is it legitimate tax planning to buy losses? The losses clearly have a real economic value. Historically, it has been acceptable to recognise that value, although the attitude to this has changed. Can or should a GAAR adapt to such change?

11.10 These issues can be seen as symptoms of the fact that at the heart of the problems in applying a GAAR lie the problems of defining tax avoidance addressed in Section 4 above. The mixed success of other jurisdictions in applying GAARs, noted in Appendix E, is indicative of this problem.

11.11 However, on a more positive note, it can be seen that a GAAR could replace many of the more general TAARs (often referred to as mini-GAARs), although in some cases the TAARs have been drafted with fewer motive or purpose limitations than a GAAR would have.[67] Indeed, it could be said that the UK system is facing the imposition of what amounts to a GAAR, but instead of one overarching provision the result is achieved in a less obvious way by numerous individual provisions through TAARs of varying breadth. The table of legislation at the end of Appendix D shows the considerable number of TAARs introduced in the past three years in particular.

11.12 In addition, a GAAR may be seen as a line in the sand, bolstering the ability of the judiciary to look at the purpose of the legislation and providing an alternative result where the legislative purpose is not being met. Currently, there can be a vacuum in the system: if the transactions do not reflect the purpose of the legislation, how do the courts treat them? Are the transactions ignored or is the purpose of the legislation to be given effect to and, if the latter, how?

11.13 If a GAAR were to be introduced, the safeguards, processes and limitations advocated by the TLRC in 1997 would continue to be recommended.

[67] See, for example, Section 75A Finance Act 2003.

12 An 'abuse of law' provision

12.1 The concept of abuse of law is familiar to many civil-law jurisdictions. Moreover, it is a principle that has been confirmed as applying to European Community (EC) law generally. The case of *Halifax plc and others v Customs and Excise Comrs*[68] confirmed that 'Community law cannot be relied on for abusive or fraudulent ends'[69] and more particularly confirmed that the concept of abuse of law applies to the European Community VAT rules.

12.2 In that case, the European Court of Justice (ECJ) considered arrangements made by Halifax in connection with the construction of call centres. The arrangements, which were clearly preordained, were intended to overcome the problem of input tax being irrecoverable by reason of being attributable to exempt supplies. They involved transactions being routed through three subsidiary companies. Customs argued that the transactions involved in the planning arrangements should be disregarded since they did not constitute an economic activity under the EC Sixth Directive.

12.3 The ECJ decided that an abuse of law arises in relation to the conditions of the Sixth Directive as implemented by domestic law if:

(i) the transaction creates a tax advantage contrary to the purpose of those provisions; and

(ii) the essential aim of the transactions concerned is to obtain a tax advantage as judged by reference to a number of objective factors.

12.4 It is clear from the judgment that the second of these tests sets a high hurdle for revenue authorities. 'The prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages … It is the responsibility of the national court to determine the real substance and significance of the transactions concerned. In so doing, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden.'[70]

12.5 The ECJ has also considered the application of the concept of abuse of law to UK legislation outside the context of VAT. In the *Cadbury Schweppes*[71] case, the court was considering whether the establishment

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[68](C-255/02), [2006] STC 919.

[69]Paragraph 68.

[70]Paragraphs 75 and 81.

[71]*Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, C-196/04.

of two finance subsidiaries in Ireland in order to benefit from the 10% tax rate was something protected under Community law as the company exercising its freedom of establishment, or whether this was an abuse of those rights and subject to the application of the UK's anti-avoidance rules in the controlled foreign companies (CFC) legislation. Again, as in the *Halifax* case, the court decided that there is a two-part test: first, there must be an intention to obtain a tax advantage; and second, there must be objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment has not been achieved.[72] UK taxation under the CFC rules must be excluded where the incorporation of the CFC reflects economic reality as evidenced by matters such as premises, staff and equipment. It is only where the CFC is a 'fictitious establishment not carrying out any genuine economic activity … that the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a "letterbox" or "front" company.'[73]

12.6 Therefore, incorporating an EC-based concept of 'abuse of law' as a means of tackling avoidance will be of limited use for HMRC. It would only be the most aggressive forms of avoidance, where there is little economic substance behind the transactions, where a concept of 'abuse' could expect to be successfully used. That said, despite the limits of such a concept, there may be circumstances in which it would be an effective tool. Where a scheme is constructed which falls squarely within the words of the tax legislation and that legislation is so technical and detailed that it is hard for any parliamentary purpose to be ascertained but the scheme lacks any economic substance, it may be easier for HMRC to rely on an 'abuse of law'-type provision rather than relying on the courts to apply existing common-law principles.

12.7 Arguably, the concept of abuse of law, albeit partially overlapping a GAAR, would apply in some circumstances where a GAAR may not because of the exclusions built into a GAAR, but of course this depends upon the precise form of the GAAR used.

[72]Paragraph 67.

[73]Paragraph 68.

13 Principles-based drafting

13.1 In the Pre-Budget Report of October 2007, the government announced three packages designed to simplify the tax system. One was a review of anti-avoidance legislation. Alongside that review, a consultation document was published in December 2007[74] proposing a principles-based approach to avoidance involving financial products. These initiatives must be warmly welcomed. It is clearly recognised by the government that the current approaches to the tackling of avoidance are not ideal. The launching of the review and consultation are important first steps in identifying more satisfactory ways of matching revenue protection with the need for simplicity. However, this is not a simple process. The review of previous methods shows just how easily well-intentioned proposals can go wrong if hastily implemented and there is real concern that historically there has been insufficient time given to this vital area of consultation and development. If principles-based drafting can be implemented simply and successfully and achieve the right balance, that outcome will more than justify the time taken in getting it right.

13.2 In this section of the paper, the issues arising from principles-based drafting are considered and ways in which these could be tackled are suggested.

What is principles-based drafting?

13.3 It is important to recognise that 'principles-based drafting' is a broad term often used by different people to mean different things. The first form of principles-based drafting could more accurately be called 'purpose-based drafting'. This is where it is sought to state Parliament's intention in introducing legislation. The rationale behind this is that purpose provisions are intended to operate as guides to the construction of the remainder of the provision. An example of a purpose statement can be seen in Paragraph 1 of Schedule 13 of Finance Act 2007:

> 'The purpose of this Schedule is to secure that in the case of an arrangement-
> (a) which involves the sale of securities and the subsequent purchase of securities, and
> (b) which equates, in substance, to a transaction for the lending of money at interest from or to a company (with the securities which were sold as collateral for the loan),

[74] HM Treasury and HMRC, *Principles-Based Approach to Financial Products Avoidance: A Consultation Document*, December 2007 (http://www.hm-treasury.gov.uk/consult_financialproducts_avoidance.htm).

the charge to corporation tax in that case reflects the fact that the arrangement equates, in substance, to such a transaction.'

13.4 The use of such clauses has been consistently rejected by legislative studies: the Renton Committee in 1975 (which concluded that purpose provisions should be used only selectively and with caution); the 1992 Hansard Society Commission (which concluded that they should not be used as a general practice); and the 2004 House of Lords Select Committee on the Constitution (which concluded that purpose provisions should not be included in Bills).

13.5 The reason for this resistance to the use of purpose clauses is that problems will arise if the general purpose provisions conflict with the specific provisions. That is most clearly seen where different words are used in the purpose provision and the specific provisions. This problem was illustrated by the draft financial products avoidance provisions. For example, the draft legislation on disguised interest stated that:

'The purpose of sections 2 to 6 is to secure that a return-
(a) which is designed to equate in substance to a return on an investment as interest, but
(b) which is not fully taxable in the same way as interest,
is treated in the same way as interest for the purposes of corporation tax.'

13.6 Numerous issues arose from the interaction of this clause and the specific clauses that follow it. One particular issue, which illustrates the concerns raised by the legislative studies, was that in the purpose clause referred to in paragraph 13.5 the expression 'equates in substance' to interest is used, while in subsequent clauses the legislation refers to amounts 'economically equivalent to interest'. This immediately raised questions as to whether the provisions using different words have different meanings.[75]

13.7 Even if the words used are not different, the relationship between the specific provisions and the general purpose provision may not be clear. In *Statute Law Review*,[76] a tax provision starting with the general purpose that 'this section is enacted to prevent the avoidance of tax' with subsequent specific rules was postulated. The problem identified was that the purpose provision might make the specific rules have a wider application than they otherwise would have, or a narrower one, or it might achieve nothing.

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[75] While this particular problem was dealt with in the next draft, a purpose clause remained which again used terms not used in the operative clauses. In the draft clauses published with the 2008 Pre-Budget Report, no purpose clause is included.

[76] 1997 at page 168.

13.8 As a result of these concerns, the 2004 House of Lords Select Committee recommended that the Explanatory Notes to each Bill should include a clear and developed explanation of the Bill.[77] (Interestingly, this was as much so that the Parliamentarians understand what they are enacting as for the public at large to understand the law.) This was endorsed by the government's response, although the government noted that 'We would need to consider how changing the approach to declaring the purposes of legislation would impact on the interpretation of law by the courts'.

13.9 Explanatory Notes do currently set out the purpose behind new avoidance provisions, but often this is written in fairly narrow terms such as 'This provision is designed to stop the following scheme …'. If the Explanatory Notes set out a more general statement of purpose to provisions, would this help? The courts' approach has been to look to the legislation, and it is only when that is unclear that other materials such as Explanatory Notes are looked at. Even if the Explanatory Notes are referred to, this will be of little benefit if the purpose description is not consistent with the terms of the legislation.

13.10 Bearing in mind all the problems of construction and the courts' apparent ability to determine the purpose of legislation without such statements, this paper rejects the use of statutory purpose statements as a useful means of tackling avoidance.

13.11 The second form of principles-based drafting requires the tax rules themselves to be restated as principles. However, this raises several issues. The first is that it is often very difficult to explain what the principle underlying the tax provision is. Take, for example, income tax. The purpose underlying the Income and Corporation Tax Act 1988 is that people should pay tax on their income, but what is 'income'? The Tax Law Rewrite process has tended to emphasise that income tax is a series of elaborately stated rules without principles or purpose. So, for example, Sections 1–5 of the Income Tax Act 2007 now list where the various charges to income tax can be found. This problem lies at the heart of the problem of dealing with avoidance. In other areas of law, it is generally possible to identify the subject matter: if dog-owners have to pay a licence fee, it is generally a straightforward matter to recognise what is a 'dog'. Tax concepts are not objectively identifiable in the same way and, in the context of avoidance, much of the legislation has

[77] Paragraph 87 of the Committee's report, *Parliament and the Legislative Process: Volume 1*, (http://www.publications.parliament.uk/pa/ld200304/ldselect/ldconst/173/173.pdf).

taken the form of a set of rules reacting to circumstances of perceived avoidance. An example of this can be seen in the leasing code.

13.12 Where concepts are not objectively identifiable, the law provides definitions through legislation and the interpretation of it by the courts. Not every situation will be dealt with but there must be sufficient rules for the citizen to understand the consequences of their actions. Hence detail is required. So, looking at the example of the disguised interest provisions in the Consultative Document, it seems that at one level the desire is to tax 'a return which equates in substance to a return on an investment as interest'. This in itself raises numerous questions, not least that in one sense any return can be expressed in terms of an interest return. How far does the principle go? Detail is then needed and distinctions are drawn between what is and what is not within this principle. The problem is exacerbated by the boundaries that are placed within the tax system. If in fact the aim were to tax all interest-like returns as interest, it would be easier to set out the principle in the legislation with much less detail required. However, that is not the aim, and so words such as 'design' and 'purpose' are used to limit the scope of the 'principle' and as a result the drafting starts to lose its principles basis.

13.13 These provisions are still being consulted upon, but it does appear[78] that the drafting has moved away from what would generally be regarded as principles-based drafting and has become effectively another TAAR, to be bolted on to existing legislation, the scope of which is intended to be limited by a clause applying the TAAR only where the sole or main purpose of the transaction is the avoidance of tax. This is a long way from 'principles'-based drafting that seeks to restate tax law (as opposed to tax avoidance law) as principles, with the intention of eliminating the need for highly detailed and prescriptive sets of rules.

13.14 To the extent that 'principles' (or, if they can be used with sufficient clarity, purpose statements) are used and that principle or purpose needs to be limited, so issues regarding the relationship between Parliament, the courts and HMRC come to the fore. That is because taxpayers need enough detail to determine what tax they must pay. If it is not the case that all interest-like returns are to be taxed as interest, then an explanation of what is and what is not taxed as interest is necessary. Where the detail is found is determined by what role it is thought Parliament, the courts and HMRC should each have.

[78] As at October 2008.

13.15 Currently, the detail is provided by Parliament in the legislation. The courts interpret that legislation and HMRC administers the collection of tax. The general preference for detailed primary legislation reflects a view that the need for parliamentary authorisation imposes a practical political restraint on government that is consistent with the UK's parliamentary and judicial heritage. If the primary legislation is only to state broad principles, where does the detail go? There are two possibilities: secondary legislation or HMRC rule-making.

13.16 Secondary legislation is generally drafted by HMRC rather than Parliamentary Counsel, although Parliamentary Counsel do scrutinise it if it amends primary legislation. Secondary legislation is viewed as suffering from the lack of parliamentary scrutiny afforded primary legislation. This has been seen to be a real problem in practice, as noted in Section 8 above in the context of secondary legislation responding to SDLT avoidance.

13.17 If Parliament leaves the detail to be formulated by HMRC, this is widely regarded with suspicion as being subject to no parliamentary scrutiny on adoption (and potentially violating the principle that only Parliament shall impose tax) and as being open to possibly no effective challenge on appeal to the courts (for the reasons referred to in Section 7, which deals with the problems of non-legislative rule-making).

13.18 A notable trend is the recent increase in legislation providing that HM Treasury or HMRC is to have the power to set out the rules that should apply in a particular area in secondary legislation.[79] It could be argued that by delegating power in this way, Parliament is effectively relinquishing some of its powers. While the empowerment of HM Treasury or HMRC to make the rules means that technically the principle that only Parliament shall impose tax is not violated, in practice such delegation looks and feels to taxpayers to be the imposition of tax by HM Treasury or HMRC. If the argument in favour of such delegation is that the rules are too lengthy and complex for Parliament to sensibly consider, then this itself is a serious indictment of the state of tax legislation. It is then perhaps appropriate to review the process of producing tax legislation and to consider whether a change in that process is needed. However, further consideration of the legislative process is outside the scope of this paper.

13.19 If the detail is to be provided by the courts, then taxpayers would be exposed to the simple problem of the delay in waiting for those details

[79]See, for example, Finance Act 2008: Sections 39, 40, 41, 156 and 157 each empowering HM Treasury or HMRC to provide the detailed rules by secondary legislation.

to be worked through. However, government would be unlikely to take the risk of the courts not providing the desired solutions. Many anti-avoidance provisions result from the government wishing to stop taxpayers relying on a court-based interpretation of the law.

13.20 If the UK is to move away from providing the detail in the primary legislation, there are significant issues that need to be addressed regarding the relationships between taxpayers, HMRC and government. If those issues are not addressed, then there will be ongoing resistance expressed by taxpayers to the simplification of primary legislation. In particular, the rights of taxpayers in relation to non-legislative rule-making need to be addressed. Parliament itself should also understand what is involved in either implicitly or explicitly giving HMRC the power to determine the detail of the rules.

13.21 In order that a system drafted on broad statements of principle is in fact workable, guidance will be needed from HMRC regarding the detailed application of the principles in particular cases. This could be through a clearance system but, more practically, HMRC would need to publish detailed guidelines. However, evidence from the OUCBT study supports the proposition that taxpayers do not trust HMRC sufficiently for such a system to work currently.[80] In order for such a system to be workable, the relationship between the taxpayer and HMRC would need to be reviewed. Taxpayers would need to feel confident in the clarity and consistency of the guidance. In reviewing the relationship, it is likely that it would be concluded that various changes to the administration of tax law would also be needed. These may include

(i) HMRC not being able to change its guidance retrospectively and

(ii) providing for an appeal right against the application of the guidance in the First Tribunal,

in order to deal with the problems of non-legislative rule-making addressed in Section 7 above.

13.22 This paper suggests that if principles-based drafting is to work as a way to tackle tax avoidance, various consequences need to be addressed in addition to the issues described above. The first is to truly enact principles, accepting the consequences of so doing. So, for example, instead of the proposed disguised interest provisions, provide that all returns that are economically equivalent to interest shall be taxed as interest. Of course, some further detail is needed. Taking that same

[80] J. Freedman, G. Loomer and J. Vella, 'Alternative approaches to tax risk and tax avoidance: analysis of a face-to-face corporate survey', OUCBT, Working Paper no. WP08/14, 2008 (http://users.ox.ac.uk/~mast1732/RePEc/pdf/WP0814.pdf).

example, the bald principle may be seen as far too wide; economists may argue that even a dividend on an ordinary share is something capable of being dissected into something with an interest-based element. However, that brings us back to the issues considered above of where that detail goes. It does not detract from the fact that if principles-based drafting is to be pursued, it needs to have at its heart the driving force to express tax rules in the form of principles.

13.23 Adding a set of avoidance provisions that are supposed to be based on principles, when the remaining legislation into which these additions are supposed to fit is left as currently drafted, is opening the system to more mismatches and holes. Instead, if principles-based drafting is to be used, then a more fundamental rewrite of the rules is required. Tinkering at the edges will not achieve the aim. This may fill many with horror, bearing in mind that the Tax Law Rewrite is still ongoing, but it may be that now is the time for a much more radical approach to the writing of the UK tax system than patch-and-mend solutions offer.

14 Overseas experience

14.1 Of course, it is not just the UK which is facing the problem of tackling avoidance. The approach of other jurisdictions is considered in Appendix E.

14.2 It is clear that no jurisdiction has found a perfect solution and, in particular, the use of GAARs in varying forms has had mixed success.

Part 5: Conclusion

15 Conclusion

15.1 Tackling tax avoidance is an inherently difficult problem as the core term – ‘tax avoidance’ – is subject to much debate. The grey areas of any definition are precisely the areas giving rise to problems in tackling the tax avoidance. Much tax avoidance is generated by boundaries within the tax system. While it is a matter of tax policy as to where those boundaries should be, it is clear that to the extent boundaries are put into the tax rules with differing tax results for the same economic activity, those boundaries will cause more tax avoidance. The question as to whether the avoidance is unacceptable is then often hotly contested between HMRC and the taxpayers.

15.2 The past 11 years of tax legislation have not proved an effective way of tackling tax avoidance and have caused the tax system to reach a point of complexity that has real costs for taxpayers and the government. These problems have been clearly illustrated by the review of the legislation introduced in the area of employee shares and the stamp duty rules.

15.3 The review of the use of a GAAR leads to the conclusion that a GAAR on its own would not provide a solution. We have seen that TAARs are not the solution on their own and the judicial approach to anti-avoidance has limits. Each of these, though, could have a role to play and recognising that may enable the tackling of avoidance to be more focused. So, where a particular avoidance can be clearly targeted, a TAAR may be the most appropriate solution. A GAAR or an ‘abuse of law’ provision may have some limited use, but other tools also need to be used. To this end, further consideration should be given to changing the way in which legislation is formulated and introduced in the UK. One possibility is to look further at a principles-based drafting approach, but the issues regarding the relationship between taxpayer, Parliament and HMRC need to be addressed and such an approach needs to be considered as part of a more fundamental change to the structure of the tax system eliminating many of the boundaries that currently cause so much of the problem.

15.4 Whatever approach is taken to tackling tax avoidance, there should be full engagement with a consultation process, allowing adequate time for all interested parties to participate properly. The problems caused by the hasty introduction of new rules in the context of stamp duty and SDLT and the abandonment of the consultation process in 2003 should serve as clear evidence that full consultation is needed. It is therefore particularly welcome that the government has announced that the proposed principles-based drafting changes dealing with disguised interest and transfers of income streams have been postponed until the Finance Act 2009 in order to leave further time for consultation on these issues and in relation to avoidance more generally.

Appendix A
The example of countering avoidance in the context of employee share awards

Introduction

A.1 The offer of shares to employees has been seen as an attractive way of remunerating many employees. It is attractive not only in tax terms but also as a means of aligning the employee's interest with that of the employer. Over the past forty years, governments of different political persuasions have taken steps to encourage this. However, there has been an increasing tension between, on the one hand, the non-tax desire to encourage wider share ownership and to give employees more of a stake in their employers' businesses and, on the other hand, the concern that this form of remuneration should not be used to reduce the tax payable by employees and employers on what is in effect a form of earnings.

A.2 Over the past four years, this tension has come to a head and produced a particular example of the difficulties associated with anti-avoidance legislation. It shows how the current approach to tackling avoidance has resulted in detailed reactive legislation which often does not achieve its aim of preventing avoidance.

A.3 In this appendix, the history and background to the changes are set out first; then the problems with the approach are addressed, illustrating them with examples. It is not the purpose of this appendix to set out a guide to the taxation of employee shares; instead, the appendix seeks to show where the problems with the legislative approach taken lie.

History and background

A.4 The first legislation in this area was in 1966[81] following the case of *Abbott v. Philbin*.[82] The legislation reversed the decision in that case and imposed a tax charge on the exercise of an option on the difference between the price paid for the shares under the option and the market value of the shares bought. However, employers turned to schemes involving the issue of shares subject to restrictions (which were later removed) to achieve the same result as had been previously obtained with the options.

A.5 In 1972, the Finance Act introduced a charge on the growth in value of shares issued to employees subject to exemptions for specified approved share option and share incentive schemes.

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[81] Finance Act 1966.

[82] [1961] AC 352, 39 TC 82.

A.6 In 1974, the exemptions for the approved share options were removed. Employees were now liable to tax on the exercise of the option and the shares themselves were liable to taxation on their growth in value.

A.7 In 1976, the tax charge on shares was increased still further by introducing a charge on the notional loan implicit in the unpaid element of partly paid shares.

A.8 After this, the trend moved to encouraging share ownership by employees and, before the Conservative government of 1979, relief was introduced in 1978 for approved profit-sharing schemes (now being phased out). This was a complex scheme which was amended on numerous occasions, but it was a step back from the previous approach to share incentives. Another approved scheme, the Savings-Related Share Option Scheme, was set up in 1980 by the Conservative government and, in 1984, a further approved scheme was added in the form of the Discretionary Share Option Scheme. This last scheme was then significantly restricted in 1996 when it was rewritten as the Company Share Option Plan with a limit of £30,000 of shares over which unexercised options could be held.

A.9 Later in the 1980s, the government's attention turned to countering avoidance. In 1986, the receipt of consideration in money or money's worth by an employee in return for allowing an option to lapse or granting a second option became a taxable event. In 1988, government attention focused on taxing schemes where employees received shares at an artificially low value. So, rules were introduced to charge tax where rights or restrictions were changed or removed and as a result the value of the shares increased; and to deal with value being shifted into shares in a company by moving profit into the company – the soon much-maligned 'dependent subsidiary' rules.

A.10 A little later, in 2000, the approved share schemes were added to by the Share Incentive Plan, and then most recently the Enterprise Management Incentive Scheme was included in the legislation.

A.11 During the 1990s, the focus shifted to the side of the employers. There were numerous factors at play: the economic desire to give employees incentives to remain with employers and possibly to meet performance targets, as well as the ability to reduce the tax and NICs payable on the benefit received by the employees. Employee share plans developed which became known as long-term incentive plans. A popular form of these plans involved the 'award' of shares to an employee subject to conditions under which the shares would be forfeited if performance targets were not met or the employee left. Under the existing rules, the initial acquisition of the shares was taxable,[83] but this was calculated by reference to the value of the shares at the time of the award. Due

[83]S19 TA 1988.

to the risk of forfeiture, this value could be very low. In practice, many companies agreed with HMRC that no tax would be payable on award and tax would be paid in full when the award of the shares was no longer subject to conditions. However, HMRC was advised in 1998 that this was not supportable in law and that the award had to be taxed when initially made. Consequently, legislation was introduced in 1998 to put the previous practice on a statutory basis.[84] Awards of shares that were subject to conditions lasting up to five years were taxed not on the making of the award, but on the satisfaction of the conditions or transfer.

A.12 However, awards of shares that were subject to conditions that could last more than five years could now face a double charge: once on the award and once when the conditions were lifted or satisfied. So, in 1999, Section 42 of the Finance Act deleted one limb of the charge imposed by the Finance Act 1998 on the conditional acquisitions of such shares and left the employee subject just to the charge on the satisfaction of the conditions or transfer.

A.13 However, the avoidance industry had latched on to the use of employee shares as a means of reducing liability to income tax and employer and employee NICs. Other forms of payment designed to avoid PAYE and NICs had been counteracted one by one by successive Finance Acts. The 1998 Finance Act conditional share provisions were avoided by various mechanisms, including making the awards to someone other than the employee or stripping out the value of the shares before the performance conditions were met and yet passing the full economic value to the employee otherwise.

A.14 At the same time, the Tax Law Rewrite was in full swing rewriting the income tax code and, in 2003, this resulted in the Income Tax (Earnings and Pensions) Act (ITEPA). Ten days after coming into force, 72 pages of Finance Bill (soon to become the Finance Act 2003) completely rewrote the taxation of employee shares. Provisions were introduced to deal with the mechanisms known to be used:

(i) restricted securities (replacing the previous conditional share rules),

(ii) convertible securities,

(iii) securities with artificially depressed market value,

(iv) securities with artificially enhanced market value,

(v) securities acquired for less than market value,

(vi) securities disposed of for more than market value,

(vii) post-acquisition benefits from securities.

[84] S49 FA 1998.

A.15 However, amendments to the new set of rules were soon needed in the Finance Act 2004. Most notably in the context of this appendix, the wording of one of the principal TAARs was changed[85] and yet another TAAR was introduced to deal with shares acquired in public offers.

A.16 It soon became clear that the 2003 overhaul had not succeeded in its aim of stopping employers and their advisors working around the rules. On 2 December 2004, the Paymaster General made the following statement:[86]

> 'However, experience has taught us that we are not always able to anticipate the ingenuity and inventiveness of the avoidance industry. Nor should we have to. Our objective is clear and the time has come to close this activity down permanently.
> 'I am therefore giving notice of our intention to deal with any arrangements that emerge in future designed to frustrate our intention that employers and employees should pay the proper amount of tax and NICs on the rewards of employment. Where we become aware of arrangements which attempt to frustrate this intention we will introduce legislation to close them down, where necessary from today.'

A.17 Despite this statement, tax avoidance did continue, and in the Finance (No. 2) Act 2005, five TAARs and numerous other changes were introduced. In the Finance Act 2006, even more steps were taken in Section 92 to counteract the use of employee share options to avoid tax and NICs. In the case of both sets of additions to the legislation, the provisions were retrospective to 2 December 2004.

A.18 For more than forty years, successive governments have tried to deal with the avoidance of income tax and NICs by the use of shares, options or other securities in a piecemeal manner, reacting to what is encountered by HMRC. What is left is arguably one of the most unwieldy areas of the tax legislation. Some idea of this is given in the table at the end of this appendix, which sets out the chart of legislation provided by HMRC in the Employee Share Schemes Manual.

Why did the tax avoidance problems continue?

A.19 In summary, the legislation has been reactive rather than proactive. Structures seen as giving rise to avoidance have been responded to in a piecemeal fashion. This was even the case in the rewrite of the Finance Act 2003, where the wholesale changes were not based on clear principles but were made as reactions to the various structures seen to date. Consequently, the provisions produced an extremely complex and unwieldy set of rules without the compensating benefit of dealing with the perceived abuse. Avoidance was not

[85] See further paragraph A.22 below.

[86] http://www.hm-treasury.gov.uk/d/pbr04_PMGstatement.pdf.

stopped by the legislation in 2003, as shown by the need for further rules in 2004, 2005 and 2006. It may be argued that now, following the Paymaster General's statement, avoidance in this area is limited, but the length of time this took is not efficient for HMRC or HM Treasury and has a real cost in terms of lack of clarity and stability for taxpayers.

A.20 While some of the legislation could be criticised for not clearly enough identifying what should be taxed when, there was also a set of rules introduced which included provisions that went far further than many would see as necessary or appropriate. Although the Paymaster General also stated in December 2004 that

> 'This action will not affect employers and employees who organise their affairs in a straightforward and ordinary way – the vast majority. In particular, genuine employee share schemes and share option plans will not be affected. We continue to believe these make an important contribution to the Government's productivity agenda',[87]

the width of many of the anti-avoidance provisions does mean that arrangements with no tax avoidance motive can be affected. This then means that HMRC statements and concessions need to be relied upon in order to make the system workable for those treading the 'ordinary and straightforward path'. Accordingly, the issues surrounding non-legislative rule-making, addressed in Section 7 above, gain increasing significance.

A.21 The issues concerning the employee share legislation are now explored in more detail.

The problems

The reactive approach

A.22 The reactive approach to the legislation resulted in various problems. Three particular examples can be seen in

(a) the way in which the timing of the charge applying to conditional shares was dealt with in the 1998 and 1999 legislation and then in 2003 (see paragraphs A.25 and A.26 below);

(b) the way the legislation uses a list approach to define terms: for example, in applying a list system to define 'securities', the rules were then open to employers using instruments that were not on the list; the list is now:

- shares,
- contracts of insurance,

[87] http://www.hm-treasury.gov.uk/d/pbr04_PMGstatement.pdf.

- loan stock (both company and government),
- warrants,
- certificates conferring rights to securities held by others,
- units in a collective investment scheme,
- futures, and
- contracts for differences,

but this is after changes in Section 12 of Finance (No. 2) Act 2005 to include contracts of insurance;

(c) building in exclusions which then need to be withdrawn or amended: for example, the exclusion for shares made available in public offers which then needed to be limited when it was seen that this exception was being used for 'avoidance' purposes. Every time an exception is built into legislation such as this, it opens up opportunities for taxpayers and their advisors to find ways to use those exceptions. Another example was the 'shareholder' exclusion to the charges imposed by the FA 2003 rules. This was included to stop employees being charged to income tax on the occurrence of a particular event when that event applied to all shareholders, regardless of whether they are employees. However, this needed to be amended to deal with abuse twice – in Finance Act 2004 and again in Finance (No. 2) Act 2005.

A.23 Whenever an exclusion to a tax charge is made, the area is ripe for avoidance structured around that exclusion. Sometimes, the exclusion is really just an omission of the legislation to cover a particular situation, i.e. it is a hole in the legislation. Despite the extent of the changes brought in in 2003, certain significant holes were still left and there were no underlying principles to plug the gaps. For example, forfeitable shares may be awarded to an employee (no tax charge). A dividend was paid (say, a month after award) on those shares, which was subject to a tax rate of 25% for a higher-rate taxpayer and no NICs. The shares were then forfeited either for no payment or for a nominal amount. The main amount was therefore payable as a tax-favoured dividend and so could be the cloak for a bonus. Changes in the 2004 Act were targeted at this and other schemes and then in the December 2004 Pre-Budget Report it was announced that there would no longer be an automatic exemption from the upfront tax on the award of forfeitable shares where tax avoidance was a reason for awarding that type of share. The piecemeal catch-up response was adopted to deal with the avoidance.

The continual change of rules

A.24 The rules in this area have changed so frequently that notwithstanding the threat of future retrospective legislation, employers and employees have been faced with uncertainty regarding the taxation of share awards. This has been seen particularly in the case of awards of shares subject to conditions or restrictions.

A.25 As explained above, there were the changes in 1998 and 1999 regarding the timing of the taxation of such shares. In 2003, the 1999 position was taken regarding timing in that there would be no tax charge on acquisition, but now the charge would apply not only on sale of the securities or the securities ceasing to be subject to restrictions, but also whenever any variation in those restrictions occurs. As an alternative, the employer and employee could jointly elect (within 14 days of the award) for the securities to be taxed on their unrestricted market value at the time of the award with any remaining uplift in value subject to capital gains tax. This election is also deemed where there is an avoidance purpose.

A.26 If the election is not made (or deemed), the employer and employee are left with difficult and potentially contentious valuations to be made to comply with the new regime. Under the 1998 rules, the tax was calculated on 'the amount (if any) by which the sum of the deductible amounts is exceeded by the market value of the employee's interest immediately after that interest ceases to be only conditional or, as the case may be, at the time of the sale or other disposal'.[88] Now a whole page of legislation sets out formulae requiring numerous valuations to be made. In particular, if the occasion of the charge is a variation in the restrictions, then the portion of market value that has been released must be identified. Bearing in mind the scope of what may constitute restrictions (see paragraph A.27 below), this may be a particularly difficult task.

A.27 In addition, there has been ongoing uncertainty as to what constitutes a 'conditional' or 'restricted' share. This has culminated in the 2003 'restricted' securities rules including many shares and securities that would not previously have been considered as 'restricted'. The extensions were not just avoidance driven; they went much further so that even standard pre-emption rights could cause a share to be restricted. Similarly, the entirely commercial 'good leaver' provisions requiring good leavers to dispose of their shares would also be caught by these rules.

A.28 This has meant that employers who were not taking part in tax avoidance have been faced with provisions applying in completely unexpected ways. They

[88] S140A(5) TA 1988.

have had to deal with uncertainty in the rules as they have changed and with difficult and potentially costly valuation exercises. The alternative for them is to use the election process, which is where those carrying out tax avoidance schemes end up. This could be seen as unfair on the compliant taxpayers. At the same time, as has been seen above,[89] the avoidance was not stopped.

A lack of clarity in the legislation

A.29 One of the main criticisms of the legislation is that it has suffered from a lack of clarity. This has made it difficult for taxpayers and their advisors to be clear how the rules are to apply in various situations.

Warrants

A.30 Warrants are included in the definition of securities[90] and, since the Finance Act 2006, options have been included.[91] Prior to FA 2006, options were specifically excluded.[92] Warrants are options, so this caused questions to be asked as to how the definitions could work alongside each other. HMRC's answer was that although a warrant would have an option embedded in it, sometimes there would be more rights such as voting rights. The 'simple' warrant with just the option would be excluded as an option but the more complex instrument would be included as a warrant.

A.31 This is a relatively small example of non-legislative rule-making by HMRC. The legislation does not include the distinctions put forward by HMRC. As a result, taxpayers are potentially exposed to the issues identified in Section 7 above.

A.32 Since FA 2006, 'securities options' are excluded rather than just options and 'securities options' are defined with their own TAAR as a right not obtained pursuant to a right or opportunity made available under arrangements with a main purpose of avoiding tax or NICs. The TAAR mechanism has been increasingly used in these rules to attempt to sweep up problems that are caused by the interaction of different legislative rules. However, as seen below in paragraphs A.54–A.56, TAARs are not watertight.

The example of Chapter 3A ITEPA 2003

A.33 There are numerous words and phrases used in the FA 2003 legislation that leave open questions of definition and application. Several arise in one part: Chapter 3A ITEPA, which applies where the market value of employment-

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[89]See paragraphs A.19 and A.20.

[90]S420(1)(a) ITEPA.

[91]S420(1)(f) ITEPA.

[92]S420(5) ITEPA.

related securities is reduced by 'things done otherwise than for genuine commercial purposes'. The first question is what does 'things done' mean? Does it cover omissions or automatic events? Similarly, Chapter 3A applies not only to employment-related securities but also to 'other relevant securities or interests in securities', which again is not defined.

A.34 It is submitted that Chapter 3A ITEPA is particularly vague in the use of many terms. While the legislation gives two non-exhaustive examples of what is non-commercial, there is no provision for clearance of a transaction. Non-arm's-length transactions may pass value into the employee's securities without any motivation to avoid NICs or income tax in relation to the award being made to the employee. The classic example can be a company subject to transfer pricing adjustments. Many a group may find itself faced by such a situation and this is completely unrelated to the employee share award but now the company and the employee can be penalised as a result. The point was made by the Tax Faculty that it is not fair that non-commercial increases are taxed with no set-off for non-commercial reductions even where the increases and reductions both arise from non-arm's-length transactions affected within the same group and not as part of a tax avoidance scheme. HMRC responded that 'in the very unlikely event that genuine trading transactions providing no benefit to an employee appear to be caught we will be pleased to consider the particular case on a sympathetic basis under Code of Practice 10'.[93]

A.35 No doubt the main purpose of the legislation is deterrence, but when the legislation is structured in such a way as to cause real practical problems in the matter of valuation and causation, it undermines the fundamental principles of legislation set out in Section 2 of this paper. It also leaves companies open to unexpected HMRC challenges where the operation of the rules is not properly understood and the charge is therefore under-reported.

A.36 Another example occurs where the market value of the employment-related securities at acquisition is reduced by at least 10% as a result of the things done otherwise than for genuine commercial purposes in the seven years prior to the acquisition. In this case, the award of the employment-related securities is taxed as employment income for the tax year in which the acquisition occurs. Where a charge on acquisition arises under Chapter 3A, the taxable amount is given by a formula. That formula includes 'FMV', which is the full market value of the securities at the time of the acquisition assuming that the non-commercial depreciatory actions had not taken place. How in practice FMV can be given a value is not clear. To what extent do actions resulting from the non-commercial and depreciatory actions get taken into account?

[93]Tax Faculty comments on the Finance Act 2003 and Revenue response of 18 December 2003 – see Tax Guide 4/03.

A.37 It might be thought that complex legislation which includes terms of uncertain definition and application would deter all tax avoidance in this area, but the very fact that future legislation was required reinforces the conclusion that this approach is not one to be advocated. Schemes used artificially depreciated restricted securities which were disposed of or cancelled in a manner that would not otherwise create a charge. These were brought into the legislation by Finance (No. 2) Act 2005.[94]

A.38 A further example of uncertainty arises under Section 446E ITEPA 2003. This applies if the market value of employment-related restricted securities (or an interest in them) is artificially low either immediately after a chargeable event or at 5 April in any year. Again, the market value is defined as being artificially low where it has been reduced by at least 10% as a result of non-commercial 'things done'.[95] The securities are then deemed to have ceased to be restricted securities giving rise to a chargeable event[96] at 5 April, but how far does the deeming apply: for the purposes of Section 446E or more generally? The legislation does not say. If it is for the purposes of imposing a charge under Section 446E, then each 5 April the conditions for Section 446E would again be satisfied and the charge would apply annually until the securities cease to be employment related or restricted. This problem was raised by the Tax Faculty, who received a response from HMRC apparently confirming that there would be an annual charge.[97] However, the Paymaster General was soon making the following statement:

> 'Some respondents appear to have misunderstood the way in which the anti-avoidance rule works and have concluded that it imposes an annual charge at 5 April. That is misguided, because once the provision has applied, the securities will no longer be restricted securities for the purposes of Part 7 [ITEPA], which means that the provisions will no longer be applicable.'[98]

In consequence, further increases in value fall within capital gains tax (unless there is an artificial enhancement in value). (Judging by the understanding of HMRC's response to the Tax Faculty's previous question, it might be thought that some of the respondents referred to in the statement included HMRC itself.)

A.39 Finally, one more example of the complexity and lack of clarity prevalent in the legislation can be found in the same Section 446E ITEPA. If all the conditions are in place, Section 446E operates to modify the formula used to

[94]Schedule 2 paragraphs 3–7.

[95]Again raising the problem of what 'things done' means.

[96]Under S427(3)(a) ITEPA 2003.

[97]Tax Faculty comments on the Finance Act 2003 and Revenue response of 18 December 2003 – see Tax Guide 4/03.

[98]Schedule 12 Finance (No. 2) Act 2005.

calculate the amount of charge on the occasion of a chargeable event. The formula is given by Section 428 ITEPA as

$$UMV \times (IUP - PCP - OP) - CE.$$

Section 446E modifies this formula by redefining UMV so as to include the reduction in value caused by non-commercial actions, but only so far as the definition of UMV relates to Section 428. One of the terms in the formula stated in Section 428 – the term OP (outstanding proportion) – is itself defined using UMV. This definition appears in Section 428(5). So, extraordinarily, UMV is supposed to mean different things within the same formula.

The legislation going beyond the intended scope of the tax charge

A.40 There are two particular examples noted here of situations caught by the FA 2003 rules which HMRC then needed to carve out of the rules by agreements with arguable, or at times no apparent, legislative basis.

Private equity 'ratchets'

A.41 The first of these situations involved the private equity and venture capital industries.

A.42 Finance Act 2003 provisions impose a charge where employee shares are increased in value by something done other than for commercial purposes. This potentially caught the 'ratchets' used by the private equity industry. Accordingly, a statement had to be made taking them out of the regime. Similar problems were encountered by the funds and private equity industries in relation to carried interests. The result was two Memoranda of Understanding between HMRC and the BVCA (British Private Equity and Venture Capital Association) covering the relevant matters.[99]

A.43 Three concerns arise out of this. The first is that the tax system should not need to rely upon HMRC reaching agreements as to how the tax rules should work beyond the way Parliament has provided by legislation. How can such extra-statutory agreements be relied upon? The second concern is that the integrity of the system is questioned if different rules are applied to different taxpayers in the same economic situation. Employees outside the private equity industry may receive shares with the same economic characteristics as the 'ratchets' but be unable to benefit from the same treatment. Finally, agreements such as this raise the question of non-legislative rule-making once more. In particular, the beneficiaries of an extra-statutory agreement are faced with the problem that no one can legitimately expect a statutory body such as HMRC to act

[99]See http://www.hmrc.gov.uk/shareschemes/bvca_and_fb2003_carried_interest.pdf and http://www.hmrc.gov.uk/shareschemes/bvca_and_fb2003_managers.pdf.

illegally.[100] So, to the extent that an agreement such as this is found wrong in law, it cannot be enforced by the taxpayers.

A.44 In May 2004, some of the concerns about taxpayers needing to rely upon such extra-statutory agreements came to the fore. The Inland Revenue announced in an answer to a frequently asked question on its share scheme website that it would be imposing tax charges on ratchets unless the employee had paid what it determined to be the full amount for his shares when he acquired them.[101] The Revenue had said in the Memoranda that, provided employees paid a value for their shares that reflected the likelihood of those shares increasing in value, there would be no tax charge on acquisition. Its silence on what happened when the ratchet came into effect was mistakenly taken to mean that there would be no tax charge on that occasion. The Inland Revenue had now said that unless 'full value' is paid when employees acquire their shares, there would be an income tax and NIC charge under Chapter 4 of Part 7 ITEPA on the value that accrues to management as a result of the ratchet. Arrangements put in place before 16 April 2003 were, by concession, excluded from the scope of the tax charge. While advisors could put forward arguments against the Inland Revenue's view, they were also sufficiently concerned to consider making sure that arrangements were put in place so that when managers acquired their shares they had to pay full value on the basis of their maximum possible economic entitlement.

A.45 However, the position was still not final as HMRC then re-revised its view: 'Advice as to the applicability of such a Chapter 4 benefit charge was sought from legal counsel, who advised that a charge under Chapter 4 was not sustainable where the benefit to the holder of the shares from these ratchets reflected rights already present in that class of share at time of acquisition by the employee'.[102] So if shares were acquired on or after 16 April 2003 and a ratchet operated on or before 5 April 2004, an error or mistake claim under S33 TMA 1970 had to be made and a reclaim of overpaid NICs made.

A.46 If it is decided that particular groups of taxpayers should be taxed in different ways, then exceptions should be built into the legislation. Dealing with the situation by means of concessions, Memoranda of Understanding, HMRC Manual statements or other such media leaves the taxpayer open to uncertainty and the problems of enforceability referred to in Section 7 above.

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[100]See *R v. C&E Commrs ex parte F&I Services* [2001] BTC 5266 and *Al Fayed v. Advocate General of Scotland* [2004] SLT 798.

[101]http://www.inlandrevenue.gov.uk/shareschemes.

[102]HMRC Employment-Related Securities Manual, ERSM90500.

The science company problem

A.47 The second example of where the legislation went too far concerned science companies. Following enactment of the rules in FA 2003, it soon became clear that HMRC had not fully understood the extent and uses of employee share schemes. The reporting requirements imposed by the legislation threw up various problems, including one with spin-out companies.

A.48 Many universities and public sector research establishments will reward employees who create successful intellectual property. One way of doing this is via shares in a company to which the intellectual property is transferred. The problems faced by those involved soon became evident. The value of the shares will be affected by the agreement to transfer the intellectual property to the company and so a charge can arise under Section 62 ITEPA or on the receipt of a benefit in connection with the shares under Schedule 7 ITEPA. How was the value of the 'idea', which would be the only asset of the company, to be decided? If there was to be a cash charge on receipt of the 'benefit', how was this to be paid? There is no cash in the company and the employee has not received any value he can change into cash to meet a tax bill.

A.49 Prior to the 2003 changes, the issue had lurked but been ignored and the view had been taken by those involved that only capital gains tax on sale was relevant. In fairness to HMRC, it should be noted that it had not been aware of the situation as there had been no reporting requirement.

A.50 The result of the problems arising in the context of FA 2003 was, first, a collection of agreements between HMRC and the research institutions to deal with the problems, culminating in a Memorandum of Understanding.[103] The tax and NICs could be deferred until the company was successful.

A.51 However, in contrast to the private equity industry, the science company position was then placed upon a legislative basis. In the 2004 Pre-Budget Report, draft legislation dealing with the problems was published which later became Sections 20–22 FA 2005 setting out a special set of rules for the science company spin-outs.

A.52 The legislation again raises questions of interpretation. For example, the new science company rules make it clear that the transfer of intellectual property is not a 'thing done' otherwise than for commercial purposes, but this in turn then raises the question as to why one would think it was other than for commercial purposes in the first place. The problem is that by drafting the provisions in the way the draftsman did, the taxpayers are left unclear as to what is meant. The phrase 'things done otherwise than for genuine commercial purposes' is not

[103] MOU between University Companies Association (UNICO) and the Inland Revenue, 14 April 2004.

defined, but two examples are given: anything done as part of a tax avoidance scheme or arrangement and non-arm's-length transactions between companies who are members of the same group.

A.53 However, this appendix would suggest that although the legislation raises some problems of interpretation, those problems are more manageable than the problems of the non-legislative rule-making involved in the making of agreements that are not supported by the law.

The difficulty of wording TAARs

A.54 TAARs are scattered liberally through the employee share legislation after FA 2003. One of the FA 2004 changes was to include a TAAR providing that the exclusion tests were 'satisfied if the avoidance of tax or national insurance contributions was not the main purpose, or one of the main purposes, of the *arrangements under which the right or opportunity to acquire the employment-related securities was made available*'.

A.55 However, this then needed strengthening by rewording in F(No. 2)A 2005 so that the exclusion is denied if '*something which affects the employment-related securities* has been done as part of a scheme or arrangement the main purpose (or one of the main purposes) of which is the avoidance of tax or national insurance contributions'.

A.56 A TAAR is a *targeted* anti-avoidance provision. It is therefore self-evident that if the target is incorrectly defined, the provision will not work. The temptation may then be to make the 'target' as broad as possible, but then the legislation runs into the type of problems of lack of clarity and coherence illustrated earlier in this appendix. More on this subject is considered above in Section 8.

Conclusion

A.57 The example of countering avoidance in the context of employee share awards has shown the problems of reactive legislation. An extremely complex and unwieldy set of rules was produced and the need for ongoing amendment to the rules in successive Finance Acts has demonstrated that the new rules have not put an end to avoidance in this area. It has not provided an efficient way of tackling the perceived problems for HMRC or HM Treasury and has given rise to real costs in terms of lack of clarity and stability for taxpayers. The use of extremely wide anti-avoidance provisions has meant that arrangements with no tax avoidance motive could be affected and HMRC statements and concessions have been needed, raising the issues surrounding non-legislative rule-making.

Table of relevant legislation over the years
from the Employment-Related Securities Manual ERSM10070

Old legislation (pre-6/4/2003)	**ITEPA 2003 as originally enacted (6/4/2003 – 15/4/2003)**	**ITEPA 2003 as amended by Schedules 21 & 22 FA 2003 (from 16/4/2003)**	**FA 2004**	**FA 2005 & F(No 2)A 2005**
Various definitions & information powers	Chapter 1 Part 7 Introduction	Chapter 1 Part 7 Introduction as from when relevant in context of other chapters	Anti-avoidance measures for public offers and approved schemes as from 18/6/04	Insurance contracts added to list of "securities" as from 2/12/04
S140A-C ICTA 1988 (intro by FA 1998) Conditional shares S78 FA 1988 Charge where restrictions removed	Chapter 2 Part 7 Conditional interests in shares Chapter 4 Part 7 Restrictions or rights varied	Chapter 2 Part 7 Restricted securities as from 1/9/03	Detailed anti-avoidance measures from 7/5/04 or 18/6/04 NIC elections as from 1/9/04	Detailed anti-avoidance measures as from 2/12/04
S140D-F ICTA 1988 (intro by FA 1998) Convertible shares	Chapter 3 Part 7 Convertible shares	Chapter 3 Part 7 Convertible securities as from 1/9/03	Detailed anti-avoidance measures from 7/5/04 NIC elections as from 1/9/04	Detailed anti-avoidance measures as from 2/12/04
		Chapter 3A Part 7 Securities with artificially depressed market value as from 16/4/03	Detailed anti-avoidance measures from 7/5/04	
S79 FA 1988 Shares in dependent subsidiaries	Chapter 4 Part 7 Increase in value of shares of dependent subsidiaries	Chapter 3B Part 7 Securities with artificially enhanced market value as from 16/4/03	Detailed anti-avoidance measures from 7/5/04	
S162 ICTA 1988 Employee shareholdings	Chapter 8 Part 3 Notional loans in respect of acquisition of shares	Chapter 3C Part 7 Securities acquired for less than market value as from 16/4/03	Detailed anti-avoidance measures as from 7/5/04	Detailed anti-avoidance measures as from 2/12/04
S162(6) ICTA 1988 Employee shareholdings	Chapter 9 Part 3 Disposals of shares for more than market value	Chapter 3D Part 7 Securities disposed of for more than market value as from 16/4/03		

Old legislation (pre-6/4/2003)	**ITEPA 2003 as originally enacted (6/4/2003 – 15/4/2003)**	**ITEPA 2003 as amended by Schedules 21 & 22 FA 2003 (from 16/4/2003)**	**FA 2004**	**FA 2005 & F(No 2)A 2005**
S80 FA 1988 Special benefits	Chapter 4 Part 7 Post-acquisition benefits from shares	Chapter 4 Part 7 Post-acquisition benefits from securities as from 16/4/03	Detailed anti-avoidance measures as from 7/5/04	Detailed anti-avoidance measures as from 2/12/04
				Chapter 4A Shares in research institution spin-out companies as from 2/12/04
S135-S140 ICTA 1988 Gains by directors & employees from share options	Chapter 5 Part 7 Share options	Chapter 5 Part 7 Securities options as from 16/4/03 for other securities and from 1/9/03 for shares	Detailed anti-avoidance measures from 18/6/04	
S47 & Schedule 8 FA 2000 Employee share ownership plans (ESOPs)	Chapter 6 Part 7 & Schedule 2 Approved share incentive plans (SIPs)	Detailed amendments in Schedule 21 FA 2003		
S185 & Schedule 9 ICTA 1988 Approved share option schemes	Chapter 7 Part 7 & Schedule 3 Approved SAYE option schemes	Detailed amendments in Schedule 21 FA 2003		
S185 & Schedule 9 ICTA 1988 Approved share option schemes	Chapter 8 Part 7 & Schedule 4 Approved CSOP schemes	Detailed amendments in Schedule 21 FA 2003		
S62 & Schedule 14 FA 2000 Enterprise management incentives (EMI)	Chapter 9 Part 7 & Schedule 5 Enterprise management incentives (EMI)			
S86 FA 1988 Priority share allocations for employees	Chapter 10 Part 7 Priority share allocations			

Appendix B
The example of countering avoidance in the context of stamp duty

Introduction

B.1 Since 1999, there have been a series of changes made to the stamp duty rules aimed at stopping avoidance, including the introduction of the stamp duty land tax (SDLT) rules in 2003.

B.2 In this appendix, the background to the stamp duty rules is noted before the approach to countering avoidance in this area is analysed.

History and background

B.3 Stamp duties have a long history, having been introduced in 1694 as ‘several duties on Vellum, Parchment and Paper for four years, towards carrying on the war against France’. They were taxes on documents and governed until recently by some of the oldest tax legislation still in operation contained in the Stamp Act 1891 (as amended by various Finance Acts). As taxes on documents, they were completely dependent on the form of a transaction; so, for example, a transfer of property that took place without a document would not be stampable. The penalty for not paying stamp duty was not being able to rely upon the document in court. This formalistic basis to the duty meant that it could be avoided or deferred, unless a document was required to transfer the property and that document transferring the property needed to be produced for registration.

B.4 The stamp duty legislation also provided for an unusual system for determining the amount of duty payable. This was the system of adjudication by which the Commissioners may be asked to determine whether duty is due and, if so, how much is due. In certain cases (such as claiming group relief), adjudication was required; in other cases, it could be applied for voluntarily.

B.5 In 1986, stamp duty reserve tax (SDRT) was introduced at a lower rate than stamp duty at the rate of ½%. This applied to agreements to transfer shares or securities: it was a tax and not a duty and applied to an agreement to transfer shares or securities and not the actual transfer of them. It was introduced at the time of ‘Big Bang’ to accommodate the changes in the system and the expected increase in volume of transactions; and while the rate would be ½% rather than 1%, so that it was competitive as compared with other stock exchange locations, the tax would apply to transactions which would not have been caught by stamp duty. As the system for transferring shares and securities became paperless, stamp duty ceased to apply to most such transactions and SDRT became the principal charge.

B.6 In 1997, the first rate change occurred and the rate of stamp duty applicable to transfers of property other than shares and securities rose to 1.5% where the consideration was £250,000–£500,000 and 2% where the consideration exceeded £500,000. Those rates then increased by 0.5 percentage points each year for the next three years until the rates became 3% for consideration of £250,000–£500,000 and 4% where the consideration exceeded £500,000. As a result, the amount raised by stamp duties and taxes in the year ended 31 March 2005 was approximately £9 billion, exceeding that raised by the aggregate of capital gains tax, inheritance tax and petroleum revenue tax.

B.7 In 1999, the first major changes to the structure of stamp duty occurred. Finance Act 1999 repealed the charging provisions of the Stamp Act 1891 and substituted three new heads of charge: sales, leases and other instruments.[104] At the same time, the first major attempt at curbing avoidance was taken by changing the rules regarding late stamping. As stamp duty was only required in order to produce a document in court as evidence or in order to register the transfer of a registered interest in property (such as land), no stamp duty needed to be paid if neither of these events was to happen. If the document was executed offshore, interest and penalties would only run from 30 days after bringing it onshore.[105] Some said that this meant that stamp duty had become a voluntary tax, although the vast majority of transactions were completely unaffected by this rule. As a result of the Finance Act 1999 changes, interest would be chargeable from 30 days after execution regardless of where the document was executed. In addition, whereas previously a document sent for adjudication would not be subject to interest until after adjudication, now the 30-day limit applied whether or not it had been sent for adjudication and so an estimate of the duty payable would need to be enclosed to forestall an interest charge. So, in the Finance Act 1999, the swing to making stamp duty a self-assessed tax started.

B.8 In 2000, another set of anti-avoidance provisions were introduced in the Finance Act 2000. These were introduced to deal with the position that instead of transferring land for a consideration of X (where the transfer is of the land and subject to a high rate of stamp duty), a taxpayer could transfer X (in the form of gilts, for example, which are exempt from stamp duty) in consideration for the transfer of land. Similar provisions countered the transfer of land to a connected company, or where the consideration included an issue of shares in a company connected with the transferor.

B.9 At the turn of the century, the City of London was lobbying government hard to abolish any form of stamp tax on transfers of shares or securities as it was

[104] Schedule 13 Parts I–III FA 1999.

[105] S15 SA 1891 prior to FA 1999 amendments.

argued that, in an increasingly global economy, London's competitiveness was being damaged. However, the government stated in 2001 that stamp duty and stamp duty reserve tax on shares would be maintained. It is a highly efficient source of revenue-raising, being almost entirely self-policing. Since 1996, SDRT has been automatically collected by the CREST paperless transactions system for dealings in stocks and shares.

B.10 So with the SDRT system effectively automated, attention was turned to the imposition of stamp duty in relation to land transactions as a new paperless system of e'conveyancing was expected. Equally importantly, it was perceived that the existing stamp duties were being fairly easily avoided due to their legalistic and document-based system. One proposal to deal with the e'conveyancing had been a fairly simple deeming provision to ensure stamp duty was still payable, but the anti-avoidance motivation for action became predominant as it became clear that the increase in rates from 1% to 4% had generated a thriving avoidance industry. So, in April 2002, the government issued a consultative document, 'Modernising Stamp Duty on Land and Buildings in the UK', and in 2003 the Finance Act abolished stamp duty on land and buildings and replaced it with a new compulsory self-assessed transaction tax: stamp duty land tax (SDLT).

B.11 Stamp duty land tax applies to any acquisition of a 'chargeable interest', which is broadly speaking any interest in land or the benefit of any obligation, restriction or condition affecting the value of the interest in land.[106] A contract for a land transaction gives rise to SDLT when it is substantially performed (as to which there are detailed rules). If the contract is substantially performed before completion and there is a subsequent conveyance completing the transaction, both the substantially performed contract and the conveyance are subject to SDLT and, if the SDLT on the conveyance exceeds that paid on the contract, the additional amount is payable.[107]

What went wrong?

B.12 As the rate of stamp duty on certain transfers and agreements increased as compared with other transfers and agreements, so the avoidance of stamp duty increased by structuring the transaction to take the benefit of the lower rate. At its simplest, it is clear that if a purchaser of some land will pay 4% stamp duty or SDLT to buy the land but only ½% stamp duty to buy the shares of a company whose sole asset is the land, the purchaser is likely to buy the company instead, especially if the value of the land is high and/or the

[106]S43 FA 2003.

[107]At least, that is the conclusion practitioners have reached. However, the wording of the section does not quite achieve that result.

purchaser is themselves a company. Such boundaries will always increase the risk of what the government may view as unacceptable tax avoidance and will therefore carry tax avoidance costs whether through that tax avoidance or through the process of including measures to deter it.

B.13 Initially, the government had responded in the usual way to avoidance, by introducing specific measures targeted at countering specific abuses of which it was aware. So, for example, in the Finance Act 2000, there were nine provisions introduced to deal with specific avoidance methods and, most notably, a provision empowering the Treasury to make provision by regulation 'where they consider it expedient in the public interest'. (Such regulations need approval by the House of Commons within 28 days of being made and can only last for 18 months.[108])

B.14 Then, in 2002, the government introduced another set of changes to the stamp duty rules aimed at countering avoidance, at the same time as issuing a consultation document considering a fundamental change to the stamp duty system. It was maintained that the 2002 changes were needed despite the proposed fundamental overhaul of the system because avoidance was so significant. It is generally agreed amongst commentators that many of the 2002 changes were introduced too hastily and this resulted in unsuccessful legislation. It is recognised that if HMRC became aware of significant stamp duty avoidance, it would feel an obligation to act, but hasty measures often achieve relatively little when there are significant loopholes left for taxpayers to use.

B.15 The government's consultation process was suddenly terminated in January 2003 as it seemed the desire to do something to counter the avoidance (despite the previous attempts, most notably in 2002) overtook the process of consultation and development of a cohesive set of rules. Commentators have described the resulting legislation as 'ill thought through'[109] and there were numerous gaps which had to be filled by regulations. In addition, the legislation needed to be supplemented by bulletins and 'customer newsletters'. As a result, statutory instruments were needed before the end of the year to correct mistakes and rewrite charging provisions, and further detailed changes have been required in the Finance Act 2004, Finance Act 2005, Finance (No. 2) Act 2005, Finance Act 2006 and Finance Act 2007.

B.16 If the problem of the differential rates applying to transactions is accepted, then how could the rules have been better implemented in order to limit the scope for avoidance? This appendix concludes that, in summary, what went

[108] S117 FA 2000.

[109] See, for example, paragraph 62:01 of *Tiley & Collison's UK Tax Guide*, 2006/07.

wrong was that the ways used to tackle the avoidance were in the first place too reactive. Then, when it was decided to stop being reactive and review the entire system, the desire to do something to counteract specific examples of avoidance appeared to override the process that was trying to improve the system and make it less vulnerable to avoidance. As a result, there is an extremely complex set of legislation and three stamp tax systems – SDRT, SDLT and stamp duty – running alongside each other and with many differences in their rules. The costs involved with taking the extra time to produce a more coherent and robust system would have been justifiable.

The problems

B.17 There were and are numerous problems arising from the changes to the stamp duty rules, especially from 2002 onwards. This appendix does not attempt a complete review of the changes but focuses on the following problems: those arising from the hasty introduction of rules; those arising from the anti-avoidance inconsistencies between the three stamp tax systems; and those caused by the lack of definition and clarity in a self-assessed system no longer benefiting from adjudication.

Hasty changes

B.18 As said, despite the fact that a complete overhaul of the stamp duty rules applying to land was on the table, another series of anti-avoidance measures applying to the existing stamp duty measure was introduced in 2002.

B.19 One example of the problems with the hasty measures is contained in Section 111 of the Finance Act 2002, which was introduced to claw back group relief if the transferee ceased to be a member of the group within two years of the transfer.[110] As originally drafted, the provision clawed back relief if the transferee ceased to be a member of the group and at the time it so ceased it held the estate or interest in land previously transferred to it by the instrument for which group relief had been obtained. The section had significant loopholes. So, for example, the clawback would not operate if the interest in the land was not held by the transferee when the transferee left the group but by an associated company of the transferee also leaving the group. Alternatively, the clawback did not apply if the interest in land had been subsequently transferred by a duly stamped transfer that had been stamped either with a fixed duty or with ad valorem duty calculated on a nominal consideration.

[110]Similar provisions dealt with grants of leases between group companies.

B.20 Both of these loopholes were dealt with by subsequent legislation in Finance Act 2003. However, there remain potential ways for taxpayers to work around the clawback rules, as described below in the context of SDLT. Also, while the SDLT rules have a further layer of anti-avoidance rules addressing a potential loophole arising from the drafting of the definition of 'associated company', the equivalent stamp duty rules do not address this issue.

B.21 Another example of problems caused by hasty rule changes is contained in Section 75A Finance Act 2003. Originally, the provision was introduced via secondary legislation. When the primary legislation was introduced in the Finance Act 2003, a power had been taken for the Treasury to make variation of the SDLT legislation by regulation 'if they consider it expedient in the public interest'.[111] This was intended to enable new rules to be introduced quickly to deal with perceived avoidance. Accordingly, when the government became aware of transactions structured to avoid SDLT, it used this power to introduce Section 75A. The regulations could have a life of no more than 18 months. Hence, primary legislation was subsequently introduced in the Finance Act 2007.

B.22 The Section 75A rule applies broadly where:

(i) an interest in land is disposed of by one person and acquired by another;

(ii) a number of transactions are involved in connection with that disposal and acquisition; and

(iii) the SDLT payable on a notional transfer of the land for a consideration equal to the highest amount or amounts paid by any one person to the transactions is lower than that actually payable on the disposal and acquisition of the land.

B.23 When the regulations were introduced, some commentators argued that the rules were 'ultra vires' as regulations which permitted non-land transactions to be taken into account.[112] However, what was clear was that the rule introduced in Section 75A was extremely wide and contained some terms that left considerable areas of uncertainty. It appeared that the rule as originally drafted could apply to almost any transaction involving anything more than just the transfer of land from A to B, and SDLT would then apply on the total consideration for the transaction. The CIOT commented that the drafting was 'fundamentally deficient' and that the section was 'almost unworkable' in practice. Some described the provision as a mini-GAAR. While it was limited to SDLT, its scope was far wider than a traditional GAAR, having no tax avoidance motive acting as a limit.

[111] S109 FA 2003.

[112] Law Society letter to the Paymaster General, 1 March 2007.

B.24 This meant that two months later, HMRC needed to issue guidance excluding various commercial property transactions from the new rules. However, the exclusions were simply stated. The reason why one transaction was on a white list, while another with fundamentally the same characteristics was not, remained unanswered. A tax avoidance motive could not distinguish cases as there was no such limitation in the legislation. For example, the guidance stated that the sale of land together with a contract under which the vendor will construct a building on the land sold where the consideration for the construction contract was not part of the consideration for the land, would not be caught. The construction contract is a transaction within the definition contained in Section 75A and is 'involved in connection with the sale of the land', so it was not clear on what basis this exclusion was listed. This type of approach leads to suggestions that HMRC has taken wide powers of taxation by such legislation with exceptions granted in non-binding guidance.

B.25 When the provisions were replaced by those contained in the Finance Act 2007, some of the concerns were dealt with by specific statutory exclusions: for example, the construction contract considered in the paragraph above was now specifically excluded.[113]

B.26 This sequence of events does lead to certain conclusions about how avoidance should be handled. First, it is suggested that this is a clear example showing the dangers inherent in providing power for the Treasury to legislate against perceived avoidance by secondary legislation. The Section 75A regulations may have prevented particular transactions, but also went much further and in so doing caused considerable uncertainty. That uncertainty would have given rise to real costs for non-avoiding taxpayers, both in terms of professional advice and potentially in commercial terms by deterring taxpayers from entering into wholly acceptable commercial arrangements. Some may argue that primary tax legislation receives insufficient scrutiny, but there is much less effective scrutiny in the case of regulations and as such this appendix suggests that regulations are an inappropriate method for introducing substantive changes in tax law.

B.27 Second, the insufficiently focused legislation meant that there was the need for HMRC to fill the legislative gaps and give guidance as to what would and would not be caught. Due to the current problems of non-legislative rule-making, taxpayers were left with considerable risk. As discussed in Section 11, it appears to be generally accepted that a GAAR would require some form of clearance procedure. When provisions equivalent to a GAAR, or, in the case of Section 75A, potentially wider than a GAAR, are introduced, the case for a clearance mechanism is just as strong.

[113] S75B (3)(a) FA 2003.

The inconsistencies between the rules

B.28 The stamp system is now left with three overlapping sets of rules: SDRT, stamp duty and SDLT. Many of the anti-avoidance provisions aim to tackle the same mischief in the case of at least two of these taxes, but different wording is used. Often, this is because the terminology at the heart of the tax is different: for example, stamp duty is a tax on transfer whereas SDLT is a tax on acquisitions. The result is layers of rules weaving in and out of each other. It is suggested that such an approach makes the drafting of a clear and consistent system very difficult and increases the likelihood of loopholes being exploited.

B.29 The example of the group rules illustrates this point. Initially, the SDLT rules providing reliefs for corporate transactions were very similar to the stamp duty rules. So, SDLT included a group relief rule for transfers between members of the same group, reconstruction relief for the acquisition of an undertaking of a 'target' in exchange for shares issued to the target's shareholders and acquisition relief for the acquisition of an undertaking in a 'target' in exchange for shares issued to the target or its shareholders. However, the SDLT rules have been altered on numerous occasions since 2003 and significant differences in the systems have arisen. For example, the three SDLT corporate reliefs are all subject to anti-avoidance rules in the form of not applying where the transaction is not effected for bona fide commercial reasons, or forms part of arrangements of which the main purpose or one of the main purposes is the avoidance of tax. The stamp duty equivalents contain no such provision.

B.30 A different type of inconsistency also arises in the context of the SDLT group rules. The group definition has incorporated certain of the corporation tax group relief tests set out in Schedule 18 Taxes Act 1988 for both stamp duty and SDLT. Confusingly, these tests have been incorporated in slightly different ways for stamp duty and SDLT. For example, the tests relating to equity holders and assets for distribution are applied with part of those tests not applying to the transferor and the transferee for SDLT purposes but only for the transferor for stamp duty purposes.[114]

B.31 More problematic, though, is the fact that the Schedule 18 tests are applied over an accounting period. Does this mean that for SDLT purposes, the purchaser has to wait and see to determine whether the relief is available? There is no legislative provision entitling him to, so in order not to be exposed to penalties, the purchaser must in theory pay the SDLT and then wait till the end of the accounting period to make the claim for group relief.

B.32 This problem arises from trying to apply tests that were not designed for the tax concerned.

[114] Paragraph 1(6) Schedule 7 FA 2003.

Uncertainty regarding terms

B.33 There are various terms used in the SDLT legislation that are unclear in their scope. The first is 'reconstruction' used in the context of one of the three corporate reliefs. In the context of stamp duty, the Stamp Office applied a narrower meaning to that term than that applied in the context of other taxes. In the debates regarding the Finance Act 2002, the government indicated that the meaning used may be aligned with that used in other tax contexts when SDLT was introduced, but there has been no subsequent guidance on the matter. Accordingly, taxpayers are left uncertain which the correct interpretation for SDLT purposes is.

B.34 The second term the meaning of which is uncertain is 'arrangements'. The guidance provided for stamp duty group relief looks to whether there is preordainment, i.e. whether there is no practical likelihood that the transaction would not proceed as expected.[115] This is in the context of an anti-avoidance section which lists the type of arrangements that cause the group relief to be unavailable but does not define the term 'arrangements'.[116] In contrast, the SDLT guidance[117] sets out the legislation which does give a definition of 'arrangements'[118] as any scheme, arrangement or understanding whether or not legally enforceable. It then states that the practical likelihood of a scheme being carried through is not in itself relevant to the existence of an arrangement for the purchaser to leave the group. Does this same term – 'arrangements' – have different meanings by virtue of the definition included in the 2003 legislation? This seems unlikely, although it could be argued that as the legislation must be read in context, and SDLT is a transaction tax, not a tax on documents, the courts may be inclined to adopt a more purposive approach. However, the result is that the position is left inconsistent and unclear for taxpayers.

B.35 The 'arrangements' restriction does not apply if the arrangements are in relation to an acquisition of shares which would be exempt from stamp duty under the acquisition relief provided for that tax. The level of likelihood for such transaction to occur is not clear. Also, what is to happen if the parties believe that the stamp duty acquisition relief is available but it turns out they are incorrect? What is to happen if the acquisition of shares may be structured in various ways and the way in fact chosen did not benefit from the acquisition relief even though another structure would have so benefited? The term 'arrangements' has been fraught with difficulty in its application to deny relief

[115]Statement of Practice SP3/98, paragraph 20.

[116]S27 FA 1967.

[117]Tax Bulletin, Issue 70.

[118]Paragraph 2(5) Schedule 7 FA 2003.

in the context of stamp duty, but that was at least in part alleviated by the original adjudication system applying to stamp duty.[119] Under that system, disclosure of the facts could be made and adjudication by HMRC as to whether stamp duty was payable would be decisive. However, SDLT is a transactional tax and is self-assessed. Consequently, uncertainty is a significant problem for taxpayers. Where broad terms such as 'arrangements' are used, clarity in the system will only be secured if there is some form of clearance process.

B.36 A similar problem arises in relation to a more general anti-avoidance rule introduced in Finance (No. 2) Act 2005, which prevents SDLT group relief from applying if the transaction is not effected for bona fide reasons or forms part of arrangements of which the main purpose or one of the main purposes is the avoidance of liability to tax (defined to include taxes other than SDLT). A provision such as this raises the question of what is tax avoidance and, because of the lobbying about the vagueness of that term, the Economic Secretary to the Treasury made a statement.[120] It was stated that 'the fact that a transaction gives rise to a tax benefit does not mean that avoidance is the main purpose – "tax avoidance" means obtaining a relief in a manner that was not contemplated by Parliament'. Three examples of transactions that were not caught were then given but it could be said that these did not give much extra guidance. Later, on 9 February 2006, HMRC published interim guidance on the provisions in the form of a 'white list' of acceptable transactions.

B.37 The problem is that the uncertainty in the application of a provision such as this remains. It may have some of the desired effect in deterring taxpayers from entering into transactions that may raise the possibility of this provision applying, but in doing so it places the onus on taxpayers to gauge what may and what may not be caught without any clearance system to support them. It is surprising that there is no clearance procedure when the same form of provision has a clearance process in the other places within the tax code where it is used.[121]

An example of the SDLT drafting problems

B.38 The SDLT legislation has been widely perceived as legislation which has suffered from lack of clarity and which has left open many opportunities for taxpayers to avoid or reduce their liability to stamp duty. One example considered here again arises in the context of the group rules.

[119] The exposure of taxpayers to problems in determining what is meant by 'arrangements' increased in 2002 when clawback provisions were introduced so that adjudication was no longer final.

[120] Hansard Committee Debates, 30 June 2005.

[121] S707 TA 1988 and S137 TCGA 1992.

B.39 Where group relief is claimed but the purchaser of the chargeable interest then ceases to be a member of the same group of companies as the vendor within three years (or longer if in pursuance of arrangements entered into before the transfer of the chargeable interest) and the purchaser or a relevant associated company holds the property, the group relief is clawed back. A relevant associated company is one that ceases to be a member of the same group as the vendor in consequence of the purchaser so ceasing. There are various situations where an associated company may not leave 'in consequence' of the purchaser leaving the group even though it may leave the group with the purchaser.[122] This meant that the purchaser could transfer on the property to another group member (X Ltd) and so long as the purchaser and X Ltd left the group without it being in consequence of the purchaser leaving the group, clawback of the group relief could be resisted. As a result, a further anti-avoidance provision was introduced in 2005.[123] If there is a change in control of the purchaser, then the clawback provisions treat the original transferor of the property as the transferor to X Ltd and so a clawback is applied. However, this provision can potentially lead to multiple clawbacks if there have been more than two successive transfers in the three-year period.

B.40 Even with this strengthening of the rules, there were still large holes in the anti-avoidance provisions. So, for example, if the purchaser of the property is above the vendor in the group structure, the purchaser could be wound up and its assets distributed (claiming reconstruction relief on the distribution[124]) without clawback as there was exemption from clawback where the purchaser and the vendor cease to be members of the same group by virtue of the winding up of the vendor or another company that is above the vendor in the group structure. This has now been plugged by provisions in the Finance Act 2008.[125]

B.41 With the stamp costs becoming so significant in commercial transactions, it encourages taxpayers to enter into structures such as this which would otherwise not be considered.

Conclusion

B.42 The approach to tackling avoidance in the area of stamp duty was too reactive. A desire to do something appeared to override the process that was trying to improve the system and make it less vulnerable to avoidance. Hasty changes have opened up loopholes for taxpayers, which are then countered one by one.

[122] See *Tiley & Collison's UK Tax Guide*, paragraph 62:17.

[123] Paragraph 4A Schedule 7 FA 2003.

[124] Paragraph 7(1) Schedule 7 FA 2003.

[125] Section 96.

More fundamentally, the different rates for land transactions and share transactions have encouraged taxpayers to use a share transaction to achieve a transfer of land. Such a boundary within the tax system will always increase the potential for avoidance and makes a coherent and robust system even more important. This appendix asks whether a complete overhaul of the entire stamp duty system, seeking to produce a more unified tax regime and starting from the premise of a general principle of taxation on transfers of property, would have been a more effective approach.

Appendix C
The drafting of TAARs

In this appendix, many of the TAARs introduced over the past 11 years are reproduced. The TAARs are set out under headings which identify the key elements of the TAAR. For example, the heading identifies whether there is a main benefit or purpose test and whether the TAAR requires a scheme or arrangements to exist. The TAARs are reproduced with the key elements highlighted in bold print. In so doing, the appendix seeks to show the variety of drafting of the TAARs and the extent to which the drafting of certain types of TAARs has altered over time.

C.1 A specific main benefit test. No scheme or arrangements are required.

Section 106(7) FA 2000 – FOREX

After section 135 of [FA 1993] there shall be inserted-

"Sterling used if avoidance of gain is the main benefit.

135A. -

(b) the **main benefit** that might be expected to accrue from that currency [not sterling] being the local currency is that no net exchange gain would accrue to the company for those purposes."

C.2 A tax advantage main benefit test with a scheme or arrangement required.

Section 138 FA 2004 – gilt strips

(5) After paragraph 14A [Sch 13 FA 1986] (strips of government securities: losses) insert—

"*Strips of government securities: manipulation of acquisition, sale or redemption price*

14B (1) This paragraph applies in any case where, as a result of **any scheme or arrangement,—**

(a) the amount paid by a person in respect of his acquisition of a strip is or was more than the market value of the strip at the time of that acquisition,

(b) the amount payable to a person on a transfer of a strip by him is less than the market value of the strip at the time of the transfer, or

(c) on redemption of a strip, the amount payable to a person, as the person holding the strip, is less than the market value of the strip on the day before redemption,

and the obtaining of a tax advantage by any person is the **main benefit, or one of the main benefits, that might have been expected to accrue from, or from any provision of, the scheme or arrangement.**

… (7) In this paragraph "**tax advantage**" has the meaning given by section 709(1) of the Taxes Act 1988.".

(6) After paragraph 14B insert—

"*Strips: manipulation of price: associated payment giving rise to capital gains tax loss*

[Equivalent provisions to Section 14B above]".

<u>C.3 The main object test. A scheme or arrangement is needed.</u>

<u>Section 84 and Schedule 30 FA 2002 – new rules for intangibles</u>

Tax avoidance arrangements to be disregarded

111 (1) **Tax avoidance arrangements** shall be disregarded in determining—

(a) whether debits are to be brought into account under paragraph 9 (writing down on accounting basis) or the amount of such debits, or

(b) whether a credit is to be brought into account under Part 4 (realisation) or the amount of any such credit.

(2) Arrangements are **"tax avoidance arrangements" if their main object or one of their main objects is** to enable a company—

(a) to obtain a debit under paragraph 9 to which it would not otherwise be entitled or of a greater amount than that to which it would otherwise be entitled, or

(b) to avoid having to bring a credit into account under Part 4 or to reduce the amount of any such credit.

(3) In this paragraph—

- **"arrangements" includes any scheme, agreement or understanding, whether or not legally enforceable;** and
- "brought into account" means brought into account for tax purposes.

<u>C.4 A main purpose test. The purpose is specified. No scheme or arrangements are required.</u>

<u>Section 26 FA 2007 – restrictions on trade loss relief for partners</u>

Inserts 113A ITA 2007.

113A Exclusion of amounts contributed to access relief

(1) An amount which an individual contributes to a firm as capital is to be excluded in calculating the individual's contribution to the firm for the purposes of section 104 or 110 if the contribution was made for a **prohibited purpose** (but see subsection (4)).

(2) If—

(a) an individual carries on a trade as a member of an LLP at a time in a tax year,

(b) the individual does not devote a significant amount of time to the trade in the relevant period for that year, and

(c) the individual contributes an amount to the LLP as capital at any time in that year, that amount is to be excluded in calculating the individual's contribution to the LLP for the purposes of section 107 if the contribution was made for a **prohibited purpose** (but see subsection (4)).

(3) For the purposes of this section a contribution is made for **a prohibited purpose** if the **main purpose, or one of the main purposes, of making the contribution is the obtaining of a reduction in tax liability by means of sideways relief or capital gains relief**.

C.5 The sole or main benefit test. The benefit is specified. No scheme or arrangements are required.

Section 82 FA 2005 – change of accounting practice

Change of accounting practice: deferment of transitional adjustments

(1) This section applies where—

(a) a company enters into a transaction on or after 14th December 2004, otherwise than in the ordinary course of its business,

(b) as a result of the transaction it incurs a loss in respect of a loan relationship or derivative contract in respect of which, apart from this section, a debit would fall to be brought into account for tax purposes in a period of account beginning before 1st January 2005,

(c) the **sole or main purpose of the company in entering into the transaction at the time it did was to enable it to bring a debit into account for tax purposes in such a period**

… (3) In determining the **sole or main purpose** of a company for the purposes of subsection (1)(c**) regard shall be had to anything done by a connected company** that would be relevant for the purposes of that determination if done by the company in question.

For this purpose companies are connected if they are connected persons within the meaning of section 839 of ICTA.

… (6) In this section, references to a **company entering into a transaction include** a reference to the company, or the directors of the company, taking a decision about a loan relationship or derivative contract that affects its treatment for accounting purposes (other than a decision to prepare some or all of the company's accounts in accordance with international accounting standards).

C.6.1 An unallowable purpose test. No scheme or arrangements are required. Unallowable excludes anything not business or commercial and tax avoidance is not to be a business or commercial purpose. A just and reasonable apportionment is provided for.

Section 69 FA 2002 – qualifying contracts for unallowable purposes

Inserts into FA 1994:

"168A Qualifying contracts for unallowable purposes

(1) Where in any accounting period a qualifying contract to which a company is party has **an unallowable purpose**, any amounts which for that period fall, in the case of the company, to be brought into account for the purposes of section 155 above as part of amount B shall (subject to subsection (2) below) not include so much of the amounts given by the accounting method used as respects the contract as, on **a just and reasonable apportionment, is referable to the unallowable purpose.**

(2) The total of any amounts which by virtue of subsection (1) above are not to be brought into account in the accounting period as part of amount B may not exceed the maximum amount.

(3) For the purposes of subsection (2) above, the maximum amount, in relation to the accounting period, is-

(a) if in the accounting period amount B exceeds amount A, the amount by which amount B exceeds amount A; and

(b) if in the accounting period amount A exceeds or equals amount B, nil.

(4) For the purposes of subsection (3) above, amount A and amount B shall be determined in relation to the qualifying contract in accordance with section 155 above and, in so determining amount B, so much of any amount as is referable to the unallowable purpose of the contract shall (notwithstanding subsection (1) above) be brought into account.

(5) **For the purposes of this section a qualifying contract to which a company is party shall be taken to have an unallowable purpose in an accounting period where the purposes for which, at times during that period, the company is party to the contract include a purpose ("the unallowable purpose") which is not amongst the business or other commercial purposes of the company.**

(6) For the purposes of this section **the business and other commercial purposes of a company do not include the purposes of any part of its activities in respect of which it is not within the charge to corporation tax.**

(7) For the purposes of this section, **where one of the purposes for which a company is party to a qualifying contract at any time is a tax avoidance purpose, that purpose shall be taken to be a business or other commercial purpose of the company only where it is not the main purpose, or one of the main purposes,** for which the company is party to the contract at that time.

(8) The reference in subsection (7) above to **a tax avoidance purpose is a reference to any purpose that consists in securing a tax advantage (whether for the company or any other person).**

(9) In this section "tax advantage" has the same meaning as in Chapter 1 of Part 17 of the Taxes Act 1988 (tax avoidance).".

<u>Section 83 and Schedule 26 FA 2002 – derivatives</u>

23 (1) Where in any accounting period a derivative contract of a company has an **unallowable purpose**, this paragraph shall apply for the purpose of determining the credits and debits which fall, in the case of the company, to be brought into account for the purposes of this Schedule.

(2) Subject to sub-paragraph (4), the credits to be brought into account in the case of the derivative contract for the accounting period shall not include so much of the exchange credits given by the authorised accounting method used as respects the contract as, on a **just and reasonable apportionment, is referable to the unallowable purpose**.

(3) Subject to sub-paragraph (4), the debits to be brought into account in the case of the derivative contract for the accounting period shall not include so much of the debits given by the authorised accounting method used as respects the contract as, on a **just and reasonable apportionment, is referable to the unallowable purpose.**

… (8) Amounts which, by virtue of this paragraph, are not brought into account for the purposes of this Schedule as respects any matter are in consequence also amounts which, in accordance with paragraph 1(2), are not to be brought into account for the purposes of corporation tax as respects that matter apart from this Schedule.

(9) For the purposes of this paragraph, a credit is an exchange credit, in the case of a company, to the extent that it is attributable to any exchange gains arising to the company which, by virtue of paragraph 16, are included in the reference to the profits arising to the company in paragraph 15(1)(a).

(10) This paragraph is supplemented by paragraph 24.

<u>Derivative contracts for unallowable purposes: supplementary</u>

24 (1) For the purposes of paragraph 23 a derivative contract to which a company is party shall be taken to have an **unallowable purpose** in an accounting period where the purposes for which, at times during that period, the company—

(a) is party to the contract, or

(b) enters into transactions which are related transactions by reference to that contract,

include a purpose ("the unallowable purpose") which is **not amongst the business or other commercial purposes of the company.**

(2) For the purposes of this paragraph **the business and other commercial purposes of a company do not include the purposes of any part of its activities in respect of which it is not within the charge to corporation tax.**

(3) For the purposes of this paragraph, where one of the purposes for which a company—

(a) is party to a derivative contract at any time, or

(b) enters into a transaction which is a related transaction by reference to any derivative contract of the company,

is a **tax avoidance purpose**, that purpose **shall be taken to be a business or other commercial purpose of the company only where it is not the main purpose, or one of the main purposes**, for which the company is party to the contract at that time or, as the case may be, for which the company enters into that transaction.

(4) The reference in sub-paragraph (3) to a **tax avoidance purpose** is a reference to any purpose that consists in securing a **tax advantage** (whether for the company or any other person).

(5) In this paragraph "tax advantage" has the same meaning as in Chapter 1 of Part 17 of the Taxes Act 1988 (tax avoidance).

C.6.2 As for C.6.1 but arrangements are needed.

Section 38 FA 2004 – expenses of management: companies with investment business

(1) For section 75 of the Taxes Act 1988 (expenses of management: investment companies) substitute—

"75 Expenses of management: companies with investment business

… (4) For the purposes of this section, expenses of management are "expenses of management of the company's investment business" to the extent that—

(a) the expenses are in respect of so much of the company's business as consists in the making of investments, and

(b) the investments concerned are **not held by the company for an unallowable purpose** during the accounting period (see subsection (5) below),

and references in this section to the company's investment business shall be construed accordingly.

(5) For the purposes of subsection (4)(b) above, investments are held by a company for **an unallowable purpose** during an accounting period **to the extent that** they are held during the period—

(a) for **a purpose that is not a business or other commercial purpose** of the company, or

(b) for the **purpose of activities in respect of which the company is not within the charge to corporation tax.**

… (10) Any apportionment falling to be made for the purposes of this section shall be made on a **just and reasonable basis**.".

Then in FA 2007, the section was amended to provide that:

(1) the business or other commercial purpose did not apply if the investment was held "**directly or indirectly in consequence of, or otherwise in connection with any arrangements the main purpose or one of the main purposes of which is to secure the allowance of a deduction (or increased deduction) under Subsection (1) or any other tax advantage**";

(2) "**arrangement**" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable),

(3) "**tax advantage**" has the meaning given by Section 840ZA.

C.6.3 Unallowable purpose test as in C.6.1 but a tax advantage can be a business or commercial purpose if it is not a main purpose. Arrangements are needed.

Section 137 FA 2004 – manufactured payments

137 Manufactured payments under arrangements having an unallowable purpose

(1) In Schedule 23A to the Taxes Act 1988 (manufactured dividends and interest) after paragraph 7 (irregular manufactured payments) insert—

"Manufactured payments under arrangements having an unallowable purpose

7A (1) This paragraph applies in any case where—

(a) a manufactured payment falls to be made by a company in an accounting period in pursuance of any arrangements (see sub-paragraphs (9) and (10) for definitions), and

(b) the arrangements have an **unallowable purpose** at any time (see sub-paragraphs (3) to (5)).

But this is subject to sub-paragraph (8) below (cases where tax relief is denied apart from this paragraph).

(2) The company is not entitled, by virtue of anything in this Schedule or any provision of regulations under it, or otherwise, to any relevant tax relief (see sub-paragraph (10)), to the extent that the relief is in respect of, or referable to, the whole or any part of so much of the manufactured payment as, on a **just and reasonable apportionment, is attributable to the unallowable purpose.**

(3) **Arrangements have an unallowable purpose** at any time if at that time the purposes for which the company is a party to—

(a) the arrangements,

(b) any related transaction (see sub-paragraphs (6) and (7)), or

(c) any transaction in pursuance of the arrangements,

include a purpose ("the unallowable purpose") which is not among the business or other commercial purposes of the company.

(4) The business and other commercial purposes of a company do not include the purposes of any part of its activities in respect of which it is not within the charge to corporation tax.

(5) Where **one of the purposes** for which a company is at any time a party to—

(a) any arrangements,

(b) any related transaction in the case of any arrangements, or

(c) any transaction in pursuance of any arrangements,

is a tax avoidance purpose, **that purpose shall be taken to be a business or other commercial purpose of the company only where it is not the main purpose, or one of the main purposes, for which the company is party to the arrangements or transaction at that time.**

(6) One or more transactions are to be regarded as related transactions, in the case of any arrangements, if it would be reasonable to assume, from either or both of—

(a) the likely effect of the transactions, and

(b) the circumstances in which the transactions are entered into or effected,

that none of the transactions would have been entered into or effected independently of the arrangements.

(7) Transactions are not prevented from being related transactions, in the case of any arrangements, just because the transactions—

(a) are not between the same parties, or

(b) are not between the parties to the arrangements.

… (10) In this paragraph—

- "**arrangements**" includes schemes, arrangements and understandings of any kind, whether or not legally enforceable, and shall be taken to include any related transactions;
- "related transaction" shall be construed in accordance with sub-paragraphs (6) and (7) above;
- "**tax advantage**" has the same meaning as in Chapter 1 of Part 17 (tax avoidance);
- "**tax avoidance purpose**" means any purpose that consists in securing a tax advantage (whether for the company in question or any other person)."

C.7.1 One of the main purposes is to secure a tax advantage. Arrangements are needed.

Section 69 FA 2006 – capital losses

Inserts:

"A loss accrues to a company in **disqualifying circumstances** if—

(a) it accrues to the company **directly or indirectly in consequence of, or otherwise in connection with, any arrangements**, and

(b) the **main purpose, or one of the main purposes**, of the arrangements is to secure a **tax advantage**.

(2B) For the purposes of subsection (2A)—

- "**arrangements**" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and
- "**tax advantage**" has the meaning given by section 184D.

(2C) For the purposes of subsection (2A) it does not matter—

(a) whether the loss accrues at a time when there are no chargeable gains from which it could otherwise have been deducted, or

(b) whether the tax advantage is secured for the company or for any other company.".

Section 27 FA 2007 – extension of restriction of allowable capital losses

Inserts a new S16A TCGA 1992.

"16A Restrictions on allowable losses

(1) For the purposes of this Act, "allowable loss" does not include a loss accruing to a person if—

(a) it accrues to the person **directly or indirectly in consequence of, or otherwise in connection with, any arrangements**, and

(b) the **main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.**

(2) For the purposes of subsection (1)—

- "**arrangements**" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and
- "**tax advantage**" means—

  (a) relief or increased relief from tax,

  (b) repayment or increased repayment of tax,

  (c) the avoidance or reduction of a charge to tax or an assessment to tax, or

  (d) the avoidance of a possible assessment to tax,

  and for the purposes of this definition "tax" means capital gains tax, corporation tax or income tax.

(3) For the purposes of subsection (1) it does not matter—

(a) whether the loss accrues at a time when there are no chargeable gains from which it could otherwise have been deducted, or

(b) whether the tax advantage is secured for the person to whom the loss accrues or for any other person."

<u>Section 164 FA 2003 – avoidance affecting proceeds of balancing event</u>

Chapter 5 of Part 12 of the Capital Allowances Act 2001 (c. 2) (miscellaneous supplementary provisions), after section 570 insert—

"Anti-avoidance

570A Avoidance affecting proceeds of balancing event

… (2) The taxpayer is not entitled to any balancing allowance if, as a result of **a tax avoidance scheme**, the amount to be brought into account as the proceeds from the event is less than it would otherwise have been.

(3) In subsection (2) a "tax avoidance scheme" means **a scheme or arrangement the main purpose, or one of the main purposes, of which is the obtaining of a tax advantage by the taxpayer.**"

<u>C.7.2 As for C.7.1, but also the advantage must include a specified advantage.</u>

<u>Section 184A TCGA 1992 – restrictions on buying losses: tax avoidance schemes</u>

(1) This section applies for the purposes of corporation tax in respect of chargeable gains if—

(a) at any time ("the relevant time") there is a qualifying change of ownership in relation to a company ("the relevant company") (see section 184C),

(b) a loss (a "qualifying loss") accrues to the relevant company or any other company on a disposal of a pre-change asset (see subsection (3)),

(c) the change of ownership occurs **directly or indirectly in consequence of, or otherwise in connection with, any arrangements the main purpose, or one of the main purposes, of which is to secure a tax advantage** (see section 184D), and

(d) the **advantage involves the deduction of a qualifying loss from any chargeable gains** (whether or not it also involves anything else).

… (4) In this section "**arrangements**" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).

(5) For the purposes of this section it does not matter—

(a) whether a qualifying loss accrues before, after or at the relevant time,

(b) whether a qualifying loss accrues at a time when there are no chargeable gains from which it could be deducted (or could otherwise have been deducted), or

(c) whether the tax advantage is secured for the company to which a qualifying loss accrues or for any other company.

Section 184B TCGA 1992 – restrictions on buying gains: tax avoidance schemes

(1) This section applies for the purposes of corporation tax in respect of chargeable gains if—

(a) at any time ("the relevant time") there is a qualifying change of ownership in relation to a company ("the relevant company") (see section 184C),

(b) a gain (a "qualifying gain") accrues to the relevant company or any other company on a disposal of a pre-change asset (see subsection (3)),

(c) the change of ownership occurs **directly or indirectly in consequence of, or otherwise in connection with, any arrangements the main purpose, or one of the main purposes, of which is to secure a tax advantage,** and

(d) the **advantage involves the deduction of a loss from a qualifying gain** (whether or not it also involves anything else).

(2) In the case of a qualifying gain accruing to a company, a loss accruing to the company is not to be deductible from the gain unless the loss accrues to the company on a disposal of a pre-change asset.

(3) In this section a "pre-change asset" means an asset which was held by the relevant company before the relevant time (but see also sections 184E and 184F).

(4) In this section "**arrangements**" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).

(5) For the purposes of this section it does not matter—

(a) whether a qualifying gain accrues before, after or at the relevant time,

(b) whether a qualifying gain accrues at a time when there are no losses which could be deducted (or could otherwise have been deducted) from the gain, or

(c) whether the tax advantage is secured for the company to which a qualifying gain accrues or for any other company.

C.8 A scheme or arrangement a main purpose of which is the avoidance of tax.

Section 57 and Schedule 16 FA 2002 – community investment tax credit

(18) The investment must not be made as part of a **scheme or arrangement the main purpose of which, or one of the main purposes of which, is the avoidance of tax**.

It is worth noting that in this TAAR, no definitions (e.g. of 'tax') are provided. In addition, the section uses a test of 'avoidance of tax', not 'obtaining a tax advantage'.

C.9 A scheme or arrangement a main purpose of which is to achieve a reduction in UK tax.

Section 82 FA 2001 – CFCs

Part 1 of Schedule 25 to the Taxes Act 1988 (acceptable distribution policy) is amended as follows:

"(2) In paragraph 2 (meaning of acceptable distribution policy) … add—

… (b) if it is chargeable under Case I, or under Case VI in the circumstances described in paragraph (a) above, it is **not involved in a UK tax avoidance scheme**;

and paragraph 2B below has effect for the purposes of paragraph (b) above."

(3) After paragraph 2A insert—

"2B (1) This paragraph has effect for the purposes of paragraph 2(1A)(b) above.

(2) No payment of dividend by a controlled foreign company for an accounting period shall be regarded as involved in a **UK tax avoidance scheme** by reason only that there is no charge to tax under section 747(4)(a) if the controlled foreign company pursues an acceptable distribution policy for that accounting period.

(3) "**UK tax avoidance scheme**" means a scheme or arrangement the **purpose**, or one of the main purposes, of which is to achieve a reduction in United Kingdom tax.

(4) **A scheme or arrangement achieves a reduction in United Kingdom tax if, apart from the scheme or arrangement, any company—**

(a) would have been liable for any such tax or for a greater amount of any such tax; or

(b) would not have been entitled to a relief from or repayment of any such tax or would have been entitled to a smaller relief from or repayment of any such tax.

(5) In this paragraph—

- **"arrangement" means an arrangement of any kind, whether in writing or not;**
- **"United Kingdom tax" means corporation tax or any tax chargeable as if it were corporation tax.**".

After paragraph 4 insert—

"4A (1) This paragraph has effect for the purposes of paragraph 4(1A)(b) above.

(2) **No payment** to a company resident in the United Kingdom which represents the whole or part of a dividend paid by a controlled foreign company for an accounting

period shall be **regarded as involved in a UK tax avoidance scheme by reason only that**—

(a) there is no charge to tax under section 747(4)(a) if the controlled foreign company pursues an acceptable distribution policy for that accounting period, and

(b) so much of the dividend as is represented by that payment will (if paragraph 4(1) above has effect) fall to be brought into account in determining whether the controlled foreign company has done so."

C.10 A scheme or arrangement a main purpose of which is as specified.

Section 38 FA 1999 – withdrawal of relief for interest on loans to buy land etc.

(4) A payment of interest falls within this subsection if it is-

… (b) made under or in accordance with any **scheme** made for **a tax-avoidance purpose** on or after 9th March 1999 (whether or not before the making of the payment).

(5) For the purposes of subsection (4) above, a scheme is made for a tax-avoidance purpose if its main **purpose**, or one of its main purposes, is to secure that a payment of one or more of the following descriptions is a relievable payment, that is to say-

(a) a payment discharging an obligation to make a payment which (but for the scheme) might have been expected to be a non-relievable payment;

(b) a payment made in pursuance of any obligation which has effect, directly or indirectly, in place of an obligation under which a payment which might have been expected to be a non-relievable payment would have become due;

(c) a payment made in pursuance of an obligation which (apart from the purpose of securing that it is a relievable payment) might have been expected to take the form of an obligation-

(i) to make a non-relievable payment, or

(ii) to make two or more payments at least one of which would have been a non-relievable payment.

(7) The references in this section to a **scheme** are references to any **scheme, arrangements or understanding of any kind whatever, whether or not legally enforceable**.

Section 86 FA 2005 – credit for foreign tax

Inserts a new S798B TA 1988 including:

"(4) If a person ("A") carrying on a trade giving rise to trade income enters into a **scheme or arrangement** with another person ("B") **a main purpose** of which is to alter the effect of section 798A in relation to A, income received in pursuance of the scheme or arrangement shall be treated for the purposes of section 798A as trade income of B (and not as income of A)."

Section 27 FA 2006 – group relief where surrendering company not resident in the UK

Inserts a new S403G Taxes ACT TA 1988:

"403G Unallowable overseas losses of non-resident companies

(1) This section applies in the case of a loss or other amount arising to a non-resident company—

(a) which is resident in any EEA territory, or

(b) which is not so resident but which carries on a trade in an EEA territory through a permanent establishment,

where the amount is not attributable for corporation tax purposes to any UK permanent establishment of the non-resident company.

(2) The amount is not available for surrender by way of group relief by the non-resident company in so far as conditions A and B are met.

(3) Condition A is that—

(a) the amount would not qualify for group relief but for any relevant arrangements, or

(b) the amount would not have arisen to the non-resident company but for any relevant arrangements.

(4) Condition B is that the **main purpose, or one of the main purposes**, of the relevant arrangements was to secure that the amount would qualify for group relief.

(5) In this section references to relevant arrangements, in relation to any amount, are to—

(a) **arrangements** made on or after 20th February 2006, or

(b) arrangements made before that date where the amount would (but for this section) first qualify for group relief on or after that date or (as the case may be) the amount arises on or after that date.

(6) In this section—

- "**arrangements**" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)…."

Section 31 and Schedule 6 FA 2007 – companies carrying on business of leasing plant or machinery

[After paragraph 38 of Schedule 10 FA 2006 insert]

38A(1) This paragraph applies if—

(a) a question arises as to the application of this Schedule,

(b) for the purpose of determining that question regard must be had to amounts (if any) which fall (or would fall) to be shown in any balance sheet of any company in respect of plant or machinery,

(c) there would (but for this paragraph) be a reduction or increase in any such amount,

(d) the reduction or increase arises **directly or indirectly in consequence of, or otherwise in connection with, any arrangements,** and

(e) the **main purpose, or one of the main purposes, of the arrangements is to secure that there is a relevant tax advantage.**

(2) There is a **relevant tax advantage** if (but for this paragraph)—

(a) any company would not be regarded for the purposes of any provision of this Schedule as carrying on a business of leasing plant or machinery (whether alone or in partnership),

(b) the amount of any income which any company is treated as receiving under any provision of this Schedule would be reduced, or

(c) the amount of any expense which any company is treated as incurring under any provision of this Schedule would be increased.

… (5) In this paragraph—

- "**arrangements**" includes any agreement, understanding, scheme, transaction or series of transactions—

  (a) whether or not legally enforceable, and

  (b) whether or not the company for which the relevant tax advantage is intended to be secured is a party to the arrangements,
- "increase" includes an increase from nil, and
- "reduction" includes a reduction to nil.

<u>C.11 Transactions with the relevant avoidance intention – a specific intention.</u>

<u>Schedule 5 FA 2007 – avoidance involving financial arrangements</u>

16 (1) Paragraph 4 of Schedule 10 to FA 1996 (company holdings in unit trusts and offshore funds) is amended as follows.

"…(2) In determining the debits and credits under [sub-paragraph (3)] there shall be left out of account amounts relating to any investment or liability of the scheme or fund where—

(a) the investment was made, or the liability was incurred, with the **relevant avoidance intention,** or

(b) any transaction (or series of transactions) was entered into in relation to the investment or liability with that intention.…

… (6) The **relevant avoidance intention** is the intention of—

(a) eliminating or reducing the credits to be brought into account for the purposes of this Chapter as respects the company's relevant holdings, or

(b) creating or increasing the debits to be so brought into account."

C.12.1 A tax advantage test. No purpose or motive test. A negative definition to determine whether companies are party to transactions.

Section 51 FA 2004 – use of different accounting practices within a group of companies

(1) This section applies where—

(a) a company (company A) prepares accounts in accordance with international accounting standards,

(b) another company (company B) in the same group of companies prepares accounts in accordance with UK generally accepted accounting practice,

(c) there is a transaction between, or a series of transactions involving, company A and company B, and

(d) a **tax advantage** would (apart from this section) be obtained by either or both of those companies in relation to the transaction or series of transactions as a result of the use of different accounting practices.

… (4) A series of transactions is not prevented from being a series of transactions involving company A and company B by reason only of the fact that one or more of the following is the case—

(a) there is no transaction in the series to which both those companies are parties;

(b) that parties to any arrangement in pursuance of which the transactions in the series are entered into do not include one or both of those companies;

(c) there are one or more transactions in the series to which neither of those companies is a party.

(5) In this section "**tax advantage**" has the same meaning as in Chapter 1 of Part 17 of the Taxes Act 1988 (see section 709 of that Act).

C.12.2 Specific tests without a purpose or motive test.

Section 76 and Schedule 6 FA 2006 – avoidance involving financial arrangements

There are numerous anti-avoidance provisions set out which are closely defined and most do not have a purpose test.

C.12.3 The test is by reference to a notional transaction. Again no purpose or motive test is included.

Section 71 FA 2007 – SDLT

71 Anti-avoidance

(1) In FA 2003, after section 75 insert (in place of the section inserted by the Stamp Duty Land Tax (Variation of the Finance Act 2003) Regulations 2006 (S.I. 2006/ 3237))—

"75A Anti-avoidance

(1) This section applies where—

(a) one person (V) disposes of a chargeable interest and another person (P) acquires either it or a chargeable interest deriving from it,

(b) **a number of transactions** (including the disposal and acquisition) are involved in connection with the disposal and acquisition ("the scheme transactions"), and

(c) the sum of the amounts of stamp duty land tax payable in respect of the scheme transactions is less than the amount that would be payable on a notional land transaction effecting the acquisition of V's chargeable interest by P on its disposal by V.

(2) In subsection (1) **"transaction" includes, in particular**—

(a) a non-land transaction,

(b) an agreement, offer or undertaking not to take specified action,

(c) any kind of arrangement whether or not it could otherwise be described as a transaction, and

(d) a transaction which takes place after the acquisition by P of the chargeable interest.

(3) The scheme transactions may include, **for example**—

(a) the acquisition by P of a lease deriving from a freehold owned or formerly owned by V;

(b) a sub-sale to a third person;

(c) the grant of a lease to a third person subject to a right to terminate;

(d) the exercise of a right to terminate a lease or to take some other action;

(e) an agreement not to exercise a right to terminate a lease or to take some other action;

(f) the variation of a right to terminate a lease or to take some other action.

(4) Where this section applies—

(a) any of the scheme transactions which is a land transaction shall be disregarded for the purposes of this Part, but

(b) there shall be a notional land transaction for the purposes of this Part effecting the acquisition of V's chargeable interest by P on its disposal by V.

(5) The chargeable consideration on the notional transaction mentioned in subsections (1)(c) and (4)(b) is the largest amount (or aggregate amount)—

(a) given by or on behalf of any one person by way of consideration for the scheme transactions, or

(b) received by or on behalf of V (or a person connected with V within the meaning of section 839 of the Taxes Act 1988) by way of consideration for the scheme transactions."

There are then detailed rules as to how to calculate the chargeable consideration on the notional transaction.

C.12.4 A specific test limited by ‘it cannot reasonably be considered that it is carried out for commercial reasons’.

Paragraph 8 Schedule 25 FA 2003 – taxation of permanent establishments

Non-resident banks: transfer of financial assets

8 (1) In accordance with the separate enterprise principle, transfers of loans and other financial assets between the permanent establishment and any other part of the company are recognised only if they would have taken place between independent enterprises.

(2) Such a transfer is not recognised where it **cannot reasonably be considered that it is carried out for valid commercial reasons.**

For this purpose the **obtaining of a tax advantage is not a valid commercial reason.**

C.13 A purpose clause.

In this case there is a purpose clause which applies to the general rules as well as a TAAR. The TAAR follows the structure of a TAAR with “arrangements” provisions and a main purpose test.

Schedule 13 FA 2007– sale and repo of securities

The provisions start by setting out a purpose clause:

(1) The purpose of this Schedule is to secure that in the case of an arrangement—

(a) which involves the sale of securities and the subsequent purchase of securities, and

(b) which equates, in substance, to a transaction for the lending of money at interest from or to a company (with the securities which were sold as collateral for the loan),

the charge to corporation tax in that case reflects the fact that the arrangement equates, in substance, to such a transaction.

(2) But this is not to be read as preventing the rules in this Schedule about corporation tax in respect of chargeable gains from having no effect in relation to debtor quasi-repos and creditor quasi-repos.

There are then specific tax rules and the TAAR as follows:

12 (1) This paragraph applies if—

(a) under an **arrangement** a person receives any money or other asset (“the advance”) from a company (or a partnership of which the company is a member),

(b) the company does not have a creditor repo or creditor quasi-repo by reference to the arrangement but would have one on the applicable accounting assumption (reading condition E in paragraphs 7 and 8 in the light of that assumption),

(c) the arrangement is designed to produce a return (“the quasi-interest”) to the company (or partnership of which it is a member) which equates, in substance, to the return on an investment of money at interest, and

(d) **the main purpose, or one of the main purposes, of the arrangement is the obtaining of a tax advantage.**

(2) Paragraph 10 is to have effect as if—

(a) the company had a creditor repo by reference to the arrangement, and

(b) the quasi-interest were an amount recorded as mentioned in sub-paragraph (4) of that paragraph.

(3) In this paragraph "the applicable accounting assumption" is the assumption that, in accordance with generally accepted accounting practice, the accounts of the company (or the partnership of which it is a member) for the period in which the advance is made record a financial asset in respect of the advance.

C.14.1 A Board/HMRC Commissioners' decision is needed. A specified list of schemes or arrangements is set out. A main purpose test is included.

Section 87 FA 2005 – schemes and arrangements designed to increase foreign tax relief

(1) After section 804 of ICTA insert—

"804ZA Schemes and arrangements designed to increase relief

(1) If the **Board consider, on reasonable grounds**, that conditions A to D are or may be satisfied in relation to any income or chargeable gain taken or to be taken into account for the purposes of determining a person's liability to tax in a chargeable period, they may give the person a notice under this section.

(2) Condition A is that, in the case of the person, there is in respect of the income or gain an amount of foreign tax for which, under any arrangements, credit is allowable against United Kingdom tax for that chargeable period.

(3) Condition B is that there is a **scheme or arrangement the main purpose, or one of the main purposes,** of which is to cause an amount of foreign tax to be taken into account in the case of the person for that chargeable period.

(4) Condition C is that the scheme or arrangement is a **prescribed scheme or arrangement**.

(5) Condition D is that the amount referred to in subsection (6) is more than a minimal amount.

… (11) Schedule 28AB makes provision about what constitutes a prescribed scheme or arrangement."

Schedule 5 FA 2005 then introduces Schedule 28AB:

SCHEDULE 5 SECTION 804ZA: PRESCRIBED SCHEMES AND ARRANGEMENTS

After Schedule 28AA to ICTA insert—

"SCHEDULE 28AB Section 804ZA: prescribed schemes and arrangements

Introductory

1 (1) A scheme or arrangement, other than a scheme or arrangement falling within sub-paragraph (3), is a prescribed scheme or arrangement if one or more of paragraphs 2 to 6 apply to it.

(2) A scheme or arrangement falling within sub-paragraph (3) is a prescribed scheme or arrangement if one or more of paragraphs 2 to 6 would, on the assumption in sub-paragraph (4), apply to it.

(3) A scheme or arrangement falls within this sub-paragraph if its main purpose, or one of its main purposes, is to cause an amount of underlying tax allowable in respect of a dividend paid by a body corporate resident in a territory outside the United Kingdom to be taken into account in the case of a person.

(4) The assumption is that the body corporate is resident in the United Kingdom.

(5) Nothing in sub-paragraph (4) requires it to be assumed that there is any change in the place or places at which the body corporate carries on its activities.

Attribution of foreign tax

2 This paragraph applies to a scheme or arrangement if the scheme or arrangement enables a person who is party to, or concerned in, the scheme or arrangement to pay, in respect of a source of income or chargeable gain, an amount of foreign tax all or part of which is properly attributable to another source of income or chargeable gain (or to more than one such other source).

Effect of paying foreign tax

3 (1) This paragraph applies to a scheme or arrangement if, under the scheme or arrangement, sub-paragraph (2) is satisfied in relation to a person who has claimed, or is in a position to claim, for a chargeable period an allowance under any arrangements by way of credit for foreign tax ("the claimant").

(2) This sub-paragraph is satisfied if—

(a) an amount of foreign tax is paid by the claimant, and

(b) at the time when the claimant entered into the scheme or arrangement, it could reasonably be expected that the effect of the payment of that amount of foreign tax on the foreign tax total would be to increase it by less than the amount allowable to the claimant as a credit in respect of the payment of that amount of foreign tax.

(3) The foreign tax total is the amount found by—

(a) aggregating the amounts of foreign tax paid or payable in respect of the transaction or transactions forming part of the scheme or arrangement by persons party to, or concerned in, the scheme or arrangement, and

(b) taking into account any reliefs, deductions, reductions or allowances against or in respect of any tax that arise to the persons party to, or concerned in, the scheme or arrangement (including any reliefs, deductions, reductions or allowances arising to any one or more of those persons as a consequence of the payment by the claimant of that amount of foreign tax).

Effect of claim, election or other arrangement

4 (1) This paragraph applies to a scheme or arrangement if under the scheme or arrangement—

(a) a step is taken by a person who is party to, or concerned in, the scheme or arrangement, or

(b) a step that could have been taken by such a person is not taken, and that action or that failure to act has the effect of increasing a claim made by a person who is party to, or concerned in, the scheme or arrangement for an allowance by way of credit in accordance with this Part or of giving rise to such a claim.

(2) The steps mentioned in sub-paragraph (1) are steps that may be made—

(a) under the law of any territory, or

(b) under arrangements made in relation to any territory.

(3) The steps mentioned in sub-paragraph (1) include—

(a) claiming, or otherwise securing the benefit of, reliefs, deductions, reductions or allowances;

(b) making elections for tax purposes.

Effect attributable to scheme or arrangement

5 (1) This paragraph applies to a scheme or arrangement if, under the scheme or arrangement, sub-paragraph (2) is satisfied in relation to a person who has claimed, or is in a position to claim, for a chargeable period an allowance under any arrangements by way of credit for foreign tax.

(2) This sub-paragraph is satisfied if amount A is less than amount B.

(3) Amount A is the amount of United Kingdom taxes payable by the person in respect of income and chargeable gains arising in the chargeable period.

(4) Amount B is the amount of United Kingdom taxes that would be payable by the person in respect of income and chargeable gains arising in the chargeable period if, in determining that amount, the transactions forming part of the scheme or arrangement were disregarded.

Tax deductible payments

6 (1) This paragraph applies to a scheme or arrangement if the scheme or arrangement includes—

(a) the making by a person ("A") of a relevant payment or payments, and

(b) the giving, in respect of that payment or payments, of consideration that satisfies the requirements of sub-paragraph (3).

(2) A payment made by A is a relevant payment if all or part of it may be brought into account in computing A's income for the purposes of United Kingdom taxes.

(3) Consideration given in respect of a payment or payments made by A satisfies the requirements of this sub-paragraph if—

(a) all or part of it consists of a payment or payments made to A or a person connected with A, and

(b) tax is chargeable in respect of the payment or payments under the law of a territory outside the United Kingdom.

(4) In this paragraph references to a payment include references to a transfer of money's worth.

(5) Section 839 applies for the purposes of this paragraph."

Sections 24–31 F(No.2)A 2005 – avoidance involving tax arbitrage

24 Deduction cases

(1) If the **Commissioners for Her Majesty's Revenue and Customs consider,** on reasonable grounds, that conditions A to D are or may be satisfied in relation to a transaction to which a company falling within subsection (2) is party, they may give the company a notice under this section.

(2) A company falls within this subsection if—

(a) it is resident in the United Kingdom, or

(b) it is resident outside the United Kingdom but is within the charge to corporation tax.

(3) Condition A is that the transaction to which the company is party forms part of a scheme that is a **qualifying scheme**.

(4) Condition B is that the scheme is such that for the purposes of corporation tax the company is in a position to claim or has claimed an amount by way of deduction in respect of the transaction or is in a position to set off or has set off against profits in an accounting period an amount relating to the transaction.

(5) Condition C is that **the main purpose, or one of the main purposes, of the scheme is to achieve a UK tax advantage** for the company.

(6) Condition D is that the amount of the UK tax advantage in question is more than a minimal amount.

… (9) Schedule 3 makes provision about what constitutes a qualifying scheme.

There are then detailed provisions regarding the recomputation of the deduction.

C.14.2 HMRC Commissioners' decision is needed. The test is of the parties' expectation on entering into a scheme that a benefit [undefined] would arise.

Section 26 F(No.2)A 2005 – receipts cases

(1) If the **Commissioners for Her Majesty's Revenue and Customs consider, on reasonable grounds**, that conditions A to E are or may be satisfied in relation to a company resident in the United Kingdom, they may give the company a notice under this section.

(2) Condition A is that a scheme makes or imposes provision ("the actual provision") as between the company and another person ("the paying party") by means of a transaction or series of transactions.

(3) Condition B is that the actual provision includes the making by the paying party, by means of a transaction or series of transactions, of a payment that is a qualifying payment in relation to the company.

(4) Condition C is that, as regards the qualifying payment made by the paying party, there is an amount that—

(a) is available as a deduction for the purposes of the Tax Acts, or

(b) may be deducted or otherwise allowed in respect of the payment under the tax law of any territory outside the United Kingdom, and does not fall to be disregarded as described in subsection (5).

(5) An amount is to be disregarded if or to the extent that it is, for tax purposes, set against any income arising to the paying party from the transaction or transactions forming part of the scheme.

(6) Condition C is not to be treated as satisfied if—

(a) the paying party is a dealer,

(b) in the ordinary course of his business, he incurs losses in respect of the transaction or transactions forming part of the scheme to which he is party, and

(c) the amount by reference to which condition C would, but for this subsection, be satisfied is an amount in respect of those losses.

(7) In subsection (6), "dealer" means a person who is a dealer in relation to a distribution within the meaning of section 95(2) of ICTA or who would, if he were resident in the United Kingdom, be such a dealer.

(8) Condition D is that at least part of the qualifying payment is not an amount to which subsection (9) or (10) applies.

(9) This subsection applies to an amount that is, for the purposes of the Corporation Tax Acts—

(a) income or gains arising to the company in the accounting period in which the qualifying payment was made in relation to the company, or

(b) income arising to any other company resident in the United Kingdom in a corresponding accounting period.

(10) This subsection applies to an amount that is taken into account in determining the debits and credits to be brought into account by a company for the purposes of Chapter 2 of Part 4 of FA 1996 as respects a share in another company by virtue of section 91A or 91B of FA 1996 (shares treated as loan relationships).

(11) Condition E is that the **company and the paying party expected on entering into the scheme that a benefit would arise as a result of condition D being satisfied** (whether by reference to all or part of the qualifying payment).

30 Interpretation

(1) For the purposes of this Chapter—

(a) references to a **scheme** are references to any scheme, arrangements or understanding of any kind whatever, whether or not legally enforceable, involving a single transaction or two or more transactions;

(b) it shall be **immaterial** in determining whether any transactions have formed or will form part of a series of transactions or scheme **that the parties to any of the transactions are different from the parties to another of the transactions**; and

(c) the cases in which any **two or more transactions are to be taken as forming part of a series of transactions or scheme shall include** any case in which it would be reasonable to assume that one or more of them—

(i) would not have been entered into independently of the other or others, or

(ii) if entered into independently of the other or others, would not have taken the same form or been on the same terms.

(2) For the purposes of this Chapter, a **scheme achieves a UK tax advantage for a person if in consequence of the scheme the person is in a position to obtain, or has obtained**—

(a) a relief or increased relief from income tax or corporation tax,

(b) a repayment or increased repayment of income tax or corporation tax, or

(c) the avoidance or reduction of a charge to income tax or corporation tax.

(3) In subsection (2)(a) the reference to relief includes a reference to a tax credit.

(4) For the purposes of subsection (2)(c) **avoidance or reduction may in particular be effected by**—

(a) receipts accruing in such a way that the recipient does not pay or bear tax on them, or

(b) a deduction in computing profits or gains.

C.15 The usual burden of proof is reversed. The taxpayer has to satisfy an officer of the Board that it would not be reasonable to conclude either that tax avoidance was a purpose; or that if transactions are genuine commercial that any one or more was more than incidentally designed for the purpose of avoiding tax.

Section 79 and Schedule 7 FA 2006 – transfer of assets abroad

Inserts a new S741 TA 1988:

"741A Exemption from sections 739 and 740 (transactions on or after 5th December 2005)

(1) The individual is not liable to income tax by virtue of section 739 or 740 for the year of assessment by reference to the relevant transactions **if he satisfies an officer of the Board—**

(a) that Condition A is met, or

(b) in a case where Condition A is not met, that Condition B is met.

(2) Condition A is that **it would not be reasonable to draw the conclusion, from all the circumstances of the case, that the purpose of avoiding liability to taxation was the purpose, or one of the purposes,** for which the relevant transactions or any of them were effected.

(3) Condition B is that—

(a) **all the relevant transactions were genuine commercial transactions**, and

(b) **it would not be reasonable to draw the conclusion, from all the circumstances of the case, that any one or more of those transactions was more than incidentally designed for the purpose of avoiding liability to taxation.**

(4) The intentions and purposes of any person who, whether or not for consideration,—

(a) designs or effects the relevant transactions or any of them, or

(b) provides advice in relation to the relevant transactions or any of them,

are to be taken into account in determining the purposes for which those transactions or any of them were effected.

(5) A relevant transaction is a commercial transaction only if it is effected—

(a) in the course of a trade or business, or

(b) with a view to setting up and commencing a trade or business,

and, in either case, for the purposes of that trade or business.

(6) For that purpose, the making and managing of investments, or the making or managing of investments, is not a trade or business except to the extent that—

(a) the person by whom it is done, and

(b) the person for whom it is done,

are independent persons dealing at arm's length.

(7) In this section—

- "commercial transaction" does not include—

  (a) a transaction on terms other than those that would have been made between independent persons dealing at arm's length, or

  (b) a transaction that would not have been entered into between independent persons dealing at arm's length;
- "independent persons" means persons who are not connected with each other (within the meaning given by section 839);
- "relevant transactions" means—

  (a) the transfer, and

  (b) any associated operations;
- "revenue" includes taxes, duties and national insurance contributions;
- "taxation" includes any revenue for whose collection and management the Commissioners for Her Majesty's Revenue and Customs are responsible.

(8) Any associated operation that would not (apart from this subsection) fall to be taken into account for the purposes of this section must be taken into account for those purposes if, were it to be so taken into account, the conditions in subsection (1) above would be failed by reference to—

(a) that associated operation, or

(b) that associated operation taken together with the transfer or any one or more other associated operations.

(9) The jurisdiction of the Special Commissioners on any appeal includes jurisdiction to review any decision taken by an officer of the Board in exercise of the officer's functions under this section."

Appendix D
A GAAR and its potential impact:
a review of the Finance Acts 1997–2008 in the context of a GAAR

Structure of the review

D.1 This set of notes reviews the Finance Acts introduced by the Labour government from 1997 (the Finance No. 2 Act) to 2008. It looks at not only provisions that purport to be anti-avoidance but also those that have an anti-avoidance effect by changing the underlying rules. It does not include oil tax, levies or customs duties, VAT, insurance company rules or the pension rules contained in FA 2004.

D.2 The notes consider each section that is either expressly stated to be an anti-avoidance provision or that changes the way in which the law operates in order to achieve an anti-avoidance aim. It is stated whether or not the section could be dealt with by a GAAR in the form of the one set out as an illustrative one by the TLRC in 1997.[126] Where that GAAR could be used, 'GAAR' is highlighted in bold. In other cases, the law change is described as a 'structure change'.

The illustrative clause: the general anti-avoidance rule

D.3 The illustrative GAAR is set out below:

(i) Purpose of the rule

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

(ii) The basic rule

(a) Where a person carries out a tax-driven transaction, he shall be taxed as if he had carried out the normal transaction.

(b) If, because the tax-driven transaction does not have any non-tax objective, there is no normal transaction, then he shall be taxed as if it did not take place.

(iii) Safeguard

This rule shall not apply where the transaction is a protected transaction; and when a transaction is a multiple-step transaction, it shall not apply where that transaction (taken as a whole) is entirely or mainly a protected transaction.

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[126] Tax Law Review Committee, *Tax Avoidance*, IFS Commentary no. 64, 1997 (http://www.ifs.org.uk/comms/comm64.pdf).

(iv) Burden of proof

(a) In the application of this rule, it shall be assumed that a transaction is not a tax-driven transaction unless the contrary is demonstrated.

(b) In the application of this rule, it shall be assumed that a tax-driven transaction is not a protected transaction unless the contrary is demonstrated.

(v) Explanation of terms

(a) *'Tax-driven transactions'*

A 'tax-driven transaction' is a transaction that has as its sole purpose, or as its main purpose, or as one of its main purposes, the avoidance of tax.

In determining whether a transaction is a tax-driven transaction, the following shall be taken into account: its legal form including the legal rights and obligations created by the transaction; its economic and commercial substance; the timing of any step; the expected duration of any step or any feature in the transaction; the change in the financial or other circumstances of the taxpayer or anyone connected with the taxpayer, as a result of the transaction; the expected tax consequences of the transaction on the assumption that this rule does not apply.

(b) *'Tax'*

In this context, 'tax' means [to be specified].

(c) *'Avoidance of tax'*

'The avoidance of tax' includes [to be specified].

(d) *'Transaction'*

A 'transaction' includes a transaction that is carried out in more than one step (a 'multiple-step transaction'), to the extent that a subsequent step was planned or envisaged by the time when the first step is taken. In this context, it is unnecessary for the precise nature or timing of a subsequent step to have been planned so long as the general nature of such step was planned or envisaged and its implementation was expected. It is also immaterial whether any particular step had a commercial or other non-tax objective.

(e) *'Multiple-step transactions'*

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

(f) *'Normal transactions'*

The 'normal transaction' is the transaction that it would be reasonable to assume would, if the avoidance of tax had not been a purpose of the tax-driven transaction, have been carried out to obtain the same or similar commercial or other non-tax objectives as the tax-driven transaction was intended to achieve. If there are two or more alternative transactions that satisfy this description, then the transaction that would be least burdensome to the taxpayer in terms of tax shall be taken as the normal transaction.

(g) *'Protected transactions'*

A 'protected transaction' is a transaction that satisfies any one or more of the following tests–

(i) It can reasonably be regarded as encouraged by legislation.

(ii) It falls within an exception to, or an exclusion from, other anti-avoidance provisions (that is to say, other provisions having the main purpose of preventing or counteracting the avoidance of tax).

(iii) It otherwise does not conflict with or defeat the purpose of legislation.

(vi) Procedure for invoking the rule

Only the Board may invoke this rule. Where it does so, the Board shall give a written notice to every person whose tax liability would be affected by the application of this rule–

(a) specifying the tax-driven transaction in relation to which it is invoking the rule;

(b) identifying the normal transaction by reference to which it proposes to charge tax;

(c) stating that in its opinion the tax-driven transaction is not a protected transaction; and

(d) giving details of every other person to whom it has given written notice relating to the same tax-driven transaction.

The 'Board' means the Commissioners of Inland Revenue or of Customs and Excise, as the context requires.

(vii) Request for review

(a) Where the Board has invoked this rule by notice given to any person, that person shall have the right to require the Board to review its decision.

(b) The request for review shall be made in writing to the Board within 30 days of receipt of the notice given by the Board.

(c) The request for review may be on the grounds that the transaction is not a tax-driven transaction, or that it is a protected transaction, or that the transaction identified by the Board as the normal transaction is not appropriate to the circumstances. Any request must also include a sufficient statement of the facts and circumstances relating to the transaction to enable the Board to make a proper review.

(d) The Board shall duly review its decision and shall, within 30 days of receipt of the request, notify the taxpayer of its final decision as to whether this rule should be applied to the transaction (either in the manner originally specified or in such modified manner as is stated in the notification).

(viii) Appeals

(a) Where the Board notifies any person of its decision to apply this rule, that person may appeal against the Board's decision by notice of appeal given to the Tribunal within 30 days of receipt of the Board's notification.

(b) Where a request for review has been made, no appeal may be made unless and until the Board notifies its final decision to apply this rule, and must then be made within 30 days of receipt of that notification.

(c) The notice of appeal must specify the grounds of appeal and state whether the appeal is on the basis that the transaction is not a tax-driven transaction, or is a protected transaction, or that the transaction identified by the Board as the normal transaction is not appropriate to the circumstances.

(d) On any appeal, the Tribunal shall have jurisdiction to decide whether and how the rule should be applied to the transaction (including, if appropriate, whether the rule should apply by reference to a normal transaction that is different from the one specified by the Board).

(e) Where there are two or more appeals relating to the same transaction, those appeals may be heard and dealt with as a single appeal.

The 'Tribunal' means the Special Commissioners or the VAT and Duties Tribunal, as the context requires.

(ix) Prior clearance procedure

(a) A person who proposes to carry out a transaction may ask the Board for confirmation that it will not apply this rule to the transaction.

(b) The request may be made on either or both of the following grounds–

  (i) the transaction is not a tax-driven transaction;

  (ii) the transaction is a protected transaction.

(c) The request shall be made in writing and must set out all the facts and circumstances material to the Board's evaluation of the transaction.

(d) The Board shall respond in writing within [30] days of receipt of the request. If the Board considers that it has received insufficient information, it may request further information within that time, and shall not be obliged to give its decision on the request until [30] days after the receipt of that further information.

(e) If the Board fails to respond within the time allowed, it shall be treated as having confirmed that the rule should not be invoked with respect to the transaction.

(f) If the Board's response is or is treated as being that the rule should not be invoked with respect to the transaction, then that response shall be binding on the Board unless it transpires that the request was made on the basis of inadequate or misleading information.

(g) If the Board's response is that the rule should be invoked with respect to the transaction, then there shall be a right of appeal against that response to the Tribunal. Such appeal shall be made within 30 days of receipt of the response. The Tribunal shall consider the appeal by reference only to the documents sent to the Board in support of the clearance application and to the Board's response. Neither the taxpayer nor the Board shall be entitled or permitted to address further arguments to the Tribunal or to attend the appeal. The decision of the Tribunal on such appeal, which shall be given within [30] days, shall be final and unappealable.

(x) Publication

Summaries of clearance requests and their outcomes may be published by the Board in such form as it considers appropriate, provided that such summaries do not divulge the identity of the parties to the transaction or any other material that may reasonably be regarded as confidential.

(xi) Operation of the rule

(a) This rule comes into effect with respect to transactions entered into on or after [the operative date].

(b) Where the transaction is a multiple-step transaction, it shall come into effect where the first step in the transaction is entered into on or after [the operative date].

(xii) Annual Report

The Board shall present each year a report to Parliament giving full details of its operation of this rule.

Other features of the legislation considered

D.4 In the course of the review of the legislation, it is also considered whether the provisions are driven by an underlying structural feature of the tax system. Those features are referred to as the 'source' of the tax provision. For example, the source of a piece of legislation may be the capital/income distinction or the source may be the way in which that area of tax law has been approached in drafting terms, such as the list-type approach of the PAYE regulations. In this way, some of the boundaries are highlighted, as are some of the problems with previous drafting approaches.

D.5 After the review of the Acts, there is a summary table showing how many 'anti-avoidance' provisions (as used in its widest sense in this paper) are derived from which 'source', how many TAARs were included and how many provisions could have been dealt with by a GAAR. (Where the analysis considers that the use of a GAAR is possible but subject to argument, it is included in the GAAR statistics.) Some provisions will derive from more than one source.

The 'source' references

D.6 The 'source' references used are set out below, with a brief explanation where appropriate. Not every piece of legislation is given a source. Only the most common sources are specified.

'IHT system'. Where a tax looks to the value of property at a set point in time, taxpayers will be encouraged to take steps to reduce that value by whatever means they practically can. Where the rules are formalistic enough that they can do so for the purpose of the rules but still economically retain an interest in the property, then this element of the rules is likely to be used and arguably abused.

'Tax-advantaged vehicles' refers to cases where the legislation is driven by the use of the tax advantages given to certain vehicles, e.g. investment trusts or venture capital trusts (VCTs).

'Tax-advantaged employment incentives' refers to cases where the legislation is driven by the use of the tax advantages given to certain types of employment incentive, e.g. HMRC-approved share schemes.

'Tax reliefs' refers to cases where the legislation is driven by the use of tax reliefs, using this term in a wide, non-technical sense so picking up not only reliefs framed as such but also provisions such as uplifts of base costs.

'Income/Capital distinction' refers to the distinction drawn for tax purposes between the taxation of amounts as income or as capital.

'Tax rules following legal form not economic substance' refers to the situations where the tax rules look to the form of the transaction to determine the tax treatment rather than the underlying economic result.

'Drafting' will often be a source of new rules in conjunction with one of the other sources. It refers to various drafting reasons for change: the use of lists in legislation (e.g. in PAYE and NICs regulations); a definitional approach to legislation (e.g. in the various forms of financial instruments legislation); a lack of purposive drafting; and layering of legislation (e.g. the various layers used to deal with financial instruments).

'Foreign tax credit system' refers to legislation driven by the way in which relief for overseas tax is given. (This paper does not look at whether a deduction system would be less prone to avoidance.)

'Residence rules' refers to legislation driven by the residence basis of tax rules.

'Employed/Self-employed distinction' refers to legislation driven by this one distinction. The legislation driven by this source will often come within one of the other source categories.

'Differential tax rates' refers to legislation that is reacting to taxpayers taking steps to structure a transaction to fall within a lower rate of tax. The classic example arises in the context of stamp duty.

'Tax Treaties' refers to legislation that is caused by the use of Tax Treaties by taxpayers.

The legislation

Finance (No. 2) Act 1997

Section 19 – pension funds no longer entitled to payment of tax credits

A structural change to the tax system which would not have been covered by a GAAR. It prevented certain forms of avoidance but went much further.

Source: Tax reliefs.
Tax rules following legal form not economic substance.

Section 20 – losses not to be set against surplus franked investment income

A structural change to the tax system which would not have been covered by a GAAR. It prevented certain forms of avoidance but went much further.

Source: Tax reliefs.

Section 24 – taxation of dealers in respect of distributions etc.

A structural change to the tax system which would not have been covered by a GAAR. It prevented certain forms of avoidance but went much further. What had previously been accepted as a fundamental of the system – the non-taxability of UK distributions – is now described as an anomaly used for tax avoidance purposes only.

Source: Tax reliefs.
Tax rules following legal form not economic substance.

Section 26 – purchase and sale of securities

Changes consequential on the S24 changes but also an extension of certain existing anti-avoidance rules applying to market makers dealing in overseas securities.

Source: Tax reliefs.
Tax rules following legal form not economic substance.

Section 27 – payments to companies under Section 687 of the Taxes Act 1998

This prevents companies obtaining, via trusts, payments of tax credits which would not be received on a direct investment in UK equities as a result of the other changes above.

A **GAAR** would have dealt with clear cases of tax avoidance, but this provision goes further. The provision is needed because of the partial changes to the tax credit system rather than a wholesale review.

Source: Tax reliefs.
Tax rules following legal form not economic substance.

Section 28 – arrangements to pass on the value of tax credits

This is a **TAAR** designed to stop one person who cannot use the tax credit on a dividend arranging for the dividends to be paid to someone who can use the credit.

GAAR.

Source: Tax reliefs.
Tax rules following legal form not economic substance.

Section 29 – unauthorised unit trusts

This prevents pension funds investing through unauthorised unit trusts in order to access the tax credit attaching to dividends.

A **GAAR** would have dealt with clear cases of tax avoidance, but this provision goes further. The provision is needed because of the partial changes to the tax credit system rather than a wholesale review.

Source: Tax reliefs.
Tax rules following legal form not economic substance.

Section 36 – foreign income dividends

This abolishes FIDs. This follows on from the other dividend tax changes.

It is a structural change and would not be covered by a GAAR.

Source: Tax reliefs.
Tax rules following legal form not economic substance.

Sections 39 and 40 – carry back of trading losses and loan relationship deficits

The carry-back period is reduced from 3 years to 12 months.

It is a structural change, not covered by a GAAR.

Source: Tax reliefs.

Section 41 and Schedule 7 – restrictions on group relief

Introduced to stop the leasing industry relying on certain provisions in the group relief rules to achieve an effective carry back of group relief, but the provision applies more generally. Described by the Standing Committee as 'impenetrable' and includes an error which is dealt with in FA 2008.

Not covered by a GAAR.

Source: Tax reliefs.

Section 42 – temporary first-year allowances

This includes a **TAAR** which applies where there is a change in the nature or conduct of a trade or business and the obtaining of an increased allowance under this section is the main benefit, or one of them, expected to arise from the change.

A **GAAR** would have made the TAAR unnecessary.

Source: Tax reliefs.

Sections 44–47 – capital allowances and finance leases

Changes purporting to level the playing field between loan finance and lease finance, but the changes go further.

These are structural changes, not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Finance Act 1998

Section 31 – abolition of advance corporation tax

This would not be covered by a GAAR. It is a change in the underlying system. A GAAR may have dealt with certain of the concerns that led to the change in system, but the actual change that occurred was much more far reaching than a GAAR would have been.

Section 38 – taxation of rents and other receipts from land

A structural change. Not covered by a GAAR. Reliance on statutory rules and case law.

Source: Income/Capital distinction.

Section 40 – treatment of premiums as rent

A structural change. Not covered by a GAAR.

Source: Income/Capital distinction.

Section 49 – employee share options; Section 50 – conditional acquisition of shares

A question (which recurs) of the timing of the tax charge.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 51 – convertible shares provided to directors and employees

This provision sets out rules for taxing convertibles.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.
Drafting.

Section 62 – provision preventing manipulation of profit periods

A structural change. Not covered by a GAAR.

Source: Drafting of a tax-advantaged incentive.

Sections 64–66 – tradeable asset rules

Add further categories of assets.

Not covered by a GAAR (although query whether the provisions in entirety would have been avoided by more principles-based drafting and a GAAR).

Source: Drafting by list rather than principle.

Section 67 – gains from share options etc.

Rules regarding how much and when the employee is taxed/subject to PAYE in relation to share options.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 99 – extension of provisions relating to guaranteed returns

An exclusion from the capital gains rules was introduced by FA 1997 to deal with non-trading transactions in futures and options which are designed to produce guaranteed returns as their main purpose. These provisions are extended to include options which are not disposed of but are exercised and to futures which run to delivery, by deeming there to be a disposal of the option or future at market value immediately before the exercise of the option or the delivery of the future.

A structural change deeming a disposal. Not covered by a GAAR. Taxpayers could rely on specific drafting of what was included/excluded from the FA 1997 rules.

Source: Income/Capital distinction.

Sections 103–105 – restriction of relief on certain interest and dividends

Reduces claim for foreign tax credit or underlying tax by financial expenditure on the interest or dividend received.

Not covered by a GAAR. The provision addresses the mechanism of how to calculate the foreign tax credit.

Source: Foreign tax credit system.

Section 106 – underlying tax reflecting interest or dividends

This changes the scope of provisions.

Not covered by a GAAR.

Source: Foreign tax credit system.

Section 107 – notification of foreign tax adjustment

An adjustment provision.

Not covered by a GAAR.

Section 108 – new regime for transfer pricing etc.

A change in substance. The changes are consequent on self-assessment.

Not covered by a GAAR.

Section 112 – exempt activities

The extension of investment business definition to intellectual property rights is one of substance and would not be covered by a GAAR, but the change in references from 'banking or similar business' to specifying 'banking, deposit taking, money lending or debt factoring' arguably only requires a more purposive reading of the legislation.

Source: List approach to drafting.

Section 114 – postponed corporation tax

This introduced legislation to ensure that any tax unpaid by the 'transferred company' can be charged to the persons who previously controlled the company where there has been a change of ownership, and where the tax was not paid within six months of the date on which it was due. The Revenue can only apply this legislation where it can infer from the circumstances that the transaction was undertaken on the basis that tax would not be paid.

GAAR.

Source: Tax liability rules.

<u>Section 126 – capital gains on stock dividends</u>

Stock dividends are no longer treated as a reorganisation.

A structural change. Not covered by a GAAR.

Source: Income/Capital distinction.

<u>Section 127 – charge to CGT on temporary non-residents</u>

A structural change. Not covered by a GAAR.

Source: Residence rules.

<u>Section 128 – disposal of interests in a settlement</u>

A structural change so that a beneficiary cannot be exempt from tax on disposing of their interest where the trustees also would be exempt as non-residents. Not covered by a GAAR.

Source: Residence rules.

<u>Section 130 – charge on beneficiaries of settlements with non-resident settlors</u>

A structural change by removing domicile and residence conditions for settlors. Not covered by a GAAR.

Source: Residence rules.

<u>Section 131 – charge on settlors of settlements for grandchildren</u>

An extension of the law.

Not covered by a GAAR.

<u>Section 132 – charge on settlors of pre-19th March 1991 settlements</u>

A retrospective structural change. Not covered by a GAAR.

<u>Section 133 – transfer within group to investment trust</u>

Potentially capable of being dealt with by a **GAAR**.

Source: Income/Capital distinction.
Tax-advantaged vehicles.

Section 134 – transfer of company's assets to venture capital trust

As S133 but this section amends S139 TCGA which already has a bona fide commercial reasons test.

Source: Income/Capital distinction.
Tax-advantaged vehicles.

Section 135 – transfer within group to venture capital trust

As S133, i.e. potentially capable of being dealt with by a **GAAR**.

Source: Income/Capital distinction.
Tax-advantaged vehicles.

Section 137 – pre-entry gains

Arguably, the tax-motivated structures covered by the pre-entry gains and losses legislation could be dealt with by a **GAAR**. However, these rules go much wider than tax-motivated transactions. This section has no motive test and limits the use of losses in completely commercial transactions and is therefore wider than a GAAR.

Source: Tax reliefs.

Section 138 – pre-entry losses

A technical change in complex group rules.

Not covered by a GAAR: transactions would be protected as falling within an exception.

Source: Tax reliefs.

Section 139 – de-grouping charges

Technical amendments to the de-grouping charges where there are connected groups.

Not covered by a GAAR: transactions would be protected as falling within an exception.

Source: Tax reliefs.

Section 141 – abolition of certain other CGT reliefs

A structural change. Not covered by a GAAR.

Source: Tax reliefs.

Section 142 – IHT: property of historic interest etc.

A structural change. Not covered by a GAAR.

Source: IHT system.

Section 143 – removal of exemption for gifts for public benefit

A structural change. Not covered by a GAAR.

Source: IHT system.

Finance Act 1999

Section 16 – groups of companies

Specific changes to rules, some anti-avoidance provisions and a confirmation of the residence test.

Not covered by a GAAR.

Sections 38 and 39 – withdrawal of relief for interest on loans to buy land etc.

A structural change with own **TAAR**. The anti-avoidance TAAR measures could have been covered by a **GAAR**.

Source: Income/Capital distinction.

Section 42 – conditional acquisition of shares

Deletes the charge on acquisition imposed in 1998. The provision is concerned with the timing of the tax charge.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 54 – reverse premiums

A structural change but the anti-avoidance provision within this section dealing with artificial lengths of leases could be dealt with by a **GAAR**.

Source: Income/Capital distinction.

Section 64 – income of unmarried child of settlor

A structural change. Not covered by a GAAR.

Sections 65 and 66 – relevant discounted securities

The change will ensure that holders of discounted securities cannot escape an income charge on the discount by arranging an artificial option – which would never in practice be exercised – for the holder to redeem early at par. In future, the test for deepness of discount will be by reference to any occasion on which the security may be redeemed, except for redemptions triggered by a default which is unlikely to happen.

GAAR.

Source: Drafting: layers of rules for securities.

Section 67 – deep discount and deep gain securities

Plugs technical holes in financial instruments legislation which could have been used as avoidance.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.
Drafting: built-in exceptions to general rules and layers of rules.

Section 70 – relief on VCT distributions

Introduces a bona fide commercial test which could be dealt with by a **GAAR**.

Source: Tax-advantaged vehicles.

Sections 72 and 73 – EIS: deferred gains and interaction with taper relief

A structural change/clarification. Not covered by a GAAR.

Source: Tax-advantaged vehicles.

Section 74 – value shifting on sales of subsidiaries: new Section 31A TCGA

The loophole that was being exploited involved the sale of a subsidiary to a non-resident company within a worldwide group prior to its onward sale outside the group. It relied on a loophole in the legislation and the new rules counteracted this by a form of **TAAR** which treats the consideration for the ultimate disposal as increased by an amount that is just and reasonable having regard to the scheme or arrangements and the tax-free benefit.

GAAR.

Source: Income/Capital distinction and tax reliefs: non-taxability of dividends and taxation of gains.

Section 75 – allowable losses where beneficiary absolutely entitled

Restricts use of losses.

A structural change. Not covered by a GAAR.

Source: Tax reliefs.

Section 76 – concessions that defer a CGT charge

Brings into charge gains previously deferred under concession. Previous statutory inadequacy.

A structural change. Not covered by a GAAR.

Source: Tax reliefs.

Section 88 – CFCs

A change in the rules to stop the routing of UK dividends through CFCs to get round acceptable distribution rules.

GAAR?

Source: Drafting: inadequacy of CFC rules.

Section 104 – IHT: gifts with reservation

Changes following the case of *Ingram v. IRC* 1990 STC 657.

GAAR?

Source: IHT system.

Sections 116 and 117 – bearer instruments

Imposes a 1.5% charge.

A structural change. Not covered by a GAAR.

Finance Act 2000

Section 52 – approved profit-sharing schemes: restriction on type of shares

Designed to stop taxpayers using schemes to replicate the old profit-related pay.

Not covered by a GAAR.

Source: Tax-advantaged employment incentives.

Section 53 – approved profit-sharing schemes: loan arrangements

As S52, i.e. designed to stop taxpayers using schemes to replicate the old profit-related pay.

Not covered by a GAAR.

Source: Tax-advantaged employment incentives.

Section 60 – provision of services through intermediary

The legislation looks through intermediaries. A **GAAR** may deal with some of the more artificial arrangements, but this goes wider.

Source: Tax rules following legal form not economic substance.
Employed/Self-employed distinction.

Section 90 – restriction of gifts relief

This section provides for the ending of capital gains tax relief for gifts of business assets on the transfer of shares or securities to companies.

'This relief was being widely abused where shares or securities, rather than assets used in a trade, were involved. The relief was being exploited in schemes where the primary purpose was to avoid a CGT liability on an anticipated sale, rather than simply defer the liability on a bona fide gift. Some of the schemes involved the direct transfer of shares or securities to companies so that a tax exemption or other tax shelter could be taken advantage of. Others employed the relief as part of a complex series of transactions where the sole purpose was to shift gains outside United Kingdom tax jurisdiction.' (Explanatory Notes)

Although this was introduced to deal with tax avoidance schemes, no bona fides exception.

GAAR.

Source: A tax relief (the CGT gifts relief).

Section 91 – disposal of interest in settled property: deemed disposal of underlying assets

Any gains arising on the disposal of an interest in (as opposed to the underlying assets of) a UK trust are not generally chargeable to CGT. The purpose of the exemption was to prevent a double tax charge – one on the sale by the trustees of assets in the trust property and the other on the sale by a beneficiary of an interest in the trust. This exemption was being used by individuals who placed assets (which are standing at a gain) in trusts in which they retained an interest that was subsequently sold to someone else. They were effectively using the CGT exemption to sell the underlying assets tax-free to third parties.

The exemption was also being used in schemes designed to circumvent rules to prevent the sale of trust losses.

The section was designed to counter these schemes. Broadly, where an interest in a settlement in which the settlor has an interest is disposed of for consideration, the assets to which the interest relates are deemed to be disposed of and reacquired by the trustees at their market value. Any resulting gains will be chargeable on the settlor under the normal provisions. Gifts holdover relief cannot be claimed to relieve the gains arising on the disposal.

This rule also applies to any property which formed part of a settlement in which the settlor had an interest at any time in the two previous tax years, or at any time in the period beginning when the contract for the sale of the interest is entered into and ending when the transaction is effectively completed. There are also rules to prevent the tax charge being avoided on property added to the trust during that period. The amount of tax paid under the new rule will be recoverable from the person who sells the interest.

GAAR? These provisions go wider than a GAAR would.

Source: Tax rules following legal form not economic substance.

Section 92 – transfers of value by trustees linked with trustee borrowing

These provisions are designed to counter an avoidance device that has become commonly known as a 'flip flop'. This is a device for extracting gains from a trust tax-free, or with a significant tax saving, using borrowed money.

The device was used to avoid tax in two situations. The first was where tax was payable by the settlor of a trust. Where a UK-resident settlor retained an interest in the capital or income of a trust (irrespective of whether the trust is a resident or non-resident trust), an amount equal to the capital gains of the trustees was chargeable on that person.

The trustees borrow money on the security of assets in the trust and advance the money to another person, usually the trustees of another trust in which the settlor of the first trust has an interest. The settlor then severs his interest in the first trust. In the following tax year, the trustees of the first trust sell the assets and use the proceeds to repay the debt. The settlor receives his or her money from the second trust. If the device is successful, the gains cannot be charged on the settlor because in the tax year that they are realised the settlor no longer has an interest in the first trust. In the case of a UK trust, the trustees are charged at the rate applicable to trusts (34%) on the gains instead of the settlor being charged at his or her marginal rate of tax of 40%.

Source: Differential tax rates.

The second situation in which the device was used was where UK-resident beneficiaries of an offshore trust received capital payments and were chargeable to tax in respect of gains realised by the trustees. In this situation, the borrowing by the trustees and transfer of funds from the trust enabled the beneficiaries to receive capital payments from another trust which had not realised the gains. The UK beneficiaries paid no tax on the benefits they received from the realised gains.

Source: Tax rules following legal form not economic substance.

GAAR.

<u>Section 93 – restriction on set-off of trust losses</u>

Assets would be transferred into a trust using gifts holdover relief so that the trust losses can then be used to offset the gains arising on the subsequent disposal of the assets so that no tax is paid.

This section prevents losses accruing to trustees being set against gains on assets that have been transferred into the trust using gifts holdover relief where the transferor or a connected person has acquired an interest in the trust and any consideration has passed in connection with the acquisition.

Wider than a GAAR.

Source: A tax relief (the CGT holdover relief).

<u>Section 94 – attribution to trustees of gains of non-resident companies</u>

Valuable assets were shifted by trustees from tax havens to countries with which the UK has a Tax Treaty just prior to the sale taking place.

This section was designed to stop Tax Treaties being used to prevent gains of offshore companies being attributed to resident or non-resident trustees as participators of close companies.

GAAR.

Source: Tax Treaties.

<u>Section 95 – disposal of interest in non-resident settlement</u>

Having realised gains which have not been charged to tax on either the settlor or beneficiaries of the trust ('stockpiled gains'), the trusts are brought onshore and then taken offshore again. The gains on the trust property escape a tax charge because they were realised while the trust was offshore. The beneficiary pays little or no tax on the sale of an interest in the trust because of the rule providing for its value to be uplifted on the trust's exit from the UK.

This section provides that there will be no uplift in the value of any beneficial interest in a trust where, on or after 21 March 2000, the trustees become non-resident at a time when there are 'stockpiled gains' in the trust, or the trust is a 'transferor or transferee trust'.

GAAR.

Source: A tax relief (the uplift rules).

Section 96 – payments by trustees to non-resident companies

Under special rules contained in SS87–98 TCGA, a charge may be made on beneficiaries in respect of gains realised by offshore trustees. Amounts in respect of such gains are attributed to beneficiaries when and to the extent that they receive 'capital payments' from the trustees.

Special rules ensure that 'capital payments' made to offshore companies controlled by beneficiaries, rather than direct to the beneficiaries themselves, are treated as made to the beneficiaries. Where the offshore company is controlled by two or more persons, existing rules require that each of those persons is resident or ordinarily resident in the UK before the capital payments can be treated as made to them.

Non-resident persons were interposed in the control of the offshore company. This section removes the UK resident condition.

A structural change. Not covered by a GAAR.

Source: Drafting: the definitional approach of the legislation and consequent ease of getting around a residence-based test.

Section 103 – double taxation relief

A major change to relief for foreign tax rules. Includes effective removal of mixer company benefits. Does so by changing the rules.

Not covered by a GAAR.

Source: Foreign tax credit system.

Section 104 – controlled foreign companies

Changes to the CFC rules and exemptions.

Specific structural changes. Not covered by a GAAR.

Source: Drafting: the definitional approach of the legislation.

Section 106 – foreign exchange gains and losses: use of local currency

Subsection (7) inserts a new **TAAR** into the FOREX legislation. It provides that if the main benefit that might be expected to accrue to a company from using a currency other than sterling is that an exchange gain would not accrue and a gain would have accrued if sterling had been used, then the company must use sterling as the local currency to calculate any exchange gain on the asset or liability concerned.

GAAR.

Source: Tax rules following legal form not economic substance.

Section 110 – rent factoring

Treating as an income receipt proceeds which might otherwise be regarded as a receipt of capital. Amounts received in schemes for giving up the right to future rental income in respect of land in the UK, whether by transferring the rights to receive rents or by granting a lease at a premium, to be charged to tax as income under Schedule A.

A structural change. Not covered by a GAAR.

Source: Income/Capital distinction.

Section 117 – power to vary stamp duties

Power to allow stamp duty avoidance devices to be countered as they arise. Under the power, regulations may be made to vary any existing stamp duty with immediate effect, subject to approval by a House of Commons vote. Puts the Stamp Office on a reactive footing. Arguably, these powers and consequent legislation would not be needed if there is a GAAR (but see comments below about the limitations of a GAAR for stamp duty where the rules are so dependent on legal form).

Section 118 – land transferred etc. for other property

This clause counteracts schemes which seek to reduce the rate of stamp duty payable by structuring transfers of land or buildings for other property in ways which avoid there being a conveyance on sale of the land or buildings concerned.

For example, if a sale of land for gilts was structured as a sale of the gilts for the transfer of the land, no stamp duty would have fallen due prior to the introduction of this provision, as there would have been no conveyance or transfer on sale of the land.

A structural change. As stamp duty is so dependent on the legal form of transactions, it would be difficult to see a GAAR working here.

Source: The legal form basis of stamp duty.

Section 119 – transfer of land to connected company

If land is transferred to a company with which the transferor is connected in consideration for the issue of securities whose value is less than that of the land, stamp duty would, prior to this clause, have been chargeable only by reference to the value of the securities. This clause ensures that there is a stamp duty charge at the relevant rate of duty on the market value of the land transferred.

GAAR.

Source: Differential tax rates.

Section 121 – grant of lease to connected company

Same as S119 but for leases, so:

GAAR.

Source: Differential tax rates.

Section 122 – marketable securities transferred etc. for exempt property

Same idea as S118 but in the context of transferring marketable securities, so:

Source: The legal form basis of stamp duty.

Section 123 – transfer of property between associated companies: Great Britain

Changes group rules to come into line with group relief.

A structural change. Not covered by a GAAR.

Source: Group rules following legal form not economic substance.

Section 125 – grant of leases etc. between associated companies

As S123, i.e. changes group rules to come into line with group relief.

A structural change. Not covered by a GAAR.

Source: Group rules following legal form not economic substance.

Section 126 – future issues of stock

Rights to receive stock now constitute stampable consideration.

A structural change. Not covered by a GAAR because of the importance of the legal form of transactions for stamp duty.

Source: The legal form basis of stamp duty.

Section 127 – company acquisition reliefs: redeemable shares

Sections 75 and 76 FA 1986 provide relief for certain company reorganisations where there is no significant change of underlying ownership. But, for the S75 relief to apply, cash must not form any part of the consideration given for shares issued under the reorganisation and cash must not be more than 10% of the consideration given for shares issued under the reorganisation if relief under S76 is to apply. This clause stops the use of redeemable shares to get around these rules.

GAAR? The problem of stamp duty looking to legal form remains.

Source: The legal form basis of stamp duty.

Section 128 – surrender of leases

It was possible to avoid the stamp duty charge by arranging for the surrender to take effect by operation of law rather than by means of a deed of surrender. This clause stops this.

Not covered by a GAAR.

Source: The legal form basis of stamp duty.

Finance Act 2001

Section 76 – limited liability partnerships: investment LLPs and property investment LLPs

Interest relief in respect of loans to purchase an interest in a partnership is denied where the partnership is an 'investment LLP' and a number of tax exemptions for income and gains are disapplied where they are received by a member of a 'property investment LLP'.

A structural change. Not covered by a GAAR.

Source: Tax reliefs.

Section 81 – double taxation relief

Further detailed changes to the operation of the new FA 2000 double tax relief rules.

Not covered by a GAAR.

Source: Foreign tax credit system.

Section 82 – controlled foreign companies: acceptable distribution policy

Deals with a CFC scheme as follows:

The schemes involve money going round in a circle from a UK bank to a CFC owned by the UK multinational and then back to the bank again. Very broadly:
(a) the CFC issues shares to the UK bank in return for cash;
(b) these shares entitle the bank to receive dividends from the CFC; but
(c) they have in effect to be sold back to the CFC for a fraction of their initial cost.
The amount the bank pays under (a) above roughly equals the amounts it receives under (b) and (c).

The measure provides that dividends paid by a CFC to UK companies that can offset losses in this way (e.g. banks, other financial concerns and insurance companies) do not count towards the ADP exemption if they are involved in a UK tax avoidance scheme.

GAAR.

Source: Tax rules following legal form not economic substance.

Section 84 – exclusion of deductions for deemed manufactured payments

Legislation was introduced (in what is now S736B ICTA) to deem manufactured payments to be made for tax purposes if the agreement did not require them. The payments are deemed to be made on the same day as the real dividend or interest is paid, and the lender is taxed on them in the same way as on real dividends or interest. Schemes were promoted to structure stock borrowing transactions without provision for manufactured payments. The stock borrower would be a payer of UK tax, but the lender would be chosen so that it would not suffer tax (or at least an immediate or effective tax liability) on its deemed receipt. The objective was to ensure that the borrower obtained a deduction for the deemed payment arising under S736B. It shares its consequent tax saving – unmatched by actual expenditure – with the lender by way of a fee payment.

This section blocks this by removing the availability of a tax deduction for the deemed payment.

GAAR? The problem is that this type of transaction falls within an exception to existing anti-avoidance legislation.

Source: Tax rules following legal form not economic substance.

Finance Act 2002

Section 37 – minor amendments to Schedule E charge

This tightens and changes rules in relation to share options and certain benefits.

A structural change. Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Sections 42–44 – substantial shareholdings

These provide for a new exemption system for disposals of substantial shareholdings by companies. Contain own anti-avoidance provisions.

A structural change. Not covered by a GAAR.

Source: Income/Capital distinction.

Section 56 – R&D tax relief

Where one company (‘the principal’) pays another (‘the subcontractor’) to carry out R&D work, the FA 2000 rules were intended to provide that, if the principal and subcontractor are related persons, the principal would be able to claim relief on the amount of the subcontractor's relevant expenditure on the R&D. Where the two parties are not related, the principal was to have been able to claim 65% of the amount of its payment to the subcontractor.

As drafted, it was possible that the rules would allow a payment to a subcontractor with whom the principal is connected to be treated as paid between unconnected persons. This could provide scope for a company making a payment to a subcontractor with whom it is connected to manipulate the rules so as to obtain relief on 65% of the payment irrespective of the fact that the qualifying expenditure incurred by the subcontractor may account for less than 65% of the payment – because, for example, the payment includes a substantial contribution towards the capital cost of equipping a new laboratory to carry out the research. This section changes these rules to deal with this concern amongst other things.

Change in structural rules, not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 57 – Community Investment Tax Credit

This sets up a new scheme, the Community Investment Tax Credit, which aims to encourage private investment in businesses and social enterprises in disadvantaged communities. The scheme provides tax relief to individuals and companies. The provisions include a **TAAR** which could be dealt with by a **GAAR**.

Source: Where credits or reliefs are given, 'tax avoidance' is likely to be encouraged.

Section 69 – qualifying contracts for unallowable purposes

This section is a **TAAR**.

GAAR.

Section 70 – forward premiums and discounts under currency contracts

Previous rules described circumstances for deduction rather than just following accounts. Some companies were claiming that although a premium or discount was recognised in the accounts, it did not fall within the precise wording of the legislation. Other companies argued that a premium which is not obviously recognised in the accounts (because it has been set off against an equal and opposite discount) should be recognised as giving rise to a loss for the purposes of the financial instruments rules, while the discount is not brought into tax.

The new rules provide that where a premium or discount is, or should be, recognised in accounts in accordance with GAAP, then it will also be taken into account for tax under the financial instruments legislation as amended.

A structural change. Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

<u>Section 71 – loan relationships: accounting method where rate of interest is reset</u>

A **TAAR**.

GAAR.

<u>Section 72 – loan relationships: convertibles</u>

Section 92 FA 1996 provided the extent to which such convertibles should be given chargeable gains treatment as quasi-equity. This section tightens those rules to stop perceived anti-avoidance where instruments were structured to fall within the S92 FA rules for CGT treatment.

A structural change. Not covered by a GAAR.

Source: The continuing capital/income categories for different financial instruments.

<u>Section 73 – convertibles: issuing company not to be connected company</u>

Designed to counter intra-group transactions where the issuer could get an income deduction and the holder would be taxable on a capital gains tax basis.

GAAR potentially.

Source: Income/Capital distinction.

<u>Section 74 – convertibles: debtor relationships</u>

This limits the issuer's expenses so that relief is not available for amounts and expenses which relate to the shares rather than the loan element of convertible and exchangeable securities.

A structural change. Not covered by a GAAR.

Source: Income/Capital distinction.

<u>Sections 75 and 76 – asset-linked securities</u>

Section 93 FA 1996 provided CGT treatment for asset-linked securities. These sections restrict that treatment to where the assets are land or qualifying listed shares and deny the CGT treatment where the security taken together with futures/options produces a guaranteed return.

The sections are more restrictive than a GAAR.

Source: Income/Capital distinction.

Section 83 – derivatives

A whole new set of derivatives rules, many modelled on other financial instruments rules. Introduces own ‘unallowable purposes’ anti-avoidance test in a **TAAR**. To this extent, the anti-avoidance provisions would be substantially covered by a **GAAR**.

Source: The layers of rules used to tax financial instruments.

Section 84 – new rules for treatment of intangibles

A whole new set of rules. Includes a **TAAR** which would be covered by a **GAAR**.

Source: Income/Capital distinction.

Section 86 – Lloyd’s underwriters

If a member enters a quota share contract to reinsure losses which have already been declared, it is possible as things stand at the moment for the member to receive two tax deductions in respect of the same loss, once when they are declared and again when the quota share premium is paid. The clause and schedule will prevent two deductions being given.

A structural change. Not covered by a GAAR.

Source: The special tax regime for Lloyd’s underwriters.

Section 89 – CFCs: territorial exclusions

‘The aim of this measure is to protect the UK against any overseas jurisdictions in which harmful tax practices continue to be prevalent. It gives the Treasury the reserve power to specify jurisdictions for which the CFC exemptions will not apply. As such, regardless of the nature of the business carried on by the subsidiary, UK parent companies of such CFCs would, in effect, fall to be taxed on an amount equal to that which the CFC would have paid had it been resident in the UK. No jurisdiction can be listed, however, without Parliament’s approval.’ (Explanatory Notes)

Not covered by a GAAR.

Section 90 – CFCs: Treaty non-resident companies

A UK-resident company can be subject to the controlled foreign company rules notwithstanding that it is treated as being non-resident under the terms of one of the UK’s Double Taxation Treaties.

An anti-avoidance measure but wider than a GAAR. In particular, there is no motive test.

Source: Residence rules

Section 104 – discounted securities

This prevents a relevant discounted security being issued by a close company (including a company which would be close if it were UK-resident) at more than its market value to a connected party and giving rise to an income tax loss on any later disposal to a connected party.

It is an anti-avoidance provision designed to counteract the artificial generation of tax losses where there is no economic loss.

GAAR.

Source: Tax rules following legal form not economic substance.

Section 108 – manufactured dividends and interest

Prevents relief against income tax for individuals (and others not within the charge to corporation tax, such as trustees) for manufactured payments in respect of UK securities where they would not have been eligible for relief for an actual payment of interest, and where they do not have an equivalent taxable receipt from the same securities.

Previously, a deduction was available.

A structural change. Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 109 – VCTs

Provisions for VCT relief where the VCT is wound up or merged. This includes a **TAAR**-type provision that the winding-up must be for bona fide commercial reasons and not part of a scheme or arrangement the main purpose, or one of the main purposes, of which is the avoidance of tax.

This provision could be dealt with by a **GAAR**.

Source: Tax-advantaged vehicles.

Section 111 – withdrawal of stamp duty group relief where a company has land transferred to it and leaves the group within two years

This is wider than a GAAR: there is no motive test.

Source: Differential stamp duty rates.

Sections 112 and 113 – restrict or withdraw alternative stamp duty relief on company acquisitions where there has been a previous land transfer or arrangements to transfer a business

The provisions are again wider and less focused than a GAAR and have no motive test.

Source: Differential stamp duty rates.

Section 114 – penalties for late stamping

Where an instrument transfers UK land or buildings, a penalty for late stamping will apply if the instrument is not presented for stamping within 30 days after the instrument has been executed. This applies regardless of whether the instrument was executed inside or outside the UK.

A structural change. Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 115 – contracts for the sale of land

This section brings certain contracts for the sale of land into the charge to stamp duty. It applies to contracts for over £10 million.

A structural change. Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 119 – IHT: powers over settled property

This provides expressly that powers over trusts are not to be treated as property. It supplements this with provision against purchasing powers. In so doing, it reverses case law and introduces a specific anti-avoidance rule.

Not covered by a GAAR.

Source: The IHT system.

Finance Act 2003

Sections 42–130 – replacement of stamp duty with stamp duty land tax

The culmination of previous anti-avoidance efforts. This is a complete rewrite of the rules and change in structure.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 136 – inclusion of domestic services in the intermediary rules

A structural change. Not covered by a GAAR.

Source: List approach to drafting.

Sections 139–142 – rewrite of the employee securities and options rules

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 143 – restriction of deduction for payments to employee benefit trusts

Limits the type of deductible payments and uses to which payments can be put for the employing company to obtain a deduction.

A structural change. Not covered by a GAAR.

Source: Mismatch between timing rules for deduction for payer (the company) and taxation of recipient (the employee).
Tax reliefs.

Section 146 – interest on late payments

Interest on late-paid National Insurance contributions, on tax deducted from construction industry subcontractors' payments and on student loan repayments is made non-deductible.

A structural change. Not covered by a GAAR.

Section 148 and Schedule 25 – permanent establishments

This sets out a new basis for charging non-residents. It includes provisions that the permanent establishment is to be treated as having:

- the same credit rating as the non-resident company of which it is a part; and
- such equity capital and loan capital as it could reasonably be expected to have in the circumstances specified in new S11AA(2).

It goes on to prohibit deductions in arriving at profits chargeable to corporation tax in excess of those which would have arisen on those assumptions.

It would not be covered by a GAAR.

Source: Income/Capital distinction.
Residence rules.

Schedule 25 includes details of computation for permanent establishment along OECD lines. It includes **one TAAR/GAAR-type provision**: the transfer of loans and financial instruments is not recognised where it cannot reasonably be considered that the transfer is carried out for valid commercial reasons. The obtaining of a tax advantage is not a valid commercial reason for this purpose.

Section 154 – double tax relief for profits of overseas permanent establishment of a UK company

For the purposes of working out the amount of foreign tax paid in respect of their activities that can be relieved against UK tax, the profits of those permanent establishments are to be computed in the same way as for the UK permanent establishments of foreign companies.

A structural change. Not covered by a GAAR.

Source: Different treatment of UK and non-UK entities.

Section 158 – application of market value rule in case of exercise of option

A structural change. Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 163 – transfers of value: attribution of gains to beneficiaries

There are two main changes.

One change is to counter further schemes which use the provisions introduced in FA 2000 to counter 'flip-flops'.

GAAR.

Another change causes there to be different tax effects depending upon whether UK or non-UK beneficiaries are paid out of the trusts.

A structural change. Not covered by a GAAR.

Source: The IHT system

Section 164 – avoidance affecting proceeds of balancing event

This is a **TAAR**. Where the proceeds from a 'balancing event' or sale are less than they would otherwise have been as a result of a tax avoidance scheme ('a scheme or arrangement the main purpose, or one of the main purposes, of which is the obtaining of a tax advantage by the taxpayer'), the business is denied a balancing allowance on that fall in value. Also, there is a sting in the tail: the purchaser gets the capital allowance treatment he would have had if the scheme had worked (so both lose out).

The schemes could have been dealt with by a **GAAR** but there would not have been the sting.

Section 166 – expenditure on software for sub-licensing

A structural change putting licensing on same basis as leasing. Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 177 – currency contracts and currency options

This is a change to technical legislation which companies had been structuring contracts around.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 181 – repos

This makes various technical changes to the repo rules including making clear how certain transactions involving manufactured dividends come within anti-avoidance rules.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 182 – relevant discounted securities

This removes relief for losses and expenses save for grandfathered listed and gilts.

It is wider than a GAAR.

Source: Income/Capital distinction.

Section 184 – intangibles and tax avoidance

These are changes made to the existing anti-avoidance rule in the rules providing allowances for intangibles and also dealing with the mismatch in definitions used in different parts of the legislation.

The first changes could be dealt with by a **GAAR**. The second would probably not be where the taxpayer relies on differing statutory definitions.

Source: Income/Capital distinction.
Tax rules following legal form not economic substance.

Section 200 – CFCs exempt activities test

These are changes to the rules designed to combat avoidance. They are technical changes stopping companies structuring around the rules.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Finance Act 2004

Sections 30–37 – transfer pricing and thin capitalisation

A structural change. Not covered by a GAAR.

Section 38 – expenses of management

A **TAAR** introduced by changing the definition of management expenses.

GAAR.

Source: Tax reliefs.

Sections 48 and 49 – loan relationships and derivative contracts: miscellaneous amendments

Various changes, including some which could be said to have an anti-avoidance effect but not within a GAAR.

Source: Tax rules following legal form not economic substance.

Section 51 – use of different accounting practices within a group of companies

A **TAAR**.

GAAR.

Section 52 – amendment of enactments that operate by reference to accounting practice

Numerous amendments are made, especially to financial instruments legislation.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 54 – trading profits etc. from securities: taxation of amounts taken to reserves

This section prevents a company whose business includes dealings in shares and other securities from escaping tax on its profits if it uses International Accounting Standards (IAS) and treats any of its investments as 'available for sale' rather than as trading assets.

Source: Tax rules following legal form not economic substance.

Section 84 – charge to income tax by reference to enjoyment of property previously owned

A structural change. Not covered by a GAAR.

Source: **The IHT system.**

Section 91 – income of spouses: jointly held property

This prevents a husband and wife using the joint ownership rules for shares in close companies. Income from shares in close companies (mainly companies owned by their directors or five or fewer people) will be taxed in accordance with the husband and wife's true share of the income, rather than simply half each.

Not covered by a GAAR.

Source: **The provision which was driven by practicality could be used as a relief.**

Section 116 – restriction of gifts relief etc.

This stops gifts relief from being available on transfers to the trustees of settlor-interested settlements.

A structural change. Not covered by a GAAR.

Source: **The IHT system.**

Section 117 – private residence relief

Private residence relief is not available where gifts relief has already obtained. The recipient of a gift would obtain private residence relief and the held-over gain on the gift would not be taxed. Clearly, it was not Parliament's intention that held-over gains should escape tax in this way by the interaction of reliefs; but clearly within the terms of those reliefs, so not automatically within a GAAR.

Source: **Tax reliefs.**

Sections 119–123 – individuals benefited by film relief

This applies to any individual who has claimed loss relief in respect of losses arising from a film trade. It raises a charge to income tax where there is a disposal of rights of an individual to profits from the trade, where that disposal is accompanied either by the individual receiving non-taxable consideration or by the amount of his losses claimed becoming greater than his net contribution to the trade. The amount of the charge is set to remove the element of unfair tax advantage.

Not covered by a GAAR.

Source: **Tax rules following legal form not economic substance.**

Sections 126–130 – losses derived from exploiting licence

This applies where partners aim to benefit from early loss relief against income tax, but then sell the income rights for a lower-taxed capital sum. The new rules ensure that the disposal of income rights is charged to income tax.

A structural change. Not covered by a GAAR.

Source: Income/Capital distinction.

Sections 131–133 – companies in partnership

Typically, income would be allocated to a non-UK partner and the capital to a UK company, which then realises untaxed profits as capital. These changes are designed to prevent this.

A structural change. Not covered by a GAAR.

Source: Income/Capital distinction.
Residence rules.

Section 134 – finance leasebacks

These are structural changes applying to sale and leasebacks or lease and leasebacks of plant and machinery.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 136 – manufactured dividends

A dividend received on UK equities under a repo or stock loan would be taxed at a lower effective rate than that at which relief was given for the manufactured payment. This is because the dividend was taxed at a maximum of 32.5% and was treated as having suffered 10% income tax, whereas the manufactured dividend is set against total income at the 40% rate. Alternatively, a person acquiring the equities could sell them on at the higher cum-dividend price, repurchase later at the lower ex-dividend price and generate a capital gain. If that person has capital losses to set against the gain, there is no tax charge but relief for the manufactured dividend is still given against income tax at the full 40% rate. Effectively, the person has set capital losses against income.

'This has led to the promotion of schemes with no economic purpose other than to take advantage of the tax benefit.' (Explanatory Notes)

The section counters these uses of the rules but is not just limited to the scheme situation.

GAAR? The problem is the ability of the taxpayer to be able to rely on specific anti-avoidance legislation.

Source: Income/Capital distinction.
Differential tax rates.

Section 137 – manufactured payments under arrangements having an unallowable purpose

A **TAAR** for manufactured dividends.

GAAR.

Source: Tax rules following legal form not economic substance.

Section 138 – gilt strips

A person acquires a strip and grants an option to another person to buy the strip. Most of the value of the strip is realised in the form of the option premium, with the remainder received as sales proceeds under the option. Because strips and options over strips are outside the capital gains net, the option premium was not taxed at all, and so a large loss arose for income tax purposes when the strip was sold on exercise of the option. This clause blocks this abuse where there is a scheme or arrangement entered into in order to secure a tax advantage, by substituting the market value of the strip.

GAAR.

Source: Tax exemption.

Finance Act 2005

Sections 46–57 – alternative finance arrangements

Provisions to deal with non-interest-bearing finance where the result is equivalent to interest-bearing finance. Includes own anti-avoidance provision which provides that where the parties to what would be an alternative financial arrangement are connected and the recipient of the alternative finance return is not subject to tax on that return, the arrangement is not treated as an alternative finance arrangement. It also denies any tax relief to the payer of the alternative finance return.

Structural changes. Not covered by a GAAR.

Source: A tax relief.

Section 59 – restrictions on film relief

This prevents film tax relief from being given more than once in relation to any film and limits relief to the cost of production.

Structural changes. Not covered by a GAAR.

Source: A tax relief.

Sections 60–65 – film relief and deferred income

These counter tax avoidance by persons who benefit from film tax relief and defer income from the film for more than 15 years. The sections effectively restrict the tax relief in proportion to the length of the income stream beyond 15 years by treating such companies as having received income in the period for which the claim is made equal to the excess relief.

Not covered by a GAAR.

Source: A tax relief.

Section 66–71 – film relief anti-avoidance

These are provisions designed to stop the tax deferral becoming permanent. Specific provisions claw back relief on various occasions which are not limited to tax avoidance.

Not covered by a GAAR.

Source: A tax relief.

Sections 72–79 – avoidance involving partnerships

These are measures concerning the extent to which individuals who have sustained losses from carrying on a trade in partnership can claim to set loss relief against their other income or capital gains. Such claims to loss relief are restricted to the amount of the partner's contribution to the trade as capital. The new rules give HMRC power to set out in regulations details of the kind of contributions which are excluded in computing the amount of the individual's contribution to the trade for this purpose. No regulations may be made unless a draft has been laid before and approved by a resolution of the House of Commons. Excess relief can then be recovered if, after loss relief has been claimed, the partner's capital contribution is reduced by the exclusion of amounts under provisions introduced under S73.

Structural changes and a mechanism for clawback. Not covered by a GAAR.

Source: A tax relief.

Section 82 – change of accounting practice

By taking certain steps, a company could crystallise differences between UK GAAP tax values and what would be the IAS tax values in the accounting period before it first uses IAS. A **TAAR** is introduced here to put the company back to the position it would have been in if it had not crystallised the difference early.

GAAR.

Source: Accounting mismatches.

Section 85 – dividends by reference to which a deduction is allowed

No underlying tax relief will be given if a tax deduction is given in another jurisdiction calculated by reference to the amount of the dividend. The extra benefit is purely a consequence of another jurisdiction's rules.

Would a GAAR look beyond the UK to counter a double tax benefit?

Section 86 – limits the credit for foreign tax

A structural change. Not covered by a GAAR.

Source: Foreign tax credit system.

Section 87 – schemes and arrangements designed to increase foreign tax relief

Introduces a wide-ranging **TAAR**, which applies if there is a scheme or arrangement, the main purpose or one of the main purposes of which is to obtain allowance by way of credit for foreign tax, and the scheme is a prescribed scheme: for example, a scheme causes foreign tax that is properly attributable to one source of income or gain to be paid in respect of a different source of income or gain; or the payment of foreign tax does not increase the overall tax liabilities of scheme participants.

GAAR? A GAAR could potentially go wider as it would not list prescribed schemes. Although the mischief involves foreign tax as in S85, here the UK company is taking steps to increase a relief, as opposed to the S85 position where there is no concept of schemes/arrangements.

Source: Foreign tax credit system.

Sections 89 and 90 – CFCs

These are provisions dealing with the acceptable distribution policies of CFCs. There are technical changes to how the dividends are calculated and credit given for underlying tax.

Not covered by a GAAR.

Source: Foreign tax credit system.

Section 91 – tax avoidance involving annual payments and double taxation relief

A structural change. Not covered by a GAAR.

Source: Foreign tax credit system.

Finance (No. 2) Act 2005

Section 12 – employee securities

Introduces specific drafting/structure changes and also introduces **five TAARs**. The TAARs would be dealt with by a **GAAR**.

Source: Tax rules following legal form not economic substance.

Sections 24–31 – avoidance involving tax arbitrage

Introduce a **TAAR** aimed at companies using mismatches between UK and non-UK tax rules. The TAAR specifies several different types of schemes caught by it.

GAAR (although the query would be whether a GAAR would pick up avoidance of non-UK tax).

Section 32 – temporary non-residents

A structural change to counteract people becoming temporarily non-resident in order to realise gains.

It goes wider than a GAAR because it is not limited by a tax avoidance motive.

Source: Residence rules.

Section 33 – trustees both resident and non-resident in a year of assessment

A change to counteract schemes where trustees rely on the rules for taxation of non-residents and trigger disposals of assets when they are non-resident.

GAAR possibly.

Source: Residence rules.

Section 34 – location of assets

A structural change, specifying the location of assets for tax purposes. Not covered by a GAAR.

Section 35 – exercise of options

A change in the way the gains on the exercise of options are calculated. Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 39 and Schedule 7 – avoidance involving financial arrangements

Numerous changes, including **8 TAARs**, designed to pick up disclosed tax structures.

GAAR.

Source: **Tax rules following legal form not economic substance**
Drafting
Income/Capital distinction
Tax reliefs

<u>Section 40 – transfer pricing and loan relationships</u>

A change to transfer pricing rules. Not covered by a GAAR.

<u>Section 41 – intangible fixed assets</u>

A structural change. Not covered by a GAAR.

<u>Section 49 – stamp duty land tax</u>

Numerous detailed changes introduced to the SDLT rules, including restricting reliefs and extending charges.

A structural change. Not covered by a GAAR.

Source: Drafting

Finance Act 2006

<u>Section 26 – abolition of corporation tax starting rate and non-corporate distribution rate</u>

These had been used by people setting up service companies to avoid income tax and NICs. *But* the step taken – replacing with the small companies' rate – still left a tax advantage to these steps. Not covered by a GAAR.

Source: **Tax rules following legal form not economic substance.**
Employed/Self-employed distinction.

<u>Section 27 – group relief where surrendering company not resident in UK</u>

Extension of group relief to EEA subsidiaries' losses where not relievable locally (following *Marks and Spencer v. IRC* ECJ Case C-446/03). Includes a **TAAR**.

GAAR could cover TAAR.

Source: **Legal form: ability to reflect economic substance of a group's activities albeit that profits and losses are in different legal entities.**

<u>Sections 31–53 – a new code for corporate tax of film making</u>

The need for the new rules was partly driven by abuse of the previous rules. A **TAAR** was included.

A **GAAR** would deal with the TAAR, but to the extent that taxpayers had brought themselves within existing reliefs it may be difficult to prove that their actions were outside the 'intention of the legislation' without more purposive drafting.

Source: The relief given to film expenditure.
Lack of purposive drafting.

<u>Sections 54–58 – charities</u>

'This clause is targeted at charities controlled by a donor, where the charity is used as a personal moneybox and the actions of the charity and donor are in effect the same. It is not possible to delineate donor-controlled charities in a way that is not easily circumvented and the clause will instead target behaviours that carry risk.' (Explanatory Notes)

Potentially, the abuse could be dealt with by a donor-control provision and a **GAAR**. The changes in SS54–58 went far further than the mischief which they were aimed at or than a GAAR would.

Source: Tax reliefs.

<u>Sections 69–72 – capital losses</u>

Three TAARs introduced to deal with corporate capital losses and gains. A **GAAR** would cover these.

A substantial amount of existing legislation limiting the use of capital gains and losses is left in place. The TAARs are layered on top and take priority where they apply.

Source: Tax rules following legal form not economic substance: the technical nature of the group rules which can be manipulated to move into and out of chargeable gains groups but not economically move groups.
Drafting: the technical nature of previous gains/losses rules which in their detail and complexity feed the ability of those designing tax products.

<u>Section 74 – exception to bed and breakfasting</u>

Amendment following *Davies v. Hicks* 2005 STC 850 where UK trustees sold shares and then ceased to be resident prior to repurchasing the shares within 30 days. The bed-and-breakfast rules matched the UK trustees' disposal with the offshore trustees' acquisition, so no significant gain was made. The offshore trustees then realised the shares free of CGT. This section changes the rules so that the bed-and-breakfast rules do not apply where the person making the acquisition is not resident in the UK.

GAAR.

Source: The inadequacy of the bed-and-breakfast rules.

Section 75 – interest relief: film partnership

The schemes targeted by this measure typically required the whole of the investment in the film partnership to be funded by loan finance. The additional amount borrowed plus a higher interest rate charge to reflect the increased risk to the lender mean that the interest rate can be set at a level that ensures that the lease rental income is only sufficient to service the interest due on the loan. In this way, relief for the interest paid is enough to completely cover the income arising from the lease structure leaving no tax payable. The individual still needs to repay the loan taken out to invest in the film partnership. To do this, the individual invests capital in a second partnership that includes a partner (the corporate partner) that is outside the charge to UK tax. The individual invests approximately 25 for every 75 introduced by the corporate partner. The partnership then invests in a financial instrument that will generate a capital return sufficient to repay the loan used to invest in the film partnership.

Over the life of the instrument, income is shared in a ratio that disproportionately favours the corporate partner. This enables the corporate partner to recover its investment. When the capital from the instrument is recovered, the profit shares are reversed and the individual takes a disproportionate share of the proceeds free of tax and the individual has enough to repay the loan capital used to invest in the film partnership.

The legislation tackled these schemes by restricting the amount of interest relief that the individual can claim in respect of the loan used to invest in the film partnership.

GAAR.

Source: Income/Capital distinction.
The lack of limit on deductibility of interest.
Tax reliefs.

Section 76 – avoidance involving financial arrangements

The main categories of affected schemes are ones which:

- create contrived losses by the purchase and sale of the rights to distributions on shares. Not covered by a GAAR as the taxpayer could rely on specific exemptions.
  Source: Tax reliefs
- avoid tax on interest using stock lending or similar arrangements where interest is effectively swapped for tax-exempt income such as UK dividends. Not covered by a GAAR.
  Source: Tax reliefs
- rely on the definition of a loan relationship requiring a debt to be satisfied by payment of money. Schemes involve satisfaction, e.g. by issue of shares. Not covered by a GAAR. Relying on specific rules.
  Source: Tax rules following legal form not economic substance
- exploit accounting rules which result in profits on loan relationships being de-recognised. Not covered by a GAAR.
  Source: Accounting rules

- attempt to get around the 'shares as debt rules' using the 'outstanding third party obligations' and 'redeemable shares' conditions. Not covered by a GAAR: specific rules relied upon.
  Source: Tax rules following legal form not economic substance
- avoid tax on intra-group loans by passing value representing interest on the loan to a third group company in non-taxable form. That company in turn passes value to the lender but that value is not derived from a 'loan relationship'. **GAAR possibly**. Taxpayers would seek to rely on the definition of loan relationship but it would not take much to collapse this and get to the 'normal' transaction of lending money.
  Source: Tax rules following legal form not economic substance

Other changes include:

- Technical change to S100 FA 1996. Not covered by a GAAR.
  Source: Drafting
- Change to the 'fair value' definition arising because of mismatch between tax and accounting values. Not covered by a GAAR.
  Source: Drafting (not keeping up with accounting changes)

  Includes **1 TAAR**.

<u>Section 77 – treating intangible fixed assets as 'existing assets'</u>

Changes were made to counter schemes which had sought to bring assets into the intangibles rules in the FA 2002.

Not covered by a GAAR. The existing legislation was insufficiently clear.

Source: Drafting: when introducing a specific relief regime such as for intangibles, taxpayers will test any unclear boundaries.

<u>Section 78 – CFCs</u>

UK companies deemed Treaty non-resident were treated as CFCs from 1 April 2002, but this left the pre-1-April companies. This section picks those up.

Not covered by a GAAR: taxpayers could rely on a specific statutory limit.

Source: The limit of 1 April 2002 imposed by the original drafting.

<u>Section 79 – transfer of assets abroad</u>

The exemption from liability under SS739–740 was recast. The exemption applies broadly where the taxpayer can satisfy a motive test, but it is now made much more detailed and a more stringent test.

The taxpayer has to show that either:

(a) it would not be reasonable to draw the conclusion from all the circumstances of the case that the purpose of avoiding tax was the purpose or one of the purposes of the transactions; or

(b) all the relevant transactions were genuine commercial transactions and it would not be reasonable to draw the conclusion from all the circumstances of the case that one or more of those transactions was more than ‘incidentally designed’ to avoid tax.

Details of what is a commercial transaction are provided and the intentions of advisors are taken into account as well.

This is a form of **TAAR**. However, it would not be completely replaced by a GAAR. The evidential burden is different and the test, while overlapping, would not be the same.

<u>Section 80 – pre-owned assets</u>

A change to the rules and their interaction with settlement rules to block a loophole. Not covered by a GAAR. It was clear under previous legislation that the tax was avoided.

Source: The IHT system.

<u>Section 81 – leases of plant and machinery</u>

This includes **five TAARs**.

GAAR.

Source: Tax reliefs: capital allowances ‘reliefs’.

<u>Sections 82–85 and Schedule 10 – sale etc. of lessor companies</u>

These are provisions designed to counteract groups taking the tax relief from capital allowances in a lessor company and then avoiding taxation on profit by selling the lessor into a loss-making group; or by allocating profits/losses in a partnership to maximise tax benefit; or by selling the leased asset and retaining the income stream; or by using the S266 CAA 2001 election.

Not covered by a GAAR.

Source: Tax reliefs: capital allowances ‘reliefs’.

<u>Section 92 – avoidance using options</u>

In a complicated way going in and out of different bits of legislation, this is another step to counter the use of options to avoid tax and NICs. Retrospectively applies the charge. (S94 provides the PAYE mechanism for collecting the tax on the payments which are retrospectively taxable.)

GAAR.

Source: Tax rules following legal form not economic substance.

Section 117 – REITs: cancellation of tax advantage

A **TAAR** cancelling the tax advantage gained by a REIT where the Commissioners 'think' a company has tried to obtain a tax advantage (other than the basic REIT reliefs) for itself or another person.

GAAR – although note that the evidential burden is fairly low for HMRC and there is no bona fides exception/sole or main purpose test so a GAAR may not go as far.

Source: Tax-advantaged vehicles.

Section 156 and Schedule 20 – IHT and trusts

New rules for IHT treatment of trusts.

A structural change. Not covered by a GAAR.

Source: The IHT system.

Section 157 – purchase of interest in foreign trusts

UK-domiciled persons bought interests in overseas trusts from non-domiciliaries and used an exemption for such assets. This section changes the law to pick up purchases of such interests.

A structural change. Not covered by a GAAR.

Source: The IHT system.

Finance Act 2007

Section 25 – managed service companies

Seeks to deal with the inadequacies of the personal service companies' legislation and the application of IR35. The basic premise of receiving payment in one form rather than another would not always be dealt with by a GAAR, so while there are differing rates there would need to be detailed provisions like this as well.

Source: Tax rules following legal form not economic substance.
Employed/Self-employed distinction.
Differential tax rates.

Section 26 – restriction on trade loss relief for partners

Introduces a **TAAR** and a cap on the amount of partnership losses which can be set against other income.

With a **GAAR**, there would be no need for the TAAR but cap would remain.

Source: Tax reliefs.

Section 27 – extension of restrictions on allowable capital losses

This replaces the FA 2006 rules which countered the generation of artificial losses but were only applicable to corporates. It replaces them with a general capital gains tax provision applying to all taxpayers.

A widely drawn **TAAR** which appears to be relying on HMRC concessionary practice to exclude certain transactions which previously were considered acceptable tax planning, e.g. transfer of a loss-carrying asset from one spouse to the other with an asset to be disposed of at a gain (‘bed and spouse’).

GAAR.

Source: Tax reliefs.

Section 28 – restriction on expenses of management

Introducing a **TAAR** limiting the availability of a deduction for expenses of management.

GAAR.

Source: Tax reliefs.

Section 29 – life policies etc.: effect of rebated or reinvested commission

Designed to stop schemes where a short-term life policy is bought with a large premium, the cost of the premium being reduced by a large commission. The commission is effectively passed back to the policyholder but the policyholder claims no gain on maturity of the policy because of the premium excluding the commission. The commission now has to be included.

Could be dealt with by a **GAAR**.

Source: Tax rules following legal form not economic substance.

Section 30 – avoidance involving financial arrangements

1. Financial traders buy income which does not qualify as taxable (under S347(1)) and claim a deduction for buying the income stream. The section removes the exemption for the income.

   A structural change. Not covered by a GAAR. The transactions fell within an exception to existing legislation.

   Source: Tax rules following legal form not economic substance.

2. Stops use of the settlements rules by companies to avoid tax by relying on provisions that state that where a settlor is liable to tax in respect of a settlement, the company cannot be.

A structural change. Changes a specific exemption. Not covered by a GAAR. The transactions fell within an exception to existing legislation.

Source: Tax rules following legal form not economic substance.

3. Changes to structured finance rules introduced in 2006.

   An example where, because of the introduction of specific anti-avoidance rules, more rules then need to be introduced to deal with people relying on the specifics and using them in an unplanned manner.

   The specific changes to the rules are **potentially within a GAAR** but could the taxpayer argue that their transactions fell within an exception to or an exclusion from the existing anti-avoidance rules? It is therefore probably too uncertain for HMRC to rely on a GAAR here.

   Source: Definitional rather than purposive drafting.

4. Extension of a TAAR applying to manufactured payments.

   Not covered by a GAAR. The transactions fell within an exception to existing anti-avoidance legislation.

5. Co A grants Co B an option to acquire an asset. The option is exercised when Co A and Co B are members of the same CGT group. The group rules result in no gain/loss on the exercise of the option. The changes stop this.

   GAAR possibly.

   Source: Tax rules following legal form not economic substance.

6. Shares treated as loan relationships.

   Detailed amendments to FA 2006 rules regarding the treatment of certain shares as loan relationships.

   Source: Tax rules following legal form not economic substance.

7. Foreign exchange gains and losses.

   Changes to counteract a specific scheme which relies on a specific exclusion from the transfer pricing rules for exchange gains and losses.

   Would not be caught by the GAAR as the transactions fell within an exception to existing legislation.

8. Investments in collective investment schemes.

Rules were introduced to stop companies putting their loan relationships into collective investment schemes in order to benefit from their continued CGT treatment. The rules were then used to generate losses so a **TAAR** was introduced.

GAAR.

Source: Tax-advantaged vehicles.

9. Lease and finance leaseback of plant and machinery.

   Rentals would be paid up front on a lease and a deduction would be sought for the upfront payment. Taxation of the receipt was limited by S228D CAA. This changes S228D so that it no longer applies to lease and finance leaseback.

   Not covered by a GAAR: relying on a statutory limitation.

   Source: A tax relief.

10. Derivatives.

    Provides that derivatives treated as 'financial assets' are valued according to fair value accounting for tax purposes.

    Not covered by a GAAR.

    Source: Accounting.

11. Derivatives: connected parties.

    Anti-avoidance rules stopped connected parties abandoning options with large upfront premiums paid in order to move value from one value to another. Taxpayers had got around the rules which looked to abandonment by only partially exercising.

    GAAR possibly.

    Source: Drafting: definitional rather than purposive drafting.
    Tax rules following legal form not economic substance.

<u>Section 31 – companies carrying on business of leasing plant or machinery</u>

A schedule of changes to the FA 2006 rules for sales of lessor companies:

1. Counteracts mismatch in control/group tests in S343 TA 1988 and the FA 2006 rules.

   Not covered by a GAAR: relying on statutory differences.

   Source: Tax rules following legal form not economic substance: the mismatch in group rules.

2. Counteracts arrangements entered into to affect the balance-sheet value of assets and to take the company into and out of being a lessor company. Partially a **TAAR**.

   GAAR.

   Source: Tax reliefs: the capital allowances code.

Section 32 – restrictions on companies buying losses or gains

This stops a scheme involving the sale of a company which has incurred a gain or loss with a subsidiary. The subsidiary buys an asset with a gain or loss and the subsidiary is sold to realise the gain or loss.

GAAR.

Source: Tax rules following legal form not economic substance.

Section 33 – Lloyd's corporate members: restriction of group relief

This stops companies buying Lloyd's corporate members who are leaving the market, expecting heavy losses, in order to access their losses as group relief.

The **GAAR**'s application may be limited.

Source: The unusual tax and accounting treatment of Lloyd's underwriters.

Section 34 – employee benefit contributions

Restrictions on deductions for employee benefit contributions operate unless the benefit is paid within nine months from the end of the accounting period in taxable and NICable form. Employers were seeking to get around the wording of the restriction, which looked to payments made to third parties, by declaring a trust over assets held by the company.

Not covered by a GAAR. The action did not fall within the existing anti-avoidance rule, i.e. it falls to be treated as an exception.

Source: Drafting: inadequate drafting of the existing rules which could more easily limit employee benefit deductions to any deductions for any amounts where a taxable payment is made to employees.

Section 35 – schemes designed to increase double tax relief

This makes 'clear' that anti-avoidance rules dealing with claims for relief for 'foreign tax' include UK tax.

Not covered by a GAAR. It would be difficult to construe anti-avoidance legislation applying to 'foreign tax'.

Source: Specific anti-avoidance rules are construed narrowly.

Section 47 – sale and repurchase of securities

This introduces a wholesale revision of the repo rules based on GAAP accounting.

(Interestingly, this clause includes a purpose clause setting out the purpose of the rules.)

Includes a **TAAR**.

The same effect as the rewrite would not have been reached by a GAAR. The rewrite goes further and a GAAR would have faced problems with the layers of complexity and specific rules.

Source: Drafting: a mechanical and highly definitional set of rules which have been made increasingly complex by layers being added over time.

Section 48 – CFC rules

This includes a change to the public quotation rule, as disclosures had shown ‘abuse’ of the rule.

Not covered by a GAAR: relying on statutory limitation.

Section 71 – SDLT anti-avoidance

A **TAAR, but unusually drafted.** It sets out wide parameters:
(a) a ‘chargeable interest’ is disposed of by one person and acquired by another;
(b) there are a number of transactions involved with this;
(c) the SDLT is less than on a notional transfer of land.
It then sets out examples of what may be caught and what may not be caught. There is no tax motive test.

Would a GAAR effectively pick up the same avoidance transactions? The lack of any motive test means that this TAAR is wider than a GAAR.

Source: Most of the avoidance is generated by the differing SDLT rates for different assets.

Finance Act 2008

Section 24 and Schedule 7 – change in the remittance basis of taxation

This is a structural change in the law. Not covered by a GAAR.

Source: Tax reliefs.

Section 37 – trade profits: changes in trading stock

This ensures that GAAP accounting rules do not take precedence over tax rules in determining a company's taxable profit and ensures the transfer pricing rules can clearly apply.

Not covered by a GAAR.

Source: The differences between tax and accounting rules.

Section 41 – tax treatment of participants in offshore funds

A power is given to HM Treasury to make provision about the treatment of participants in offshore funds. Consultations on this are still progressing, but this power gives HM Treasury the power to respond by regulation to these anti-avoidance rules.

Not covered by a GAAR (although the contents of the regulations may to a certain extent be capable of being dealt with by a GAAR).

Source: Income/Capital distinction.

Section 55 and Schedule 20 – lease of plant and machinery

These provisions apply where plant and machinery are leased. They deal with mismatches between the tax of lease rentals paid and received, and the sale and finance leaseback of plant and machinery by entities not subject to tax, and they treat payments which were previously capital (for example, premiums) as income.

Not covered by a GAAR.

Source: Tax rules following legal form not economic substance.

Section 57 – double taxation relief

The credit for foreign tax on earnings is not to exceed the UK income tax on those earnings. This is a change following a decision in the courts.

Not covered by a GAAR.

Source: Foreign tax credit.

Section 58 – UK residents and foreign partnerships

Designed to counteract a scheme where income of a UK-resident individual is diverted to a foreign partnership of which the individual is a beneficiary.

GAAR.

Source: Tax Treaties.

Section 59 – UK residents and foreign enterprises

Those involved in the scheme which S58 seeks to counteract relied on the Business Profits Article in Double Tax Treaties. This section more generally aims to stop reliance being placed on that Article to prevent income of a UK resident being charged to UK income tax.

GAAR.

Sections 60 and 61 and Schedule 21– restrictions on loss relief for individuals

An annual limit of £25,000 is applied to sideways loss relief (relief for trading losses which can be set against other income) where the taxpayer is 'not active' in the trade and there is a **TAAR** providing that no relief is available where the loss arises from 'tax avoidance arrangements'.

A GAAR would pick up the TAAR but would not go as far as this set of provisions which set a limit on non-tax avoidance sideways relief of £25,000.

Source: Tax reliefs.

Section 62 – financial arrangements avoidance

A set of anti-avoidance measures:

1. Rent factoring of leases of plant or machinery – amendments to stop taxpayers relying on detail of existing anti-avoidance legislation which seeks to tax the sale of an income stream as income and not capital.

2. Provisions designed to counteract schemes relying on legislation to claim credit for foreign tax which is not in fact paid.

3. A **TAAR** designed to stop taxpayers relying on the avoidance provisions which tax interest as a distribution where there are arrangements with a tax advantage main purpose.

4. **Two TAARs** to stop taxpayers with the 'relevant tax avoidance' intention avoiding tax by disposing of loan relationship rights for consideration which is not recognised by accounting practice.

5. Picking up on loopholes in previous anti-avoidance rules categorising shares as debt in certain circumstances and dealing with investments in shares which are designed to generate losses or to produce interest-like returns.

6. **Two TAARs** designed to counteract other schemes involving partnerships and the rules as to what is taxed as income or capital to produce an interest-like return where there are arrangements with a tax advantage main purpose.

7. Stopping tax benefits arising from intra-group financing where convertible securities are issued which have a mismatch in tax treatment between debtor and creditor.

8. Amending the scope of what returns from derivative contracts are taxed as income and doing so by extending the income treatment to all producing interest-like returns.

9. Counteracting schemes where an interest-bearing loan is taken out, the interest payments are accelerated and the loan is repaid but it is a smaller amount repaid as the loan no longer carries interest.

The TAARs, and possibly (7) and (9) above, could be dealt with by a **GAAR** but the other changes are to detailed rules and/or seek to alter the distinctions between income and capital which previously operated in the tax system.

Source: Income/Capital distinction.
Tax rules following legal form not economic substance.
Drafting.
Foreign tax credit system.

<u>Section 63 and Schedule 23 – manufactured payments</u>

Four TAARs designed to block disclosed avoidance schemes where individuals make manufactured payments to reduce their taxable income without suffering an economic loss. They apply to arrangements with an income tax advantage as a main purpose.

GAAR.

Source: Tax rules following legal form not economic substance.

<u>Section 64 – CFCs</u>

Changes to stop the rules being circumvented by the use of trusts or partnerships.

A GAAR would not have as wide application.

Source: Tax rules following legal form not economic substance.

<u>Section 65 – intangible fixed assets: related parties</u>

A definitional change.

Not covered by a GAAR.

<u>Section 87 – phasing out of industrial buildings allowance: anti-avoidance</u>

A provision designed to prevent avoidance arising from the transitional arrangements for phasing out of the allowances.

Not covered by a GAAR.

Source: Tax reliefs.

<u>Section 89 – balancing allowances on transfer of trade</u>

A **TAAR** to stop capital allowances benefits being obtained on the transfer of a trade where there is a scheme or arrangement with a main purpose of obtaining a balancing allowance.

GAAR.

Source: Tax reliefs.

<u>Section 90 – pensions: spreading of relief on indirect contributions</u>

A **TAAR** designed to stop employers obtaining deductions for payments which would have been denied if the payments had been made directly to a pension scheme.

GAAR.

Source: Tax rules following legal form not economic substance.

<u>Section 91 – inheritance of tax-relieved pension savings</u>

Rule changes to prevent pensions and lifetime annuities being used to avoid inheritance tax.

Not covered by a GAAR.

Source: IHT rules.

<u>Section 95 – charge where consideration includes rent: 0% band</u>

This alters the thresholds for different rates to apply so as to ‘prevent manipulation in order to minimize or avoid SDLT’.

Not covered by a GAAR.

Source: Differential rates.

<u>Section 96 – withdrawal of group relief</u>

Legislation to deal with one of the holes in the SDLT group relief clawback rules.

Not covered by a GAAR.

Source: Tax reliefs.

Section 155 – alternative property finance: anti-avoidance

This **TAAR** seeks to stop an exemption for a particular form of finance, whereby the lender would acquire the property from the borrower, and then put the property in a subsidiary which could then be sold with stamp duty only payable at the lower shares rate. The TAAR looks to arrangements for a person to acquire control of the subsidiary.

Not covered by a GAAR.

Source: Differential tax (stamp duty) rates.

A summary of the review

Finance Act	GAAR	TAARs	Income/ Capital distinction	Legal form[a]	Drafting	Foreign tax credit system	Residence rules	Tax-advantaged vehicles	IHT system	Tax reliefs	Tax-advantaged employment incentives	Employed/ Self-employed distinction	Differential tax rates	Tax Treaties	Misc.[b]
F(No2)A 1997	4	2		8						11					
FA1998	4		7	3	4	2	3	3	2	4					6
FA1999	7	2	3	2	3			2	1	3					3
FA2000	10		1	11[c]	2	1	1			3	2	1	3	1	1
FA2001	2			2		1				1					
FA2002	8	6	6	7	1		1	1	1	1			2		4
FA2003	4	2	3	8	1		1		1	2					2
FA2004	5	3	3	6			1		2	2			1		4
FA2005	2	2				4				5					2
F(No2)A 2005	15	14	1	8	4		2			1					5
FA2006	17	13	1	7	5			1	3	11		1			5
FA2007	10	7		9	4			1		5		1	2		6
FA2008	16	13	2	16	2	2			1	5			2	1	3

[a]Short form of 'Tax rules following legal form not economic substance'.
[b]Picks up any changes not dealt with under the other sources.
[c]The large number was caused by the large number of stamp duty changes.

Notes:
This type of analysis could be cut in many ways. Here the changes are counted by reference to each change and not by section numbers or pages of legislation. So, for example, the replacement of stamp duty on land with SDLT took 88 sections but this is counted as one change. In other cases, one general section provides for a schedule with a raft of different changes, each of which is counted.
In some cases, a GAAR may cover the main anti-avoidance mischief that the legislation is aimed at but the legislation goes much further. In these cases, the legislation is counted as arising from avoidance that could have been dealt with by the GAAR. Where a provision has more than one source, it is counted under both sources.

Appendix E

A summary of the techniques used to counter tax avoidance in other jurisdictions

Australia

E.1 Australia has adopted a multifaceted approach to tackling avoidance:

(a) the use of GAARs;

(b) the use of TAARs;

(c) the introduction of legislation containing penalties imposed on promoters of 'tax exploitation schemes';

(d) the development of rules regarding the approach of the revenue authorities to compliant and non-compliant taxpayers; and

(e) the drafting of legislation according to 'coherent principles'.

E.2 Australia and New Zealand have a long history of using GAARs. The earliest income tax one was included in an income tax act in 1900[127] and there are earlier examples in the estate duty statutes.

E.3 The main provision operating in Australia is a GAAR in Part IVA of the Income Tax Assessment Act 1936, which has operated since 1981. However, it appears to be seen as a weapon of last resort. In order for it to apply, the following must hold:

(a) There must be a scheme, which is very broadly defined.

(b) A taxpayer must obtain a 'tax benefit' in connection with the scheme.

(c) Having regard to eight listed factors, it would be concluded that any person who entered into or carried out the scheme (or any part of the scheme) did so for the sole or dominant purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme. The eight factors are:

(i) the manner in which the scheme was implemented;

(ii) its form and substance;

(iii) the timing of the scheme;

(iv) the result that would be achieved by the scheme but for Part IVA;

(v) any change in the financial position of the relevant taxpayer arising out of the scheme;

(vi) any change in the financial position of any other person;

[127] Land and Income Tax Assessment Act 1900 (New Zealand).

(vii) any other consequences for the taxpayer or any other person connected with the scheme;

(viii) the nature of the connection between or amongst parties to the scheme.

E.4 To determine the tax benefit and purpose, the legislation requires the question 'What would have happened if the scheme had not been entered into?' to be answered. If the GAAR applies, the tax benefit may be cancelled. There is no clearance procedure and while a taxpayer may apply for a private ruling for a particular transaction, the Australian Tax Office (ATO) will reply in general terms warning that the GAAR may apply.

E.5 In terms of success, one measure is the results of court cases. The High Court has heard four cases, of which three were lost by the taxpayer (one only partially lost).[128] Many more cases have been heard by the lower courts, with the decisions generally going in the revenue authority's favour. It appears that the GAAR has proved to be a useful weapon for the revenue authorities. However, there is much criticism in Australia of the uncertainty regarding the application of the GAAR. One commentator lists various areas of uncertainty, including some fairly fundamental ones such as the role of legislatively permitted choices and the extent to which a tax benefit may be attributable to the making of a choice.[129] In response to the uncertainty concerns, the ATO released a series of publications in December 2005 designed to outline its approach to the use of GAARs, but as in the UK, this Revenue guidance cannot be relied upon by taxpayers to determine whether a transaction is caught by the GAAR.

E.6 The TAARs introduced in Australia have been both the narrowly focused provisions and the much wider sort seen in the UK. As in the UK, they have provoked the criticism of causing too much complexity, being too reactive and giving rise to more avoidance often as a result of the intricate weaving of the provisions and the holes that result.

E.7 The promoter penalty legislation was introduced in 2006. Some commentators suggested that there was a real risk of straightforward tax planning advice being caught.

E.8 The annual ATO Compliance Plan setting out how it will deal with compliant and non-compliant taxpayers is similar to the approach being put forward by HMRC described in Section 10 in this paper. The results of this are not yet clear.

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[128] *FC of T v. Peabody* (1994) 181 CLR 359; *FCT v. Spotless Services Ltd* (1996) 186 CLR 404; *FCT v. Consolidated Press Holding Ltd* [2001] HCA 32; *FCT v. Hart* [2004] HCA 26.

[129] T. Pagone, 'Part IVA – the voyage continues', *The Tax Specialist*, 2006, vol. 10, no. 1.

E.9 It is interesting to note that Australia does not have a disclosure regime akin to that adopted in the UK.

E.10 However, Australia has attempted to use a new approach to the drafting of tax legislation in order to deal with the problem of tax avoidance seeking to rely on the inadequacies of the legislation. The approach has been called the 'coherent principles' approach. It is described in a paper by Greg Pinder from the Australian Government Treasury.[130] He explains that in 1998 the Australian government made a commitment to use general principles in preference to long and detailed provisions. A principle is defined by him as 'a statement about an intended outcome in a general field'. Carve-outs and add-ons may be needed to deal with general situations which it is not intended should be covered. It is recognised that in some circumstances specific detailed rules about the application of the 'principle' will be needed and Pinder indicates that this can be by way of a note in the legislation or by secondary legislation, but more generally will be by an explanatory memorandum that accompanies a Bill into Parliament. Under Sections 15AA and 15AB of the Acts Interpretation Act 1901, courts can rely on such 'extrinsic material' where the interpretation of a particular provision is otherwise unclear.

E.11 In addition, the tax authorities may publish rulings and interpretative material.

> 'In many situations ATO interpretations or actions create informal law, in that practitioners and their clients accept ATO practices or rulings without formal challenge, and structure their affairs accordingly. To this extent, bureaucratic rules are elevated into an informal source of tax "law". The ATO has made this type of "law" more formal by requiring its tax officers to search for, identify and follow "ATO precedential tax views", that is, "a settled ATO view" of the interpretation of the law on particular issues as determined by a Tax Counsel or relevant Centre of Expertise. Taxpayers following such precedential views are "protected" administratively from liability. ATO rulings are in an unusual situation, because since 1 July 1992 relevant ATO rulings are statutorily binding in the sense that a taxpayer relying upon an appropriate and relevant ruling is protected by statute from penalty or other adverse action by the ATO. Thus, under the "self assessment" system, these rulings have moved closer to "formal" law.'[131]

There is some concern at the level of discretion given to the ATO.

E.12 This could be said to come back to the problem that an approach such as this is a way of moving the complexity from one location – the statutes – to another location – tax authority guidance, with all the issues that raises as described above. This is, in part, recognised by Pinder, who says that the aim is not to move the detail but to remove it, but who recognises that this requires a major

[130] G. Pinder, *The Coherent Principles Approach to Tax Law Design*, The Treasury, Australian Government, 2005 (http://www.treasury.gov.au/documents/987/HTML/docshell.asp?URL=07_coherent_principles.asp).

[131] Page 52 of R. Woellner, S. Barkoczy, S. Murphy and C. Evans, *Australian Taxation Law*, 18th edition, CCH, Sydney.

change in approach both by the tax authorities and by the taxpayers and their advisors. It is queried whether this is a realistic prospect. Taxpayers look for certainty in the taxation of their affairs and this position is unlikely to change at least for as long as penalties for non-compliance exist, as they surely will.

New Zealand

E.13 New Zealand has employed both TAARs and GAARs in its battle against tax avoidance. As in Australia, there is a long history of GAARs in New Zealand. Currently, there is an income tax one found in Sections BG1 and GB1 of the Income Tax Act. At its heart, a 'tax avoidance arrangement' is required. An 'arrangement' is widely defined and 'tax avoidance' is defined to include: directly or indirectly altering the incidence of income tax; directly or indirectly relieving a person from liability to pay income tax or from a prospective or potential liability to future income tax; directly or indirectly avoiding, postponing or reducing any liability to income tax or any potential or prospective liability to income tax.

E.14 While the GAAR has been invoked successfully by the tax authorities, the recent case of *Peterson v. CIR*[132] has raised many questions about the efficacy of its use by the tax authorities. That was a decision by the Privy Council, and, following that case, the New Zealand Supreme Court has become the final Court of Appeal in New Zealand. The approach of the New Zealand Supreme Court is not yet wholly clear.

E.15 In 1998, the New Zealand government appointed a Committee of Experts on Tax Compliance to report on how the tax system should be developed, particularly with regard to dealing with tax avoidance.[133] One of the main recommendations of that Committee was to broaden the tax base and lower the variability of tax rates.[134] There has been no major base broadening but there have been regular maintenance and improvement amendments. However, the company and trust rates and the maximum individual rates have been decoupled and this has led to a considerable amount of income splitting. In addition, several new incentives have been introduced which have increased 'tax planning'.

E.16 The Income Tax Act 1994 includes provisions that may have had the potential to lead to a more purposive construction of tax statutes than previously adopted by the New Zealand courts. The provisions state:

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[132](2005) UKPC5.

[133]*Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance*.

[134]See paragraph 6.32 of the Report.

‘**AA 1 Purposes of Act**
AA 1 The main purposes of this Act are
(a) to impose tax on income;
(b) to impose obligations in respect of tax;
(c) to set out rules to be used to calculate the tax and to satisfy the obligations imposed.

‘**AA 3 Interpretation**
AA 3(1) The meaning of a provision of this Act is found by reading the words in context and, particularly, in light of the purpose provisions, the core provisions and the way in which the Act is organised.’

E.17 The effectiveness of this wording was called into question by the Committee of Experts and has proven to be minimal.

Canada

E.18 Canada relies on TAARs, both widely drawn and specific, and a GAAR to counteract avoidance.[135] The GAAR was introduced in 1987 as a response to a case[136] that rejected the concept of a business purpose test being read into the tax rules. The GAAR has been considered by the courts in around 30 cases.

E.19 In brief, it provides that the tax benefit arising from an avoidance transaction may be denied. An avoidance transaction is one that would result directly or indirectly in a tax benefit. A tax benefit is a reduction, avoidance or deferral of tax or an increase in the refund of tax.

E.20 Various problems have arisen with the Canadian tax authority using the GAAR in the courts. These problems have given rise to apparently contradictory results, and the effectiveness of the GAAR has consequently been seriously questioned.[137] In addition, practitioners are saying that their task of deciding what is and what is not acceptable is almost impossible now.

E.21 Apart from relying upon the legislative aids of TAARs and the GAAR, the Canadian Revenue Authority (CRA) states that it combats tax avoidance by:

‘• adapting the way we audit to include reviews for potential tax avoidance issues
• monitoring tax avoidance trends – for example, the CRA now reviews 100% of all tax shelters;
• ensuring timely communications to CRA auditors so they are kept up-to-date about tax avoidance strategies people are using; and

[135] Section 245 Income Tax Act.

[136] *Stubart Investments Limited v. The Queen* [1984] CTC 294.

[137] See, for example, B. Arnold, ‘Confusion worse confounded: the Supreme Court’s GAAR decisions’, *Canadian Tax Journal*, 2006, vol. 54, pp. 167–209.

- consulting the Department of Finance on legislative changes related to abusive tax avoidance strategies that are being used.'[138]

E.22 This is clearly therefore a less responsive approach than that adopted by countries using an avoidance disclosure regime, such as the UK. Many would argue that with a GAAR, there is less need for piecemeal reaction to avoidance, although this position is itself questionable when the GAAR has become so uncertain in its application.

South Africa

E.23 South Africa has had a GAAR since 1941, but case law effectively resulted in the provision having little effect. In 2005, this was recognised and a year's consultation produced significant amendments to the GAAR and other elements of the South African anti-avoidance approach.

E.24 Dealing first with the GAAR itself, the GAAR is based on the following:

(a) there has to be a scheme;

(b) the effect of the scheme must be to obtain a tax benefit;

(c) the sole or main purpose of the scheme must be to obtain a tax benefit; and

(d) certain abnormal rights or obligations or abnormal means or manner must have been adopted.

The changes resulted in some interesting new terminology. First, the legislation talks of 'impermissible avoidance arrangements', recognising that some avoidance is legitimate. Second, two further alternatives were added to the abnormality test. The first is that in a business context, the arrangement 'lacks commercial substance'; and the second is that the arrangement results in the misuse or abuse of the provisions of the Act.

E.25 The term 'lacks commercial substance' is defined to mean that the arrangement would result in a significant tax benefit for a party, but the arrangement does not have a significant effect upon either the business risks or net cash flows of that party. The legislation proceeds to give a list of indications where this lack of commercial substance may exist.

E.26 The other points that are important to note are that:

(a) the South African Revenue Service issued a general binding ruling as to its interpretation of the GAAR;

(b) a new advance tax ruling system was introduced;

[138] See the CRA website at http://www.cra-arc.gc.ca/gncy/lrt/vvw-eng.html.

(c) a central committee was introduced to decide when the GAAR would be applied in order to seek consistency;

(d) some of the deficiencies in the tax system that had been seen as a source for many avoidance methods were dealt with, although many key ones (such as a lack of corporate group relief) remain.

E.27 In addition to the GAAR reform, South Africa also has ‘reportable arrangements’ legislation, which picks up on arrangements that may be caught by the GAAR but also goes further in seeking disclosure of tax avoidance schemes generally in a way similar to the UK disclosure rules.

E.28 However, there is not yet evidence that all these changes have adequately dealt with the problem of tax avoidance in South Africa.

The Netherlands

E.29 The approach of the Netherlands is quite different. There is a ‘sham’ doctrine which enables sham transactions to be ignored. This is similar to, but distinct from, the ‘abuse of law’ doctrine. The Netherlands also has two other law-based approaches to avoidance and also, more recently, a practical approach to the management of the relationship with certain taxpayers.

E.30 The law-based approaches are a statute-based anti-avoidance rule, called ‘richtige heffing’, and a case-based concept known as ‘fraus legis’. The richtige heffing was introduced in the 1930s but is quite narrowly defined. It requires that a transaction has no other purpose than to save tax and that it is in conflict with the purpose and spirit of the law. As a result, it has fallen out of use.

E.31 Fraus legis means that the person has acted contrary to the intention of the law even though they have complied with the letter of the law. In order for it to apply, the avoidance of tax must be the only or paramount motive for the transaction and there must be a conflict with the intention and purpose of the law. Once applied, the judges may decide to ignore the tax avoidance transaction or replace it with other transactions if that would better fit with the purpose of the law.

E.32 The practical approach takes the HMRC proposals in the UK for taxpayer relationship management to another level. Since 2005, the Dutch tax authorities have entered into ‘enforcement covenants’ with certain multinationals. Currently, there are more than 40 who have concluded these agreements. The Dutch tax authorities agree to reduce their supervision of the taxpayer’s affairs and in return the taxpayer agrees to report tax risks. The taxpayer must be recognised as compliant for this option to be offered to them. The taxpayer effectively agrees to abide by not only the letter of the law but also its spirit and has to be seen to be paying a fair share of tax. A multinational with its tax burden reduced to nil would not be viewed as suitable for this approach.

E.33 This is an extract from the 2006 Annual Report of one Dutch multinational (Nutreco, which sells animal feeds):

> 'Tax (horizontal supervision)
>
> 'In January 2006 Nutreco Holding N.V. concluded an enforcement covenant with the Dutch tax authorities as part of the "horizontal supervision" project initiated by the Dutch Ministry of Finance on the basis of which existing cooperation was further enhanced. The starting points of the covenant are openness and transparency, based on mutual respect and trust, resulting in an intensive exchange of information and preliminary consultations on matters with potentially material tax consequences.
>
> 'During 2006, under the covenant, agreement was reached on the Dutch tax position up to and including the fiscal year 2005 and the final tax assessments for any outstanding years up to and including 2005 were imposed accordingly.
>
> 'With regard to 2006, any relevant tax matters were raised – and agreement was reached – at pre-consultation sessions. As a result, any uncertainties concerning the Dutch tax position have been reduced to a minimum.
>
> 'This form of collaboration fits within Nutreco's policy on risk management in respect of taxation and is partly made possible by a constant focus on the level and quality of the internal control framework in the area of taxation, which is also included in the collaboration under the covenant.'

Germany

E.34 Underlying German civil law is the doctrine of 'Rechtsmissbrauch' (abuse of law or rights). In the context of taxation, the German equivalent of a GAAR is Section 42 of the Federal Code of Tax Procedures, which disallows the tax effect of any transactions that constitute an abuse of law or rights. The section provides for the taxpayer to be taxed according to the economic substance of the transaction. It provides that:

> '(1) The tax law may not be circumvented by an abuse of possible legal arrangements. If there is such an abuse, the taxpayer shall be taxed as if he had chosen an adequate legal arrangement.'

E.35 The legislation does not specify what constitutes an abuse. This has been determined by the courts. The test of inadequacy is whether an independent person would have entered into the same transaction in the same circumstances. If it is inadequate, the arrangement must also result in a lower tax cost than an adequate transaction.

E.36 However, the section can only be applied if the inadequate arrangement does not have a main purpose which justifies it as being reasonable and if it can be shown that the transaction was chosen with the intention of reducing tax. Despite these hurdles, the section has been successfully applied.

E.37 However, in a case concerning the use of a Dublin Docks company,[139] the Federal Fiscal Court declined to apply Section 42 because of the existence of the German CFC regime. The court decided that this was the appropriate legislation to counteract the use of a company in a low-tax jurisdiction, and for Section 42 to be invoked, the company would need to have been little more than a letter-box company. The company concerned had in fact carried on very little activity: its sole purpose was to invest the capital payments received from its German parent but it did have a board of directors who met in Ireland and decided its investment strategy.

E.38 So, despite the high hurdle for the German authorities, the test has been applied successfully, but this approach is more indicative of the use of an abuse-of-law-type test than of other possible anti-avoidance approaches.

[139]BFH, 19 January 2000, IR 94/97, DStR 2000, 511.