

General Anti-Avoidance Rules (GAARs) – Experience of the UK in introducing a statutory anti-abuse rule

Judith Freedman, Pinsent Masons Professor of Tax Law, Oxford University and Oxford Centre
for Business Taxation, Tokyo September 2014

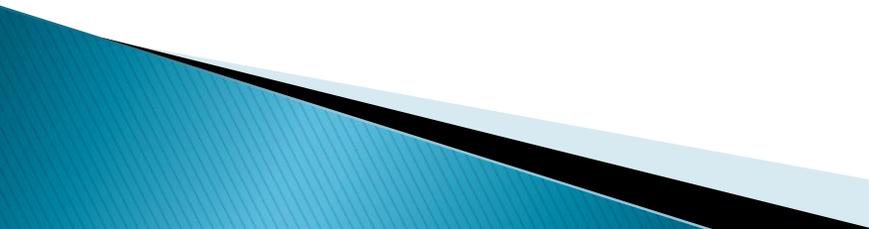
Tax avoidance concepts

- ▶ Not dealing here with evasion
 - ▶ Not dealing with avoidance that can be defeated under specific provisions.
 - ▶ Need to see the GAAR as one of many tools, in wider context.
 - ▶ Relationship with BEPS– Action 6 Sept 2014 paper
 - ▶ Tax policy making, drafting, disclosure .
- 

General background

- Complexity and imperfections of international and domestic tax systems: BEPS
 - Increased mobility of profits
 - Global Financial Crisis/austerity– ‘tax gap’ concerns
 - Increasing media interest
 - NGO’s interest in taxation and corporate social responsibility pressures
 - But balance pressure for competitiveness and growth.
- 

GAARS worldwide

- ▶ Most common law countries have a GAAR, many for some time– including Australia, New Zealand, Hong Kong, South Africa, Kenya
 - ▶ These vary substantially
 - ▶ India plans to introduce GAAR in 2015
 - ▶ Many civil law countries have abuse of rights and/or a GAAR
 - ▶ EU has Halifax principle– abuse of law
 - ▶ USA – largely judicial rule until recent codification of economic substance
 - ▶ Japan– DAAR, but otherwise literal approach?
- 

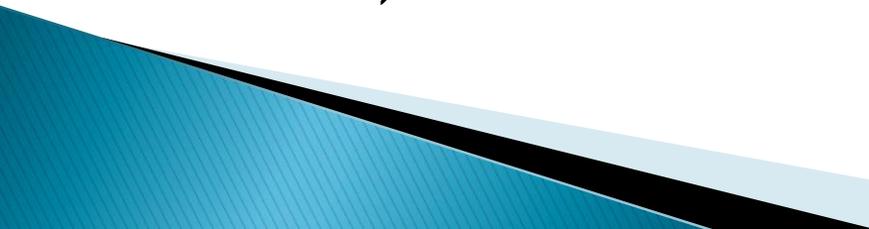
UK – history

- GAAR rejected after consideration in 1998
- Coalition Agreement 2010 includes review of GAAR
- Government appoints Graham Aaronson QC to lead study group. (Members of study group include three judges (one retired– Lord Hoffmann), two academics (including JF) and one tax director (BP))
- JF speaking here in personal capacity
- Aaronson GAAR study November 2011– report and illustrative draft clauses
- **Proposes ‘moderate rule targeted at abusive arrangements but not applying to reasonable tax planning’ NOT a broad spectrum anti-avoidance rule**

Further developments

- Draft clauses drawn up by Parliamentary draftsman—publication June 2012 and revised Dec 2012 following consultation
- Interim panel appointed under Graham Aaronson as Chair to consider draft guidance
- Third version of legislation published in Finance Bill March 2013 for enactment in June 2013. Now in force for transactions entered into after that date. Guidance published April 2013
- Permanent panel chair appointed 28 March 2013— Mr Patrick Mears retired solicitor. Further 7 members appointed June 2013 (one has since ‘resigned’)

Legal position in UK prior to 2013

- No statutory general anti-avoidance rule
 - No general abuse of law doctrine
 - No clear judicial anti-avoidance doctrine (see next slides)
 - No penalties for avoidance (unless negligence or fraud)
 - No general statutory clearance (binding rulings) system (but some in individual cases)
 - Disclosure requirements
 - Restrictive rules of evidence in court
 - Detailed method of legislating (not principles based)
- 

UK 'solutions' (pre- 2013 and continuing)

- Disclosure of Tax Avoidance Schemes –DOTAS– legislation in Finance Act 2004 as amended
 - Disclosure provisions for selected transactions– hallmarks etc
 - By promoter within 5 days of making scheme available
- Specific provisions.
- Over 300 'targeted anti-avoidance rules' (TAARs)– subjective –'main purpose or one of main purposes of the arrangements is to secure a tax advantage'– linked with other conditions related to specific legislation.
- 'Voluntary' methods–
 - Tax law in the boardroom
 - Risk rating/co-operative compliance with business
 - Bank Code.

UK case law – the judicial doctrine

- *W.T. Ramsay Ltd. V IRC* [1981] as elaborated in subsequent case law to late 1990s – a judicial principle?
 - Pre-ordained series of transactions (may or may not have legitimate commercial end overall)
 - Inserted steps with no commercial purpose other than the avoidance of tax
 - No practical likelihood that the events would not take place in the order ordained
 - Pre-ordained events do take effect

Judicial doctrine rejected – only ‘interpretation’?

- *Barclays Mercantile Finance Ltd v Mawson* [2004] (BMBF)
 - *Ramsay* case did not introduce a new doctrine specific to revenue statutes but rescued tax law from ‘island of literal interpretation’
 - ‘Going too far’ to say that transactions or elements of transactions with no commercial purpose should always be disregarded.
- ▶ But same day, same court – *IRC v Scottish Provident*
 - applies ‘*Ramsay*’ principle to have regard to ‘series of transactions intended to have a commercial unity’

A very special rule of interpretation

- *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] Hong Kong case cited in BMBF) per Ribeiro PJ:

“The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.”

- Normal interpretation ?
- Stretched or strained interpretation?
- OR judicial doctrine?

Uncertainty under case law

- *HMRC v Tower MCashback LLP* 1 [2011] decided in favour of HMRC
 - Special Commissioner and Supreme Court decide against taxpayer BUT High Court and Court of Appeal judges would have found for taxpayer
- *Mayes* CA 2011 decided in favour of taxpayer–
 - ‘The Ramsay principle does not allow legal events to be deprived of their legal or fiscal effects simply because they are inserted for a tax saving purpose or can be described as ‘unreal’ or ‘artificial’
 - Toulson LJ concurs but it ‘instinctively seems wrong, because it bears no relation to commercial reality and results in a windfall which Parliament cannot have foreseen or intended’

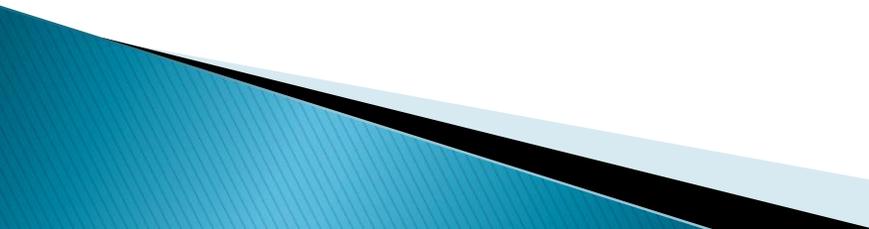
Aaronson Report 2011

- Judges inevitably are faced with the temptation to stretch the interpretation, so far as possible, to achieve a sensible result; and this is widely regarded as producing considerable uncertainty in predicting the outcome of such disputes. In practice this uncertainty spreads from the highly abusive cases into the centre ground of responsible tax planning. **A GAAR specifically targeted at abusive schemes would help reduce the risk of stretched interpretation and the uncertainty which this entails.**
- 

Issues encountered in design of GAAR I

- Aid to purposive interpretation or overriding principle?
 - Drawing the line between legitimate planning and or abuse– finding intention of legislature.
 - Burden of proof
 - Role of factors such as commerciality, “economic substance”, artificiality, business purpose.
 - Response to deliberate tax incentives
- 

Issues encountered in design of GAAR II

- Objective or subjective tests?
 - The counterfactual (avoid Australian problem?– now amended in Australia)
 - Relationship with specific provisions in domestic legislation
 - Decisions of Court of Justice of the European Union
 - Relationship with Double Taxation Agreements
- 

Key features of GAAR in UK

- Substantive overriding provision– not just interpretation
- Targets only ‘abuse’ not avoidance.
- Non–exhaustive indicators of abuse
- Objective double reasonableness test
- Burden of proof on HMRC to show abusive and counteraction just and reasonable (clarification in guidance?)
- Rules of evidence
- Advisory Panel
- Guidance – not in statute but referred to in statute
- Scope– all but VAT (EU law)
- Intended to override DTAs– express in legislation

Excursus: interaction with DTAs

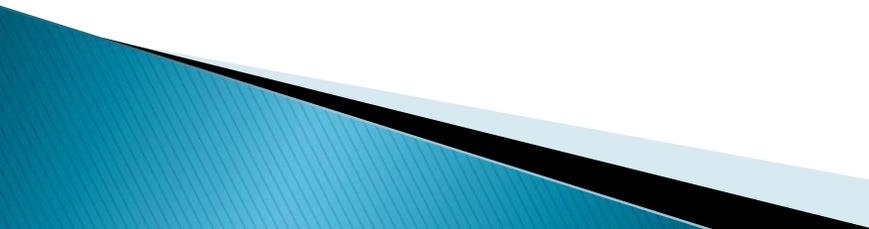
- ▶ OECD Commentary to Art.1 (2010 version) – added 2003
- ▶ 22. Other forms of abuse of tax treaties (e.g. the use of a base company) and possible ways to deal with them, including “substance-over-form”, “economic substance” and **general anti-abuse rules have also been analysed, particularly as**
- ▶ concerns the question of whether these rules conflict with tax treaties, which is the second question mentioned in paragraph 9.1 above.

OECD Commentary cont.

22.1 Such rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability; these rules are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule and having regard to paragraph 9.5, there will be no conflict. For example, to the extent that the application of the rules referred to in paragraph 22 results in a recharacterisation of income or in a redetermination of the taxpayer who is considered to derive such income, the provisions of the Convention will be applied taking into account these changes.

22.2 Whilst these rules do not conflict with tax conventions, there is agreement that member countries should carefully observe the specific obligations enshrined in tax treaties to relieve double taxation as long as there is no clear evidence that the treaties are being abused.

Action 6 report Sept 2014

- ▶ Revised commentary will make clear that rules found in domestic case law will have an impact on how treaty provisions are applied rather than producing conflicting results. Thus GAAR and judicial anti avoidance doctrines will not conflict with treaty in vast majority of cases.
 - ▶ In addition – recommends adding Principal Purposes of transaction or arrangements test to Treaties (PPT)
- 

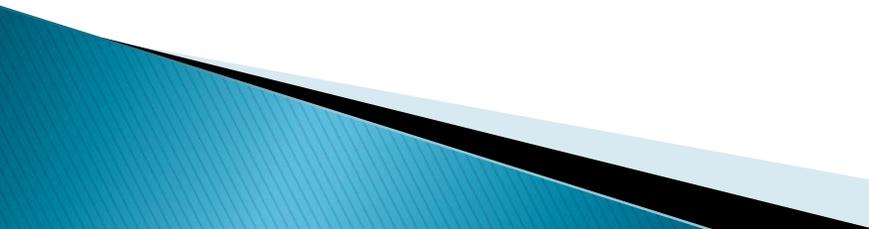
Back to UK– Rules of evidence

- Court MUST take into account
 - HMRC GAAR guidance as approved by the GAAR Advisory panel at the time the arrangements were entered into
 - Opinion of Advisory Panel about arrangements
- Court MAY take into account
 - ministerial, HMRC and other material in the public domain at time arrangements entered into.
 - Evidence of established practice at time of arrangement

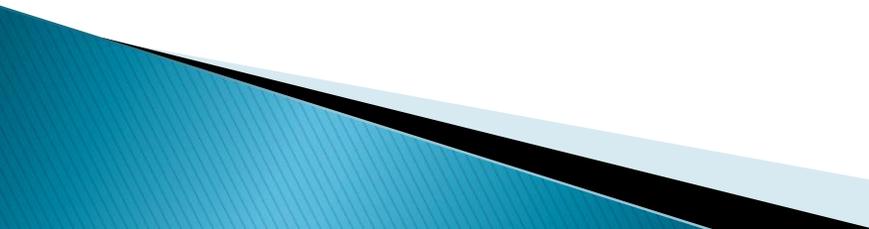
Not included in proposal

- No subjective element – objective test only but narrow –no need for subjective protection
 - No advance rulings provisions– why?
 - Narrowness of test
 - Administrative and compliance burden
 - Large corporate taxpayers have informal means of discussing issues (enhanced relationship)
 - Guidance not contained in statute (but must be taken into account by Court).
- 

The Advisory Panel (AP)

- HMRC not represented on AP but appoints Chair
 - HMRC designated officer must give notice to taxpayer of GAAR being applied
 - Taxpayer has 45 days to respond
 - If case to continue must then go to AP
 - Chair of AP appoints sub-panel to give opinion on whether the arrangements are a reasonable course of action or not, or whether they cannot reach a view.
 - Anonymised general reports of opinions to be published?
- 

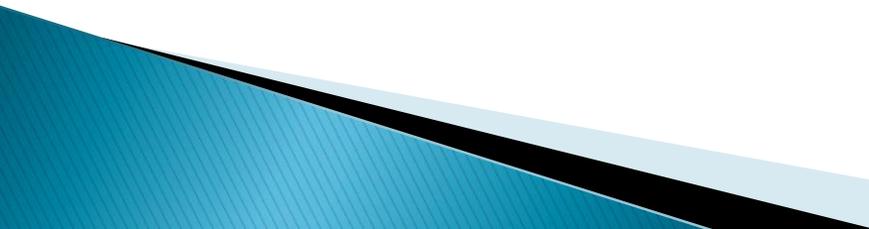
Process of drafting the GAAR

- Study Group
 - Consultation (or lobbying?)
 - Rule or principle?
 - Political debates and confusion of different forms of avoidance leading to unrealistic expectations?
 - Agreeing the guidance – interim panel.
 - Appointment of Chair and Panel
- 

Effects of GAAR

- Deterrence– routine or weapon of last resort?
- (nb no other rules have been removed, including case law– but some new provisions considered and not introduced)
- Should reduce need for retrospective legislation and/or strengthen argument against it (cf *Barclays* case 2012)
- Might be used to impose penalties or downsides– eg accelerated payments 2014 Finance Act
- Should increase the case for underlying principled legislation. GAAR only works if taxpayer not acting reasonably having regard to policy objectives of provisions of Taxes Acts.

Limitations of GAAR: what is tax avoidance?

- GAAR can make effective avoidance ineffective and fill obvious gaps, but cannot reform underlying faults in domestic and international tax system design.
 - Thus cannot operate well if policy of underlying legislation unclear or poor.
 - Does GAAR increase uncertainty for law abiding business? UK GAAR design and panel seeks to limit this. May eventually decrease uncertainty due to Panel rulings
- 

Limitations of GAAR– needs administrative framework that can sustain it.

- Still requires detection and enforcement
- Requires courts to apply and uphold so is it better than judicial approach?
 - Yes, added legitimacy and administrative framework and protection
- Is there too much discretion in courts and in revenue authority?
 - Depends on administrative and other frameworks provided so may depend on legal system into which it is inserted.
- need to ensure there is sufficient downside–penalties?

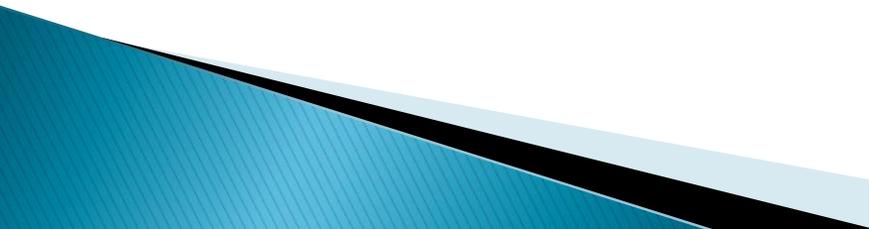
European Commission Recommendation on aggressive tax planning

- Non binding recommendation of 6/12/2012
- Members states should adopt a general anti abuse rule as follows
 - An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance.'

Both too wide and too narrow?

Follows CJ case law, influenced by UK law and other MS law and in turn influences them.

Conclusions

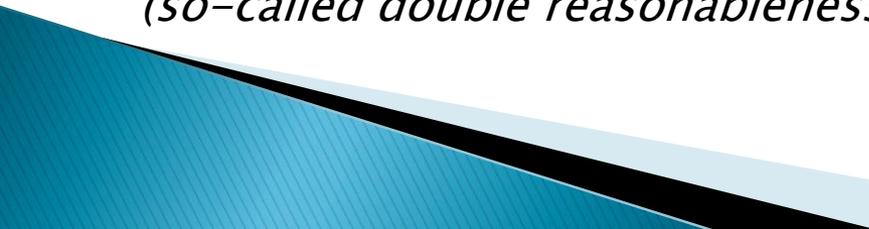
- GAARS are designed to deal with extreme schemes where specific legislation simply results in cat and mouse game.
 - Need to be objective tests
 - GAARs require administrative framework so that any uncertainty can be managed within the rule of law. How this can be done depends on existing institutions, resources and mutual trust levels.
 - Properly drafted and managed they give administrators and courts another important tool and added legitimacy
 - GAARS are not appropriate mechanism for rewriting domestic or international tax law to change the tax base originally envisaged, retrospectively or at all.
- 

2013 Finance Act

207 Meaning of “tax arrangements” and “abusive”

(1) Arrangements are “tax arrangements” if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements

207 cont– non exhaustive definition of abusive

- (2) Tax arrangements are “abusive” if they are arrangements the entering into or carrying out of which cannot **reasonably** be regarded as a **reasonable** course of action in relation to the relevant tax provisions, having regard to all the circumstances including—
- (a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,
 - (b) whether the means of achieving those results involves one or more contrived or abnormal steps, and
 - (c) whether the arrangements are intended to exploit any shortcomings in those provisions.
- (3) Where the tax arrangements form part of any other arrangements regard must also be had to those other arrangements
(so-called double reasonableness test)
- 

207 cont –non exhaustive indicators

- (4) Each of the following is an example of something which might indicate that tax arrangements are abusive—
- (a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,
 - (b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and
 - (c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid,
- but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.
- 

207 cont –non exhaustive indicators

- (4) Each of the following is an example of something which might indicate that tax arrangements are abusive—
- (a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,
 - (b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and
 - (c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid,
- but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.
- 

Selected sources and references

- Aaronson Study (2011) http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf
- J Freedman, '[Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle](#)' (2004) *British Tax Review* 332
- J Freedman, '[Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament](#)' (2007) 123 *Law Quarterly Review* 53
- Devereux, Freedman and Vella, *Tax Avoidance*, http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/TA_3_12_12.pdf
- J. Freedman Creating new UK institutions for tax governance and policy making :progress or confusion? [2013] BTR 373
- J. Freedman, Designing a General Anti-abuse Rule: Striking a Balance [2014] IBFD Asia-Pacific Tax Bulletin 165