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General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World?

The UK GAAR

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Abstract
This book chapter discusses the background to the UK General Anti-Avoidance Rule, analyses the wording of the legislation and looks at its relationship with double taxation treaties and EU and OECD developments

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General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World?

The UK GAAR **Professor Judith Freedman, Oxford University** [1]

1. **GAARs – an emerging trend in the tax landscape and in the political debate of many countries**

Introduction

For many years the UK has been an outlier in a world of statutory general anti-avoidance rules (GAARS). Despite having been instrumental in the enactment of GAARs in many of its former colonies, it had not had not seen the need to introduce any such legislation in the UK itself. In addition, for a long time the judicial approach to statutory interpretation in tax cases was a somewhat literal one.

During the 19980's, this literal approach was relaxed to some extent, especially in cases which involved circular schemes, and it was thought that the UK courts were creating a judicial anti-avoidance doctrine or approach, sometimes known as the *Ramsay* approach after the case in which it was originally enunciated.[2] The so called 'new approach' did at first appear to be a success in creating a deterrent to the more artificial forms of tax avoidance schemes that had been marketed prior to the *Ramsay* decision, but subsequent decisions arguably reduced the doctrine to a rule of statutory interpretation that resulted in uncertainty and was sometimes ineffective. Following criticism and concerns about inconsistency and unpredictability, the UK finally introduced a type of statutory GAAR in the Finance Act 2013 (FA 13). The report that proposed this development is known as the Aaronson Report after its

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[2] *W.T. Ramsay Ltd v. IRC* [1982] AC 300

author, Graham Aaronson QC.[3] The Aaronson Report rejected the appellation 'avoidance' and instead called the rule a "general anti-abuse rule". Conveniently, this is also a GAAR and for the purposes of this chapter, the term GAAR will be used to embrace both a general anti-avoidance rule and anti-abuse rules in the sense used in the UK statute unless otherwise stated. The supposed difference between the two will be discussed below, but the chapter proceeds on the basis that "avoidance" in the extended sense in which that word is now being used in the media and political discussion is almost impossible to define so as to give a viable operational rule. The UK GAAR, therefore, covers a defined area of egregious abuse and not everything that might be described as avoidance in recent popular discourse.

The UK GAAR and the BEPS Action Plan

The introduction of a GAAR in the UK was under discussion well before the OECD's Base Erosion and Profit Shifting (BEPS) report was commissioned and published (as will be shown below), but in the minds of politicians, the press and some commentators, the two developments have tended to become conflated. As a result there has been criticism of the UK GAAR by some commentators because it does not prevent profit shifting and base erosion of the type being discussed at the OECD in the context of BEPS. The answer to this criticism is that a GAAR cannot solve underlying structural issues of the type being tackled at an international level. It was never suggested by its proponents that it could. That means that it is limited in scope, but it may nevertheless be a valuable tool for the taxing authority, provided its role is properly understood.

Given that it is very new and was finely balanced, it is highly unlikely that the wording of the UK GAAR would be changed as a result of the BEPS Action Plan or any of the ensuing reports.

Development of the judicial 'Ramsay' principle into a rule of statutory interpretation

An early UK view on interpretation in tax cases, which lasted throughout much of the 20th century, can be found in the seminal *Duke of Westminster* case [4] where Lord Tomlin stated that

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[3] G. Aaronson, *GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system*, (London: November 2011) (Aaronson Report) produced at the request of the UK Government. Available at http://webarchive.nationalarchives.gov.uk/20130605083650/http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf (accessed 13/08/2014) (Aaronson Report).

[4] *IRC v Duke of Westminster* [l936] A.C. l; 19 TC 490

‘It is said that in revenue cases there is a doctrine that the Court may ignore the legal position and regard what is called 'the substance of the matter'...The sooner the supposed doctrine [is] given its quietus, the better it will be for all concerned for the doctrine seems to involve substituting "the uncertain and crooked cord of discretion" for "the golden and streight metwand of the law". Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however, unappreciative the IRC or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax’.

Even when this case was first decided, this did not mean that the courts would not investigate the *legal* substance of the case. For example, the courts at the time of the Duke of Westminster’s case would not be satisfied by mere labels that did not represent the actual position. They were not, however, interested in arguments about *economic* as opposed to *legal s*ubstance.

This position became problematic as more tax schemes were built on the foundations of this approach and by the 1970s an intensive tax avoidance industry had grown up, selling highly artificial “off the shelf” schemes, which often involved money going round in circles. The courts began to change their approach in a series of cases, notably a decision of the UK’s highest court at that time, the House of Lords, in the case if *W.T. Ramsay v. IRC*.[5] The decision in this case was known as the “the new approach”. This was elaborated in subsequent case law, which took various twists and turns. Initially, the case law appeared to be creating a judicial rule that: where there was a pre-ordained series of transactions with inserted steps with no commercial purpose other than the avoidance of tax and no practical likelihood that the events would not take place in the order ordained, the courts could view the scheme as a whole and tax on the basis of the overall result.[6]

This position began to be strained, however. Taxpayers started to rely on the precise wording of the so-called judicial rule as if it were a legislative rule and argued that not all the conditions were satisfied for the rule to apply. Taxpayers won some important cases on the

[5] For more complete surveys of this area and the relevant cases and arguments see Freedman BTR supra n. 1, and. Freedman, LQR supra n. 1. The new approach did not overrule the *Duke of Westminster (1936)* discussed above, but it did limit its application. The account set out here is necessarily simplified due to space constraints and the focus of this article.

[6] This judicial ‘rule’ was fully set out in *Furniss v. Dawson* [1984] A.C. 474.

basis that the scheme was not fully pre-ordained, for example.[7] The courts began to review their approach and assert that there was not, and never had been, a judicial rule. The so-called 'Ramsay principle' is now said to be merely a form of statutory interpretation.[8] This is an approach to construction where:

> *The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically*.[9] (The *Arrowtown* test.)

Arguably this goes beyond a normal rule of statutory interpretation, but this is debated. In some cases, the judiciary take this to be an invitation to apply a purposive form of construction and even to reach a result which may involve some stretching of the wording.[10] In other cases, where they find it hard to discern a clear purpose to which to give effect, and particularly where a detailed statutory code applies, the courts find in favour of the taxpayer.[11] The simple fact that a scheme is tax motivated is not sufficient to bring it within this special principle of statutory interpretation if the words themselves do not permit this. [12] Whilst this judicial approach has been used to combat some forms of tax avoidance, it is uncertain and not wholly reliable. It depends upon a sympathetic court being prepared to stretch the wording of legislation to its limits.

There is no general concept of abuse of rights in the UK.[13] The use of purposive interpretation has been developing in non tax areas of the law for longer than it has in tax law and increasingly so as a result of the influence of cases decided by the Court of Justice of the European Communities (CJ). There is now no reason to suppose that interpretation in tax cases should be out of line with this development: the question is whether the so-called *Ramsay* principle is purely an application of ordinary principles of statutory interpretation or whether the *Arrowtown* test adds another layer to it that is unique to tax cases. In the view of

[7] For example, *Craven v. White* [1989] A.C. *398 (*HL*)*
[8] For example, *IRC v. McGuckian* [1997] STC 908 (HL) and *MacNiven v. Westmoreland*. [2001] UKHL 6. The leading case on this is *Barclays Mercantile Business Finance Ltd v. Mawson* [2004] UKHL 51.
[9] This formulation, taken from the Hong Kong case, *Collector of Stamp Revenue v.Arrowtown Assets Ltd* [2003] HKCFA 46, has now been accepted by the UK courts as summarising the position reached in the UK case law as it has evolved from the *Ramsay* case onwards.
[10] For example, *Tower MCashback LLP1 v. HMRC* [2011] UKSC 19. See comments in *Aaronson Report supra* n.3 at para. 3.13.
[11] *Mayes v. HMRC* [2011] EWCA 407.
[12] *DB Group Services(UK) Limited v. HMRC*; *HMRC* v. *UBS AG* [2014] EWCA 452.
[13] Vinelott J, *Bayliss v Gregory* [1986] STC 22 Ch.D at p43.

this author it should be the former, but the desire of some of the judges to combat tax avoidance sometimes converts it into something more. This is not, however, a consistent application, so something more is needed to deal with the most extreme forms of abuse of tax legislation.

Introduction of a statutory GAAR

The UK tax system has a considerable volume of specific anti-avoidance legislation. It is one of the longest sets of tax legislation in the world and is very detailed in nature, being rule based rather than building on principles. The system contains both very specific provisions and what have come to be known as TAARS or 'targeted anti-avoidance rules. These TAARs relates to particular areas of law but may be quite wide and general within that area. Examples are considered below. Despite this, the detailed rules in the tax legislation have led to considerable amount of 'creative compliance' [14] using those rules and, as described above, the courts have not been able to stop this due to the very specific nature of such rules.

A proposal was put forward in 1998 to introduce a statutory GAAR, but this was rejected after some discussion.[15] Partly this was because no wording could be agreed that was as flexible and acceptable as the judicial language, and partly because it was considered by the representatives of taxpayers that an advance clearance procedure was essential, whereas the revenue authority did not consider it had the resources to provide such a service, nor did it wish to do so as a matter of principle. The view was that scarce revenue authority staff should not spend their time advising taxpayers attempting to implement schemes.

Nevertheless, there continued to be considerable concern in the UK at the perceived number of highly complex artificial and often aggressive tax schemes being carried out. Whilst the UK has extensive advance disclosure provisions as discussed below, the disclosed schemes still require legislation to combat them and retrospective legislation brings its own

[14] D. McBarnet and C. Whelan, *The Elusive Sprit of the Law: Formalism and the Struggle for Legal Control* (1991) 54 MLR. 848.

[15] The history can be traced in Tax Law Review Committee (TLRC) *Tax Avoidance* (IFS, 1997): available at http://www.ifs.org.uk/comms/comm64.pdf (accessed 14/08/2014) ; Inland Revenue, *A General Anti-Avoidance Rule for Direct Taxes* (London: Inland Revenue, 1998) available at http://www.hmrc.gov.uk/consult/consult_1.htm (accessed 14/08/2014) and TLRC ,*A General Anti-avoidance Rule for Direct Taxes: Response to Inland Revenue 's Consultative Document* (IFS, 1999) available at http://www.ifs.org.uk/comms/comm77.pdf (accessed 14/08/2014)

difficulties. Only a GAAR can deal with an aggressive scheme that has already taken place where the underlying legislation and any specific anti-avoidance provisions do not cover the position under normal rules of interpretation.

In 2011, the new coalition government in the UK agreed to set up a study group under the leadership of a leading tax barrister, Graham Aaronson QC, to investigate whether the UK should have a GAAR. The Government may have anticipated that the business and professional communities would reject the idea once again, but in fact the Aaronson Report recommended a moderate, targeted anti-abuse rule. The use of the word 'abuse' rather than the word 'avoidance' was important to underline the moderate nature of the rule proposed. It will be referred to here as a GAAR, however. The study group comprised a business representative, two academics (including the author of this chapter), and three judges, led by Mr Aaronson QC himself.[16] The Aaronson Report notes that the study had business and professional backing. Both groups wanted a level playing field for those who did not want to engage in 'contrived and artificial' schemes.[17] In addition to deterring such schemes and providing a level playing field, the Aaronson Report considered that a GAAR of the kind proposed would reduce uncertainty surrounding the case law and the need to stretch statutory interpretation; that it would reduce the need for specific remedial legislation in the future; and that it might even eventually lead to the possibility of simplification of existing legislation by the removal of anti-avoidance provisions rendered unnecessary by the GAAR. Further the report suggested that the proposed GAAR process might inform the public debate on tax avoidance, and help to clarify the boundaries between 'acceptable' and 'unacceptable' behaviours.

The Government consulted[18] on the Aaronson Report and there was broad support from business and the professions, although there has been some criticism from these groups of the detailed wording of the legislation and some of the administrative arrangements. There were

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[16] The full list of members was John Bartlett (Group Head of Tax, BP plc) , Sir Launcelot Henderson (Judge of the Chancery Division of the High Court of Justice) , The Rt. Hon. Lord Hoffmann (formerly Lord of Appeal, Non-Permanent Judge of the Court of Final Appeal of Hong Kong) , Howard Nolan (formerly Tax Partner at Slaughter & May, part time Judge of the First-Tier Tribunal (Tax Chamber)), John Tiley QC (Hon) (Emeritus Professor of the Law of Taxation, Cambridge University), and the author of this article. The resulting Aaronson Report (supra n.3) was that of Mr Aaronson alone. The analysis was supported by the group except that the judges were required to maintain strict neutrality as to whether a GAAR should be introduced or not.

[17] *Supra* n 3, para. 1.7(ii).

[18] For details of the consultation and the consultation papers, see http://www.hmrc.gov.uk/avoidance/gaar.htm. (accessed 14/08/2014).

also more fundamental and familiar criticisms, suggesting on the one hand that GAARs create uncertainty and that the reliance on guidance is undesirable and on the other that this moderate GAAR did not go far enough.[19] The consultation period included an important phase during which an interim GAAR Panel was set up to advise and approve extensive extra-statutory guidance.[20]

The Government introduced the GAAR in the FA 13 and it came into force in July 2013.[21] It applies only to tax arrangements entered into on or after the day on which the FA13 was passed. Thus the UK GAAR has no retrospective effect which is an important feature in terms of the rule of law, but one which means that there is little likelihood of litigation on the provisions in the near future.

The UK GAAR applies to income tax; corporation tax; capital gains tax; petroleum revenue tax; inheritance tax; stamp duty land tax, and the new annual tax on enveloped dwellings and it was extended to social security contributions by the National Insurance Contributions Act 2014, but it does not apply to VAT. VAT has been left to be dealt with under the case law being evolved by the CJ in the *Halifax* case and those that have followed.[22] The rationale for this was to ensure that there would not be conflicting law applying to any transaction.[23] The UK GAAR is considered to be more clearly targeted than the *Halifax* principle. It was suggested in some quarters that one single rule would be preferable; indeed some in the UK were arguing strongly for the use of the *Halifax* principle[24] as a universal GAAR for tax in

[19]See, for example, P. Mason, *No GAAR without GADR* Tax Adviser 28 May 2013 ; M. Gammie, *Moral Taxation, Immoral Avoidance- What Role for the Law?*, [2013] BTR p. 577 (2013); R. Murphy The General ant-abuse rule si a step in the right direction but we have a long way to go available at http://www.taxresearch.org.uk/Blog/2013/04/16/the-general-anti-abuse-rule-is-a-step-in-the-right-direction-but-we-have-a-long-way-to-go-to-het-the-attack-on-tax-avoidance-right/ (accessed 14/08/2014); *The Deficiencies in the General Anti-Abuse Rule* TUC available at http://www.tuc.org.uk/sites/default/files/GAAR.pdf (accessed 14/08/2014) .
[20] Various versions of the guidance can be found at http://www.hmrc.gov.uk/avoidance/gaar.htm (accessed 14/08/2014)
[21] In sections 206-15 Finance Act 2013. The full wording can be found at http://www.legislation.gov.uk/ukpga/201/29/part/5/enacted (accessed 14/08/2014)
[22] The '*Halifax*' principle as modified by subsequent cases: *Halifax plc v Commissioners of Customs & Excise*, Case C-255/02, [2006] ECR I-1609.
[23] Aaronson Report fn 3 above para 1.9
[24] *Halifax*, Case C-255/02, *supra* n 23.

the EU,[25] but this idea did not prevail due to the widely held belief in the UK that UK direct tax law is an area that is not subject to EU tax law.[26]

2. **Requirements for the application of GAARs**

As explained above, the UK GAAR has been designed to be a moderate, targeted GAAR. What follows is taken from the legislation and the published guidance (the Guidance). There have been no cases taken to the courts on the basis of the GAAR as yet, given how new the legislation is and the fact that it is not retrospective, so any examples, even those given in the Guidance are, to a degree, speculative.

Definitions and the double reasonableness test

The moderate targeted approach can be seen in the "**double reasonableness test**" which forms the centre piece of the UK GAAR legislation. The structure of the provision is logical if a little cumbersome. It is necessary to work through this step by step to appreciate the nature of the proviso.

Section 209, FA 13 provides that if there are **tax arrangements** that are **abusive**, the tax advantages that would arise from the arrangements are to be counteracted by the making of adjustments. 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.[27] The words 'it would be reasonable to conclude' show that the main purpose test is an objective one.[28] It was considered that a sole purposes test would have been too easy to manipulate: it is almost

[25] "The prospect of a multiplicity of GAARs for different taxes in different countries creating a fiscal version of the Tower of Babel is too terrible to contemplate": G. Sinfield, *The Halifax principle as a universal GAAR for tax in the EU*, [2011] BTR 235.

[26] This is despite the application the *Halifax* principle in *Cadbury Schweppes plc v Commissioners of Inland Revenue*, Case C-196/04, [2006] ECR I- 7995. The issue in the latter case is of a somewhat different nature. See J. Freedman, *The Anatomy of Tax Avoidance Counteraction: Abuse of Law in a Tax Context at Member State and European Union Level ch, 25* in *Prohibition of Abuse of Law*, (R. De la Feria and S. Vogenauer , eds. Hart, 2011).

[27] S207 (1) FA 13.

[28] *Guidance approved 15 April 2013* para C3.3 available at http://www.hmrc.gov.uk/avoidance/gaar.htm (accessed 14/08/2014).

always possible for a well advised taxpayer to construct some commercial purpose alongside the tax purpose.

Tax advantage is defined as including (a) relief or increased relief from tax; (b) repayment or increased repayment of tax; (c) avoidance or reduction of a charge to tax or an assessment to tax; (d) avoidance of a possible assessment to tax; (e) deferral of a payment of tax or advancement of a repayment of tax, and (f) avoidance of an obligation to deduct or account for tax.[29]

Subsection 207 (2) FA 13 defines tax arrangements as **"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 some that are listed as examples. This is the central 'double reasonableness' test. It is seeking to provide a norm of "acceptability". It is not for the judge (or the GAAR Panel) to decide what they think would have been reasonable but for them to decide what could have been reasonably regarded as reasonable. For this reason there are special rules of evidence as to what can be considered in evaluating this, as discussed below.

The circumstances to which the court must have regard include:-

"(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." [30]

Section 207 (2) provides that if the tax arrangements form part of any other arrangements, regard must also be had to those other arrangements. It then goes on to catalogue some indicators that tax arrangements might be abusive in a non-exhaustive list, being:-

- the arrangements result in an amount of income, profits or gains, or deductions or losses for tax purposes that are significantly less or greater than the amount for economic purposes,

[29] S208 FA 13.
[30] S 207 (2) FA13.

- 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.

Each case is subject to the qualification that arrangements are abusive “only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted”.[31] So economic substance might be relevant as a factor that could override form, but in limited circumstances; not a general rule. We might even call this a triple reasonableness test.

Rules of evidence, the GAAR Advisory Panel and statutorily recognised guidance.

In determining abusiveness, reasonableness is something to be judged in the light of established practice. Thus the section provides explicitly that “the fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive.”[32]

Further evidential rules can be found in the legislation. UK courts do not normally need to deal with issues of this nature and so novel rules are required. These new style rules of evidence also refer to the innovative solutions created to manage the discretion inherent in a GAAR, even a moderate one. First, the legislation creates a GAAR Advisory Panel (the GAAR Panel).[33] Secondly, it refers expressly to and gives a role to extra-statutory guidance relating to the GAAR.

The original idea for the UK GAAR Panel came from the Australian Panel, which was set up to create an expert group to assist the tax office with decision making about the application of the Australian GAAR and to ensure consistency. It has external advisers, but is essentially an internal mechanism.[34] The Aaronson study group intended that the UK GAAR Panel should play a similar role to that of the Australian one, but during the consultation period in the UK there was a shift towards a panel that was more independent of the revenue

[31] S 207 (4) FA13.
[32] S 207 (5) FA13
[33] Details of the Panel and other procedural aspects of the UK GAAR can be found in Schedule 43 to the FA2013 available at http://www.legislation.gov.uk/ukpga/2013/29/schedule/43/enacted (accessed 15/08/2014) with guidance in *Guidance PART E—GAAR procedure* available at http://www.hmrc.gov.uk/avoidance/gaar.htm (accessed 14/08/2014).
[34] T.Pagone, The Australian GAAR Panel, Lecture delivered at the Oxford University Centre for Business Taxation Conference, London (10 February 2012) available at http://www.austlii.edu.au/au/journals/VicJSchol/2012/2.pdf (accessed 14/08/2014).

authority, so that the UK version has no representative of HMRC as a member. This shift seems to have been based on a misunderstanding amongst consultees about the intended role of the Panel as a forum for discussion about the line between abusive and non-abusive tax mitigation. The Panel is now independent to an extent, but the members are still appointed by the tax authority. This might not have mattered under the original plans, but given that the Panel is now stated to be independent it looks unsatisfactory and leaves the status of the Panel unclear and open to criticism.[35] The Panel is intended to represent a spread of interests including business, tax advisers and wider taxpayer interests, although how well these groups are currently represented is open to question. The attempt to make the Panel more independent, without making it fully so, has led to calls for further change. Arguably, it would have been preferable had it retained the role originally intended for it by the Aaronson study group.

The role of the Panel under the legislation as it stands is primarily to consider whether the entering into and carrying out of the tax arrangements in question was a reasonable course of action as defined in the GAAR legislation.[36] In effect, as described below, all GAAR cases must be put to the Panel if they are to proceed and this is a very important safeguard. The Panel process is stated by the Guidance not to be judicial in nature,[37] though this could be disputed and there could be pressure for moves towards a more judicial status, or even just a drift in that direction. In addition the Panel has the task of advising on the Guidance and keeping it up to date. It may be some time before the role of the Panel is comprehensively worked out, but potentially it has an important part to play in ensuring that there is good oversight of the implementation of the GAAR and a measure of control over the application of the GAAR by HMRC.

Section 211 FA13 provides that, in determining any issue in connection with the GAAR, a court or tribunal must take into account the Guidance about the general anti-abuse rule that was approved by the GAAR Advisory Panel at the time the tax arrangements were entered into, and any opinion of the GAAR Advisory Panel about the arrangements. The court or tribunal may take into account guidance, statements or other material (whether of HMRC, a Minister of the Crown or anyone else) that was in the public domain at the time the

[35] Discussed further at J. Freedman, *Creating new UK institutions for tax governance and policy making: progress or confusion,* [2013] BTR, p. 373
[36] Schedule 43 FA 13.
[37] *Guidance, PART E, supra* n. 33 at para. 4.2.9.

arrangements were entered into as well as evidence of established practice at that time. This gives the opinion of the GAAR Panel and the extra statutory guidance, which the Panel must approve, a weight that goes beyond that of other forms of HMRC guidance. Normally, HMRC guidance is enforceable only in cases of judicial review and only in so far as it can be said to have give rise to legitimate expectations. [38] Generally guidance is not evidence as to the correct interpretation of the law. In the case of the GAAR Guidance, however, the guidance must be taken into account. It is still not binding and can be changed by HMRC and the Panel, but will be hard to counteract when it comes to the court deciding what was reasonable on the part of the taxpayer, so that it comes very close to attaining legislative weight.

The provision permitting the court to take into account statements of Ministers and other materials in addition to the Guidance is important and unusual in the UK. Generally there are severe restrictions on the extent to which reports and especially statements in Parliament are permitted to be taken into account, so this is a novel provision.[39]

In cases where HMRC seeks to apply the GAAR, the burden of proof will be squarely on HMRC to show that the tax arrangements are abusive.[40] Taking this together with the role of the Panel and the double reasonableness test, the legislation provides considerable safeguards against over-active use of the GAAR.

Disclosure rules and the GAAR

The UK has had extensive rules requiring disclosure of certain types of arrangement since 2004 well before it had a GAAR.[41] This Disclosure of Tax Avoidance Schemes regime (DOTAS) can apply to arrangements that would not fall foul of the GAAR or indeed any anti-avoidance provisions, so it is not dependent on the GAAR in any way. DOTAS is seen as having been very successful and is unlikely to be narrowed to fit in with the GAAR criteria.

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[38] Judith Freedman and John Vella *HMRC's Management of the U.K. Tax System: The Boundaries of Legitimate Discretion* in C. Evans, J. Freedman, R. Krever *The Delicate Balance: Tax, Discretion and the Rule of Law* (IBFD 2011).

[39] The UK rules on statutory interpretation permit some note to be taken of materials in ascertaining the purpose of the legislation in a limited way, but parliamentary statements are not normally permitted as evidence of parliamentary intention. There is an exception in certain cases where the legislation is ambiguous or obscure or leads to an absurdity, when some clear statements in Parliament may be looked at under the exception in *Pepper v. Hart* [1993] AC 593 (HL). This exception has not been used frequently.

[40] S 211 (1) FA13

[41] The primary legislation is Finance Act 2004, Part 7 (s.306 to s.319) (as amended).

One interesting development is that the GAAR may be used to trigger other powers. An example is an important new power under the Finance Act 2014 for HMRC to require payment before a dispute is resolved in certain cases.[42] One specified type of case where this applies is where HMRC issues a GAAR counteraction notice in relation to a tax advantage and at least two members of the Panel conclude that entering into the arrangements was not a reasonable course of action. If an accelerated payment notice is issued in such a case, payment of any tax must be made even if an appeal is in process, givng HMRC a clear cash flow and tactical advantage. We may see further use of the GAAR as a trigger for other provisions to come into play in the future.

GAAR and the Rule of Law

The UK has no written constitution, but this does not make the rule of law issues any less significant than they are elsewhere, though opportunities for challenge on this basis may be less obviously available. The question of whether the GAAR as drafted satisfies the rule of law has been widely discussed. The safeguards provided and discussed above have largely satisfied practitioners and business people, though some believe it is too uncertain.[43] Much will depend upon the way in which the Panel and courts apply and interpret the Act in the future.

Examples of application of the GAAR

With no cases decided or even brought to the Panel as yet, the only examples that can be provided are those set out in the Guidance. These have not yet been tested by the courts, but, given that the court may take the Guidance into account, the examples are significant. They are also extensive: section D of the Guidance note is 136 pages long.[44] The Guidance relies on decided cases under the pre GAAR law and fact situations revealed under the DOTAS legislation to show where the dividing line would be drawn. Thus the case of *BMBF v. Mawson*,[45] which was not defeated by the so-called *Ramsay* principle, would not be caught by the new GAAR either because

[42] Sections 219-229 and Schedule 32 Finance Act 2014.
[43] See for example, Mason (2013); Gammie (2013) *supra* n. 19.
[44] *Guidance Part D.*
[45] BMBF (2005).

"There was nothing in the capital allowances legislation at the time that required anything other than capital expenditure to be incurred on equipment and ownership (or in certain cases deemed ownership) to be the result. It was clear that economic ownership was not required; and tax-based leasing was very well established. "[46]

Part D of the Guidance also covers the case of *Mayes*,[47] as being a case where the GAAR *would* affect the outcome. Here there was an arrangement designed to exploit shortcomings in the relevant provisions and the purposive approach to statutory construction did not prevent a result which Parliament could not have contemplated when enacting the relevant provisions. This would be defeated under the GAAR because

"The taxpayer sustained no economic loss beyond the fees for the scheme, which consisted of abnormal and contrived transactions, including circular and self-cancelling steps. All of the transactions were created solely for tax reasons with a view to the generation of the tax loss. The scheme could not reasonably be regarded as a reasonable course of action and the GAAR would apply. ...
In the circumstances the just and reasonable counteraction would be to treat the taxpayer as having entered into an arrangement with the scheme provider with no tax consequences (or as having entered into no arrangement)."[48]

Which of these two counteraction approaches was used would depend ultimately on the court in all the circumstances. There are many further examples along the same lines, dealing with fact situations, whether the GAAR would apply and, if so, what the counteraction would be as will be discussed further below.

3. Applying GAARs : process and legal consequences

Opinion of the Panel on reasonableness and application of counteraction powers

Section 209 of FA 13 provides that if there are tax arrangements that are abusive, the tax advantages that would arise from the arrangements are to be counteracted by the making of

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[46] Guidance Part D, para D 7.6.1
[47] *Mayes v. HMRC* [2011] EWCA Civ 407
[48] *Guidance Part D* paras D.15.6-7

adjustments. The adjustments to be made “are such as are just and reasonable”. These adjustments can relate to the tax in question or any other tax to which the general anti-abuse rule applies. Any such adjustments have effect for all purposes.

Potentially this gives enormous discretion to revenue officials, but once again the GAAR Panel is intended to provide protection.[49] Only a designated HMRC officer can apply the GAAR in order to maintain a level of central control. Where such an officer considers that a tax advantage has arisen to a taxpayer from tax arrangements that are abusive, he or she can give the taxpayer written notice that the advantage ought to be counteracted.

The notice must give full details of the counteraction that the officer considers ought to be taken, and may set out steps that the taxpayer may take to avoid the proposed counteraction. The taxpayer then has 45 days to make written representations to the designated HMRC officer in response. If no representations are made, a designated HMRC officer must refer the matter to the GAAR Advisory Panel and, if representations are made, a designated HMRC officer must consider them. If he then still considers that the tax advantage ought to be counteracted under section 209, the officer must refer the matter to the GAAR Advisory Panel. The legislation provides for the information that must be provided to the Panel and the taxpayer at this stage. The taxpayer then has 21 days to respond in writing, but no opportunity to appear before the Panel.

The GAAR Panel Chairman appoints a sub- panel of three members of the overall Panel, which must produce a joint opinion notice or separate opinion notices if they cannot agree. It is important to note the limits of this opinion: it is not a complete adjudication. The Panel is directed to assume that the arrangements are tax arrangements as defined. The opinion notice covers whether or not the entering into and carrying out of the tax arrangements is a reasonable course of action in relation to the relevant tax provisions having regard to all the circumstances as directed by the legislation and also the reasons for that opinion. If no opinion can be reached, that can be stated too.

At this point the taxpayer and HMRC can accept the Panel’s view or reject it. Either side may refer the matter to the court. There is no appeal from the Panel’s notice since it is not a final adjudication and is said by HMRC not to be a judicial process. It is more akin to taking advice from an expert witness. It remains to be seen whether the courts would allow a judicial

[49] The rules are set out in Schedule 43 FA 13.

review of an opinion notice from the Panel. It is certainly arguable that this should be available, but since judicial review would only be successful in very limited circumstances under the UK legal system, if at all, it is more likely that a taxpayer would proceed to challenge the decision of the Panel during the substantive hearing if he or she wished to do so. It should be remembered that the Panel may not have all the facts and will not have had a chance to question the parties or witnesses, so that a court could well decide the case differently from the Panel, having heard the evidence, without necessarily undermining the Panel process or members. On this basis, the court might also decide not to follow the view of reasonableness the Panel put forward, but the Panel's view on reasonableness of a transaction is likely to be highly persuasive.[50]

Where a counteraction is made there are requirements to set out the counteraction details and the taxpayer has the right, within 12 months of the counteraction becoming final, to make a claim for one or more consequential adjustments to be made in respect of any tax to which the general anti-abuse rule applies. HMRC is required to make such of the consequential adjustments claimed (if any) as are just and reasonable.[51]

The provisions are such as to make this a justiciable issue so that ultimately the decision will be for the courts. The wide wording has attracted some criticism, though there is more detailed guidance in Part C of the Guidance. Consequential adjustments may be made in respect of any period, and may affect any person (whether or not a party to the tax arrangements). They may not, however, increase any person's liability to tax.

Rulings

The UK does not have a comprehensive advance rulings system, although there are specific provisions for rulings in a few areas. It had been thought in earlier discussions on the GAAR in the UK that an advance rulings procedure would be an essential part of the introduction of a GAAR. [52] This was considered to be problematic for a variety of reasons. First there was the question of resource and cost. Even if taxpayers were required to pay for clearances, there would still be a need to devote highly trained and skilled revenue staff to the clearance procedure and HMRC felt it had better ways of using this scarce resource. Quite apart from

[50] See J. Freedman (2013*)* *supra* n. 35.
[51] S 201 FA 13.
[52] This was a factor in rejection of the idea in 1998: see references to the debate *supra* n.15

the resource issue, clearances can be problematic in that they cause delay. Once they exist as a possibility, there is a tendency for taxpayers to apply for them whether they are needed or not as a kind of insurance policy.

The Aaronson Report argued that there was no need for clearances where the GAAR being introduced was a targeted one that did not apply to “the centre ground of responsible tax planning”. This was accepted by the UK Government in implementing the proposed GAAR. It should be noted that in the UK the largest businesses have HMRC “Customer Relationship Managers” who would be able to discuss proposed transactions with them, and indeed would expect to do so as part of the co-operative compliance approach. This could be valuable in reducing any remaining uncertainty surrounding the GAAR in the commercial sphere, but at the same time there could be a concern that it might be unfair that large businesses have this facility available to them when others do not, so it is important that there are also other arrangements in place to give guidance; namely the extensive Guidance approved by the GAAR Panel and the Panel itself. It is hoped that once cases start to go through to the Panel for consideration it will revise the Guidance and also issue an annual report. There is currently no plan to report on the Panel cases individually, but that may change if any volume of cases does go through to the Panel in due course.

4. **GAARs and SAARs (Special Anti-Avoidance Rules)**

The UK has many specific anti-avoidance provisions (SAARS) and also what are known as targeted anti-avoidance provisions or TAARS. Prior to enactment of the GAAR, the TAARs were used as mini-GAARs and there are over 300 of them, with subtly different wording. Many of them have extensive extra statutory guidance of their own because they are so widely drawn that in practice they need to be cut down. One hope in enacting the GAAR is that eventually some of the TAARs might be removed, but this seems unlikely until the Government is sure that the GAAR is being firmly applied by the courts.

In terms of the relationship between the GAAR and the SAARs and TAARs, the GAAR is an overriding legal rule. The Guidance makes clear the view that in principle the GAAR operates independently of SAARs and TAARs. Indeed the GAAR t might well be used to counteract an abusive arrangement which was itself contrived to exploit a defect in the other anti-avoidance rules, whether a TAAR or otherwise.[53]

The GAAR is also independent of the *Ramsay* principle, especially as it is said to be a principle of statutory construction.[54] In theory the substantive legislation will be applied first, as construed applying purposive interpretation, and then the GAAR if necessary. In practice it is expected that some of the stretched interpretation seen under the *Ramsay* approach can now been curtailed, given that the GAAR is available. Exactly how that will work out remains to be seen, however, and will depend both on how the parties approach litigation and the attitude of the courts.

5. GAARs and tax treaties

The GAAR, as an ordinary part of domestic law, is generally capable of applying in cases where a tax treaty is in place. The Commentary to the OECD Model Tax Convention, as amended in 2003, states that as a general rule there is no conflict between GAARs and tax treaties.[55] The tax treaty is applied, taking into account any adjustments made under the domestic GAAR.

The UK GAAR contains provisions to make clear that the GAAR can apply even where there is a tax treaty. The Guidance explains that where there are abusive arrangements which try to exploit particular provisions in a tax treaty, or the way in which such provisions interact with other provisions of UK tax law, then the GAAR can be applied to counteract the abusive arrangements.[56] Clearly this does not mean that the domestic GAAR can override tax treaties. As the Commentary to the OECD Model Tax Convention points out, specific relieving provisions must still be observed and GAARs cannot undermine these. Thus, as the Guidance underlines, the mere fact that arrangements benefit from express rules on attribution of profits or allocation of taxing rights does not mean that the arrangements amount to abuse, and so

[53] *Guidance* para B7.2
[54] On the so-called *Ramsay* principle, see supra, text to n. 8
[55] Commentary to Art. 1 of OECD Model Tax Convention, para. 22 as amended.; See also P. Baker Improper Use of Tax Treaties *Papers on Selected Topics in Administration of Tax Treaties for Developing Countries Paper No. 9-A* May 2013 available at http://www.un.org/esa/ffd/tax/2013TMTTAN/Paper9A_Baker.pdf
[56] *Guidance* para. B5.3

the GAAR cannot be applied to them. It might be thought that this is so obvious as to need no reference in the Guidance, but the reference is a response to some commentators in the UK who appeared to suggest that a GAAR could be a solution to the issues around BEPS, which were beginning to attract attention at the time the Aaronson study group was concluding the report. The Guidance makes it clear that this is not intended to be, and indeed never could be, the role of a GAAR.

The relationship between the domestic GAAR and the anti-avoidance provisions in treaties will be handled in the same way and the relationship between the domestic GAAR and other domestic anti-avoidance provisions. Technically they are independent of each other.

This matter has now been discussed further as part of the BEPS project in the Public Discussion Draft on BEPS Action 6: Preventing the Granting of Treaty Benefits[57] and the analysis and proposals there broadly support the analysis of the UK Guidance. In particular, the discussion draft makes the point that it is generally easier to conclude that the guiding principle in paragraph 9.5 of the Commentary on Art 1 of the Model OECD Treaty is met in the case of a GAAR that refers expressly to the purpose of entering into the transaction than in the case of specific anti-abuse rules that apply regardless of whether the transactions are tax motivated. The UK GAAR would appear to meet this motive test despite the motive test being objective rather than subjective.

6. GAARS and European Union law requirements (the Freedoms, directives)

The UK GAAR has been designed to apply only to direct taxes. VAT was not included in its scope because, as the Aaronson Report puts it, "this tax has its own anti-abuse rules derived from EU law, and applying a UK GAAR in parallel could raise issues of consistency with EU law". [58] Although some argued that the UK should adopt a GAAR along the lines of the abuse of law case law developed by the CJ, in order to avoid a multiplicity of rules,[59] this was considered too uncertain and wide an approach for UK domestic direct taxation. Should the

[57] OECD, *BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances* 14th March – 9 April 2014 available at http://www.oecd.org/ctp/treaties/treaty-abuse-discussion-draft-march-2014.pdf (accessed 16/08/2014).
[58] Aaronson Report para 1.9.
[59] Eg Sinfield (2011) *supra* n 25.

UK GAAR apply in a cross border situation affected by EU case law, it seems likely that the relatively narrow and targeted approach of the UK GAAR would ensure that it would satisfy the requirements of *Cadbury Schweppes*, [60]and that it would be considered to apply only to "wholly artificial arrangements" even though that wording is not echoed in the drafting of the UK GAAR. The UK courts have shown themselves capable of reading principles of EU law into UK legislation in such a way as to ensure that it conforms to EU law where necessary. [61]

All member states face similar problems in tackling abuse and there are great similarities amongst the attempts to deal with these, and between GAARS in different jurisdictions. The anti-abuse rules in each country may gradually converge, in part as a result of the influence of the jurisprudence of the CJ. There will always be a need, however, when applying national legislation, to look to the origins and objectives of that legislation, the national modes of drafting and rules of statutory interpretation, and so there are likely to be continuing differences between domestic GAARS. Total harmonisation seems unlikely in the foreseeable future. [62]

7. GAARS and recent European developments (CCCTB, recommendation of the Commission)

The recent inclusion of GAAR clauses in the proposed Directive for a Common Consolidated Corporate Tax Base (CCCTB),[63] the proposed amendment to the Parent-Subsidiary Directive,[64] and the Commission's Recommendation on Aggressive Tax Planning (ATPR),[65] reflect a Commission view that all member states should adopt a GAAR with similar wording. The ATPR proposes wording that was probably based in some respects on the UK

[60] *Cadbury Schweppes plc v Commissioners of Inland Revenue* (Case C-196/04) [2006] ECR I-7995
[61] *Vodafone 2 v HMRC [2009] EWCA 446.*
[62] See further J. Freedman (2011*), supra* n 26.
[63] Common consolidated corporate tax base (2013): European Parliament legislative resolution of 19 April 2012 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) (COM(2011)0121 – C7-0092/2011 – 2011/0058(CNS)), Amendment 28, OJ C 258 (2013).
[64] Commission, Proposal for a Council Directive amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (COM(2013) 814 – 2013/0400(CNS)). Note, however, that the Council has agreed to split the proposals for a new rule on hybrid loans from the introduction of a common anti-abuse provision in this area (Luxembourg, 20 June 2014 PRESSE 254)
[65] Commission Recommendation of 6.12.2012 on aggressive tax planning (COM(2012)8806).

Ramsay principle (in particular the reference to a "series of arrangements"),[66] but this approach was rejected by the Aaronson Report as too vague for the UK's own GAAR. Whilst a harmonised GAAR appears to make some sense on the face of it, in relation to harmonised provisions, as explained in section 6, even with similar wording there will need to be differences in application to national provisions.

Where a common, harmonised provision is concerned then the issue is a different one. There is a case for an EU GAAR in such cases, but thought needs to be given to the wording to make it acceptable to member states. Reliance on some of the concepts still being evolved by the CJ will lead to a high level of references. There is a danger that, in the attempt to provide guidance and certainty, there will be pressure from references to the CJ to turn the principle into a set of detailed rules and this lack of flexibility could be unhelpful in controlling abuse.[67]

8. **Alternatives to GAARs**

The UK does not have any substance over form or abuse of rights principles in its general law.[68] As discussed above, the UK GAAR will only apply if the usual rules on purposive interpretation fail to catch the abuse in question. As explained in part 1, however, there have been concerns that purposive interpretation is being stretched too far to deal with abuse, resulting in something approaching judge made legislation. This has created some uncertainty, especially around the extent of the so-called *Ramsay* principle or approach, and, if this approach is taken, there can be difficulties about the extent of the consequences and interaction with other provisions. If the GAAR applies, on the other hand, there are safeguards and guidance to deal with these matters.

Specific anti-avoidance provisions- SAARs and TAARs- exist in abundance in the UK tax system, but it is a mistake to consider that this reduces uncertainty. These provisions are often very wide in themselves and yet do not have the safeguards surrounding the GAAR. In an ideal world, the underlying legislation would be well drafted and based on clear principles so that fewer SAARs and TAARs and no GAAR would be needed. Adding more and more

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[66] See R. Lyal, *Cadbury Schweppes and Abuse* in De la Feria and Vogenauer (2011) *supra* n. 26.
[67] As argued in Freedman (2011) *supr*a n 26.
[68] *Supra* n. 13.

detail is not the answer- what is needed is better tax policy and clearer objectives, probably with a wider tax base and fewer tax reliefs. The experience of all the contributors to this book suggests that no jurisdiction has yet reached this exalted state of perfection and it seems unlikely that they will do so.[69] GAARs will be needed to contain the worst kind of abuse for the foreseeable future, but care needs to be taken to ensure that the discretion that a GAAR inevitably opens up is constrained by appropriate safeguards. Only time will tell whether the UK has achieved this necessary balance with its 2013 legislation.

[69] See further J. Freedman *Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited* [2010] BTR 717.