

Does the General Anti-Abuse Rule (GAAR) improve upon pre-existing methods of tackling Tax Avoidance?

INTRODUCTION

“Every man is entitled if he can to arrange 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 that result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.”¹

Spoken by Lord Tomlin in the *Duke of Westminster's case*, 1936; it is likely that some reference to this quote will have found its way into almost every tax avoidance defence case since. However, once seen to represent the attitude of the taxpaying public,² the principle that it sets forth has lost favour of late. Tax avoidance has become a highly emotive topic. It is difficult to pick up a newspaper these days without encountering a headline vilifying the next tax dodging celebrity or much adored multinational.

Yet, tax avoidance is not a new phenomenon. It's emergence as high-grade media fodder seems to have been spurred on by widespread disillusionment at Government cut backs and the effects of the recession. Why should the wealthy avoid paying tax when the rest of society is paying a greater share than ever before? It therefore came as no surprise that the Government felt it had to do something, to introduce a new method of tackling tax avoidance; the General Anti-Abuse Rule (GAAR).

Although the timing of the GAAR raises its own questions, it is clear that the pre-existing methods of tackling avoidance were plagued with difficulties. In order to assess the ability of the GAAR to improve upon these methods, this paper will consider early judicial attempts at tackling avoidance via a judicially created doctrine, along with the reasons for its demise.

¹ *IRC v Duke of Westminster* [1936] AC 1 (HL) at 19.

² Judith Freedman, 'Defining Taxpayers Responsibility: In Support of a General Anti-Avoidance Principle' [2004] BTR 332, 33.

In terms of the GAAR itself, early attempts at a general anti-avoidance rule will be considered, before moving on to look at the aims and perceived deficiencies of the GAAR, as enacted. These include claims of administrative creep; an increase in Her Majesty's Revenue & Customs' (HMRC) discretionary powers; its inability to tackle the very cases that appear to have led to its creation; and, not least, the uncertainty that it is seen to bring.

Of all its perceived flaws, perhaps the most disappointing feature of the GAAR is its inability to address the complexity and uncertainty plaguing the pre-existing regime. Possible solutions to this are therefore suggested, including a move towards principle-based legislation and the rethinking of the decision not to support the GAAR with a general clearance system.

The pre-existing regime

In order to understand the rationale behind the introduction of the GAAR, it is first necessary to understand the problems inherent in the tax system itself. Only then can the problems associated with the pre-existing anti-avoidance regime, both in terms of legislative controls and attempts at judicial intervention, be fully appreciated.

Rules Based Drafting of Tax Law

After the revelations that Starbucks had paid no corporation tax in the UK during the years 2010–2012 (despite sales of over £400 million in 2011 alone), the company made the unprecedented declaration that it would pay £10 million over the following two years, regardless of whether it made any profits during those years.³ The company had not reduced its tax bill illegally: it had been operating well within the law. And yet, the company had felt it necessary to volunteer to pay extra tax in order that it may be seen, in the eyes of the paying public at least, to be paying its 'fair share.'

Heightened public unrest over the issue of tax avoidance has led to increased discussion on the moral duty of taxpayers to pay their 'fair share.' Despite frequent references to such a duty, no such moral obligation exists within our law. Although recent press coverage

³ 'UK Uncut Protests Over Starbucks Tax Avoidance' *BBC News* (8 December 2012) <www.bbc.co.uk/news/uk-20650945> accessed 24 February 2014.

may have caused some to believe that morality *should* play a wider role in our tax system, its subjective nature and inability to create clear and definite rules makes it a poor guide in this respect.⁴ As Freedman has stated, Tax:

“...calls on morality, where the law proves inadequate to achieve what government intends, are unreasonable, unfair and incomprehensible since taxpayers are entitled to be able to rely on the law as it is written. If this does not accord with the intention of Parliament, it is for Parliament to make its intention clearer.”⁵

The Bill of Rights 1689 states that only Parliament has the power to impose taxation, meaning there is no common law of taxation in the UK.⁶ As Parliament tends to legislate in the tax arena following a prescriptive, rules-based approach, it is generally the case that taxpayers *can* rely upon the law as it is written. However, the consequences of this approach must be acknowledged. Goldberg talks of an experiment he carried out in March 2013, comparing the UK rules-based system to the more principles based approach adopted in Hong Kong:

“I read out loud, first, a number of pages from the Inland Revenue Ordinance of Hong Kong which contains the whole of what is the most widely admired, efficient and accepted tax system in the world and then the same number of pages from our tax legislation... there are 267 pages in the Hong Kong Ordinance, each with fewer words than are to be found on each page of UK legislation; and I took there to be 13,316 pages in the UK’s direct tax legislation...The experiment indicates that it would take 9 hours and 19 minutes to read the whole of the Hong Kong Tax Code. The equivalent exercise with the UK legislation would take 768 hours, just over 19 working weeks or about four and a half months.”⁷

It is against this backdrop of an already complicated legislative regime that we must consider the techniques adopted to tackle avoidance.

Legislative Approaches to Tax Avoidance

A 2009 discussion paper commissioned by the Tax Law Review Committee (TLRC) found that legislation created to tackle tax avoidance typically falls into one of two categories:

⁴ Freedman, ‘Defining Taxpayer Responsibility’ (n. 2), 337.

⁵ Ibid.

⁶ Eden (n. 8), 308.

⁷ David Goldberg, ‘How Clear, Transparent, Accessible and Foreseeable is Tax Law and Practice?’ (2013) 4 PCB 238, 238.

legislation which alters the way in which the system deals with a particular transaction or arrangement; or by introducing targeted anti-avoidance rules (TAARs), which are either added to pre-existing legislation, or written-in to new legislation.⁸

Rule Changes

Rule changes involve Parliament reacting to avoidance behaviour by altering legislation after identifying current loopholes in the law. One such example is the treatment of employee share awards.⁹ Seen as a tax effective means of remunerating employees, the practice was promoted by successive governments keen to encourage wider employee share ownership in their employer's businesses. However, the practice raised concerns that it was being used as a means of reducing the employee's tax bill, on what was really just another form of earnings. After forty years of legislative re-drafting and amendments in an attempt to tackle the unintended avoidance of income tax and NICs, the approach has been criticised for the piecemeal fashion in which they have been carried out, resulting in 'arguably one of the most unwieldy areas of the tax legislation.'¹⁰

This example is indicative of many of the problems associated with this method of tackling avoidance. As avoidance schemes taking advantage of loopholes are identified, more legislation to tackle them is created. All too often this results in the creation of further schemes, which are then addressed via further rules and legislation. A legislative game of cat and mouse plays out, with an already overly complicated tax system becoming ever more complex.¹¹

The reactive nature of the changes is also problematic, as it is seen to give the impression that HMRC is changing its view of what is and what is not acceptable, and that the system lacks any real principle.¹² HMRC has also acknowledged that the often narrowly focussed nature of the changes means that they are sometimes incapable of dealing with all of the potential avoidance techniques which may arise in that particular area.¹³ It is therefore

⁸ Tracey Bowler, *Countering Tax Avoidance in the UK: Which way forward?* (TLRC Discussion Paper No.7, IFS 2009), 23 (TLRC Paper).

⁹ *Ibid.* Appendix A.

¹⁰ TLRC paper (n. 24), A.18.

¹¹ David Haworth, 'Finance Act notes: section 48 and Schedule 24 - disguised interest' (2009) 5 BTR 570, 570.

¹² TLRC Paper (n. 26), 5.

¹³ Haworth (n. 29), 571.

the case that making a change may actually serve to highlight an inherent weakness and encourage further attacks, or the changes may be so narrow that taxpayers find it easy to navigate around them.¹⁴

Targeted Anti-Avoidance Rules (TAARs)

The second legislative method of addressing avoidance is TAARs. With more than 300 now in existence,¹⁵ TAARs sit alongside legislation granting reliefs or exemptions, and tend to take the form of a ‘purpose test.’ The format of these purpose tests is not, however, uniform as they vary in terminology and scope. Section 16A of the Taxation of Chargeable Gains Act 1992 (TCGA) is particularly wide and excludes relief for a capital loss if:

“it accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements, and the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.”

The TLRC Paper suggests that this lack of uniformity adds further confusion to an already complicated tax regime, fostering further uncertainty among taxpayers.¹⁶ It also raises concerns that the uncertainty could lead to disputes over nuances in the meaning of certain words, and situations whereby cases concerning the interpretation of one TAAR would have reduced significance for cases concerning a differently worded TAAR.¹⁷

The amount of non-legislative rule making that TAARs require is seen to be a further problem. It is the case that the more general the TAAR, the greater the requirement for HMRC explanatory notes.¹⁸ For example, the explanatory notes provided by HMRC in respect of the TCGA TAAR referred to above run into 17 pages of detailed exposition, detailing the types of transaction viewed as being subject, or not, to the provision.¹⁹ This is seen to be problematic, as explanatory notes are not as carefully scrutinised as legislation.²⁰ It also gives HMRC quasi-tax imposing powers, and, as we have heard, it is

¹⁴ Ibid.

¹⁵ Judith Freedman, ‘Designing an anti-abuse rule (GAAR) for the UK – Issues, Benefits and Limitations’ (Japan High Level Conference, Tokyo, 2013).

¹⁶ TLRC Paper (n. 26), para 7.1.

¹⁷ Ibid. para. 8.12.

¹⁸ Eden (n. 8), 321.

¹⁹ HMRC, ‘Capital Gains Tax: Avoidance through the Creation and Use of Capital Losses’ (CG/APP9, 2007).

²⁰ TLRC Paper (n. 26), 17.

the case that only Parliament is entitled to impose taxation. Any increase in HMRC's discretionary power should therefore be discouraged.

Thus, it is the case that TAARs do little to aid certainty and improve upon the complexity surrounding the anti-avoidance regime.

Disclosure of Tax Avoidance Schemes (DOTAS) Regime

Reacting to problems surrounding existing methods of tackling tax avoidance, in 2004, the then Chancellor Gordon Brown announced the Disclosure of Tax Avoidance Schemes (DOTAS) regime, aimed at those marketing and using avoidance schemes.²¹ Intended to work alongside the 'plug and fix' approach, the scheme was created using best practice from the US, Australia and Canada, with the aim of improving HMRC's understanding of the avoidance market, thus allowing it to better protect against losses flowing from such.²²

Generally, the regime has been heralded a success. The HOL Economic Affairs Committee has considered the operation of DOTAS on a number of occasions and found it to be making an impact on marketed schemes,²³ and, in 2012, the National Audit Office (NAO) stated that the regime had made "some important headway by closing legal loopholes and reducing the opportunities for avoidance."²⁴

The same NAO report noted, however, that over 100 new schemes had been disclosed in each of the four years to 2012, many simply variations of previous schemes taking advantage of further loopholes identified.²⁵ Although the promotion of schemes appeared to be less favoured by large accountancy firms, they were now more commonly being promoted by smaller specialist tax advisers, set up purely to assist their clients pay less tax.²⁶ The market could therefore not be said to have been reduced.

The NAO report also raised concerns that HMRC was facing problems enforcing compliance with the regime, as promoters were able to use a legal adviser's opinion that a scheme does not have to be reported as a "reasonable excuse" to prevent HMRC from

²¹ HC Deb 17 March 2004, col 329.

²² IR, 'Regulatory Impact Assessment: Tackling Tax Avoidance- Disclosure Requirements' (April 2004), para 10

²³ Ibid. 19-20.

²⁴ NAO, 'Tax avoidance: tackling marketed avoidance schemes' (HC 730, 2012), para 7 (NAO Report).

²⁵ Ibid.

²⁶ Ibid.

applying a penalty.²⁷ Over the five years to 2012, HMRC opened 365 enquiries of suspected failure to disclose, yet issued only 11 penalties.²⁸

A study commission to consider the introduction of GAAR into the UK also found that DOTAS was of limited use in addressing schemes in their infancy, as legislation to tackle them takes time to formulate and introduce.²⁹ It also pointed out that such schemes are often complex, and prove to be very labour intensive for HMRC who must examine whether the scheme would contravene existing rules and, if not, work out what needs to be done to address them.³⁰

In addition, the NAO report highlighted the fact that, although HMRC believe that most marketed schemes would be defeated if tested in the courts, such action will normally involve a lengthy court battle, often played out over many years.³¹ In the case of marketed schemes, it is generally the case that only one taxpayer using the scheme will be litigated, allowing so-called 'follower' taxpayers to argue that their situation is different, thus allowing them to hold on to the disputed money for even longer.

Appearing to react to this problem and the fact that there was an estimated legacy stock of 65,000 avoidance cases in 2013, of which 85% predated 2010, the Chancellor has announced in his 2014 March Budget statement that Government will be legislating to allow HMRC to request upfront payment of tax from these 'follower' taxpayers, and that this will also apply to any disputes under the DOTAS regime and schemes that HMRC counteracts under the GAAR.³² The Chartered Institute of Taxation (CIOT) has expressed its opposition of such measures, particularly in respect of DOTAS, as it believes in many cases disclosure will have been made merely to 'be on the safe side' and the promoter or taxpayer may not truly have believed it to be necessary.³³ It also believes that, to

²⁷ Ibid. para. 8.

²⁸ Ibid.

²⁹ Graham Aaronson, 'GAAR Study: A study to Consider Whether a General Anti-Avoidance Rule Should be Introduced into the UK Tax System' (HM Treasury 11 November 2011), para 3.1 (GAAR Study).

³⁰ Ibid.

³¹ NAO Report (n. 53), para 21.

³² HM Treasury, *Budget 2014* (HC 2013-14 1104-I), para. 2.188.

³³ CIOT 'Tax Avoidance Schemes: 'Emergency measures' Tolerable for Dealing with Courts Backlog, but Wider Application goes too far' (Press Release 4 March 2014) <www.tax.org.uk/media_centre/LatestNews-migrated/November+2013+Exam+Results+Now+Available> accessed 24 march 2014.

introduce what amounts to a retrospective change in the law, leading to an accelerated payment of tax, is unreasonable and that the requirement should only apply to arrangements entered into after Finance Bill 2014 is passed.³⁴

It seems therefore that recent Budget proposals may be capable of creating a greater deterrent to the use of marketed schemes. The DOTAS regime has also allowed legislation to be created to tackle schemes at a much earlier stage, without as much effort being spent on identification. And yet, to date, the system cannot actually be said to have reduced avoidance to any great extent. And ultimately, the scheme only exacerbates the problem of complexity by requiring that more legislation be written to tackle the avoidance identified.

Conclusion

It is therefore submitted that the rules based approach to tax legislation leaves the system wide-open to abuse by being so specific as to allow loopholes which are then exploited by those willing and able to do so. The reactive nature of legislation created to plug these holes will always leave a window of opportunity, even where schemes have been disclosed, as legislation takes time to write and enact. What is also clear is that the aforementioned methods of addressing avoidance all add to already overly complicated landscapes, whilst offering little hope that the situation might one day improve.

The Judicial Doctrine

As we have heard, purely legislative control of avoidance plays out like a game of cat and mouse, leaving judges helpless during the early stages of a scheme's lifespan. There was a time, however, when it appeared that judges were unwilling to let this happen, and a judicial doctrine to tackle avoidance was seen to emerge.

The Emergence of a Judicial Doctrine?

In the 1970's, tax avoidance was seen to take on a new twist with the emergence of commercially marketed avoidance schemes. Until this point, courts had been carrying out a strict literal interpretation of the relevant tax statutes which involved considering any

³⁴ Ibid.

series of transactions one at a time, rather than looking at the result of the transactions as a whole.³⁵ However, the case of *W. T. Ramsay Ltd. v. Inland Revenue Commissioners*,³⁶ concerning a completely artificial circular off-the-peg avoidance scheme, seemed to indicate a sea change in the court's approach. Showing the level of exasperation felt in respect of these schemes, Lord Templeman's comments represent the feeling of judges at this time:

"The facts ... demonstrate yet another circular game in which the taxpayer and a few hired performers act out a play; nothing happens save that the Houdini taxpayer appears to escape from the manacles of tax ... the play is devised and scripted prior to performance ... The object of the performance is to create the illusion that something did happen, that Hamlet has been killed and that Bottom did don an ass' head so that tax advantages can be claimed as if something had happened."³⁷

In *Ramsay*, the court looked at the legal nature and outcome of the series of transactions as a whole, rather than considering the legality of each step separately and, in doing so, was able to identify that certain steps had been inserted with no commercial purpose other than the avoidance of tax. It was therefore able to find that no real loss had occurred. Lord Diplock, in *IRC v. Burmah Oil*,³⁸ referred to this as "a significant change in the approach adopted by th[e] House."³⁹ And the approach was further underlined in *Furniss v. Dawson*,⁴⁰ where the HOL extended the *Ramsay* principle to a situation involving linear rather than circular transactions, once again ignoring the inserted steps and instead considering the end result and its resultant tax consequences.

Problems

In November 1997, the TLRC published a report into "whether current methods of dealing with tax avoidance [were] adequate and satisfactory and what, if any, other measures might be taken."⁴¹ The report applauded the likes of *Ramsay* and *Furniss* in their thwarting of "some of the most uncommercial tax avoidance operations;"⁴² however, it was also

³⁵ IFS TLRC, 'Tax Avoidance' (TLRC November 1997), 12-13 (TLRC Report).

³⁶ (1979) 54 TC 101, 128.

³⁷ Ibid.

³⁸ (1981) 54 TC 200.

³⁹ Ibid. 214.

⁴⁰ [1984] 55 TC 324.

⁴¹ TLRC Report (n. 64), vii.

⁴² Ibid. 31.

critical of the uncertainty the cases seemed to create. Its concern stemmed from the perception that, instead of sticking to strict statutory interpretation of relevant statutes, courts now appeared to be taking into account the intentions of Parliament in passing the legislation.⁴³ As previously mentioned, legislation may have been written many years previously and a judge's interpretation of the intention of Parliament is highly subjective, leading to uncertain results. And, as Freedman has pointed out, this uncertainty can spread from the highly abusive cases into the centre ground of responsible tax planning, thus impacting on even the most honest of taxpayers.⁴⁴

As well as the uncertainty, the fact that the doctrine could be applied retrospectively was also seen to cause great concern.⁴⁵ When statutes are enacted, Parliament can specify when they are to come into force, however this is not a feature of judicial doctrines, which can be applied as the courts see fit. This runs contrary to the rule of law and contributes further to the uncertainty and distrust felt by taxpayers.

Doctrine Denied

It is perhaps of no surprise, therefore, that subsequent judgments have been at pains to rule out the existence of any judge made doctrine, with some questioning whether one ever really existed. In *Barclays Mercantile Business Finance Ltd v Mawson*⁴⁶ it was said that the *Ramsay* case did not introduce a doctrine, but instead rescued tax law from the "island of literal interpretation." It was "going too far" to say that transactions, or elements of transactions, with no commercial purpose should always be disregarded.⁴⁷

And in *HMRC v Mayes*⁴⁸ it was found that "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 concurred, but acknowledged that the outcome "instinctively seems wrong, because it bears no relation

⁴³ Ibid.

⁴⁴ Freedman, 'Designing Anti-Abuse Rule (GAAR) for the UK' (n .36).

⁴⁵ TLRC Report (n. 64), para. 15.

⁴⁶ [2004] UKHL 51.

⁴⁷ Ibid.

⁴⁸ [2011] EWCA Civ 407.

to commercial reality and results in a windfall which Parliament cannot have foreseen or intended.”⁴⁹

In *Mayes*, because Parliament had chosen to express its intention through highly mechanistic legislation, there was no way of taking a more purposive interpretation of the legislation.⁵⁰ This is typical of tax law in the UK, and Lord Hoffmann has described the problem of legislating in such a way thusly:

“... Parliament may not be content to describe the economic event which should attract tax because it does not trust the courts to understand such a concept and apply it in a practical way. Instead it enacts a mass of detailed rules which it is hoped will tie the taxpayer in a net from which he cannot escape. But sometimes there are holes in the end and the courts find that they cannot plug them by appealing to the economic event which at a higher level of generality Parliament wished to tax. It is one thing to give the statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there.”⁵¹

This suggests that if rules were written in a more general, principled way, rather than the highly prescriptive way which is favoured, judges would be able to take a more purposive approach to their interpretation and application of the rules, perhaps obviating the need for any kind of general rule.⁵²

What is clear is that, although there were real concerns surrounding the perceived uncertainty and legitimacy of a judicial doctrine addressing avoidance, it had allowed courts to look beyond the ordinary rules of statutory interpretation, and to challenge blatantly artificial avoidance schemes where the legislation was deemed to be lacking. The outcome of casting down such a doctrine is that it leaves avoidance legislation to pick

⁴⁹ Ibid. 100.

⁵⁰ Hui Ling McCarthy, ‘HMRC v *Mayes*: SHIPS That Pass in the Night—Reconciling *Mayes* and *Drummond*’ (2011) 3 BTR 297, 284.

⁵¹ Lord Hoffmann, ‘Tax Avoidance’ [2005] BTR 197, 205.

⁵² See further discussion at chapter 4.3.

up the slack once more, adding further to the complexity which already plagues the regime.

THE INTRODUCTION OF THE GENERAL ANTI-ABUSE RULE (GAAR)

Having considered the problems with pre-existing tax-avoidance regime, it is now necessary to consider the development and introduction of GAAR. Early Government proposals will be revisited, before going on to look at the development of the GAAR, leading to its ultimate enactment within the Finance Act 2013. In doing so, a review of its aims, objectives, and perceived inadequacies will be carried out, along with its ability to improve upon pre-existing measures.

Early considerations

The idea behind a general rule to tackle tax avoidance is not particularly recent. As illustrated, concerns surrounding the complexity of the system had been around for some time. The body of anti-avoidance legislation continued to increase, the problem was not going away. When the TLRC published its report in November 1997, it was particularly concerned with whether cases such as *Ramsay*⁵³ and *Furniss*⁵⁴ produced a satisfactory method of addressing avoidance.⁵⁵ At that stage, the Ramsay principle was still perceived to represent some form of judicial doctrine. As we have heard, the Committee had concerns about the uncertainty of such a doctrine, and concluded “specific anti-avoidance provisions should continue to be in the forefront of the battle of tax avoidance,” but suggested that these should be supported by a targeted general anti-avoidance provision with appropriate safeguards for taxpayers along with a clearance procedure.⁵⁶ This report was then used as the stimulus for an Inland Revenue (IR) proposal for a general anti-avoidance rule.⁵⁷

⁵³ *Ramsay* (n. 65)

⁵⁴ *Furniss* (n. 69)

⁵⁵ TLRC Report (n. 64), Foreword.

⁵⁶ *Ibid.* para. 1.

⁵⁷ IR, ‘A General Anti-Avoidance Rule for Direct Taxes; Consultative Document’, (1998)

<http://tna.europarchive.org/20060214032954/http://www.hmrc.gov.uk/consult/consult_1.htm> Accessed 1 March 2013, (IR Consultative Document).

In order to make its introduction more manageable and less burdensome for the general public,⁵⁸ the IR's proposal recommended that any general anti-avoidance rule should be restricted to corporation tax, petroleum revenue tax and income tax payable by companies only.⁵⁹ Acknowledging that a narrow definition of tax avoidance would be capable of being circumvented by "ingenious avoidance schemes," the proposal also recommended that a rule with a very wide definition of tax avoidance should be preferred; one which could be narrowed down by an exception for acceptable tax planning, triggered only by a purposive test.⁶⁰

The TLRC's response to the proposal was not favourable.⁶¹ In particular it raised concerns over the proposal's failure to achieve a sensibly targeted statutory provision and its failure to provide any kind of appropriate safeguards for taxpayers.⁶² Unsurprisingly, the then Labour Government decided against the proposal.⁶³

The GAAR's Inception

Although there were mutterings of an anti-avoidance rule again in 2003, the GAAR that we see today can be traced back to a proposal within the Liberal Democrat manifesto which, following the formation of the coalition government in May 2010, became a commitment to consult on the introduction of a general anti-avoidance rule within the Coalition Agreement.⁶⁴

This time round, however, there was more impetus behind the proposal. As discussed, there was a perception that existing case law and regulation was becoming increasingly complex and confused. This had been the case in 1997 when a general anti-avoidance rule had initially been considered; however, with the continued creation of specific avoidance legislation, the situation had undoubtedly worsened.⁶⁵

⁵⁸ Ibid. para. 6.4.2.

⁵⁹ Ibid. para. 6.4.4.

⁶⁰ Ibid. para. 6.5.1.

⁶¹ Tax Law review Committee, *A General Anti-Avoidance Rule for Direct Taxes: A response to the Inland revenue's Consultative Document* (TLRC, February 1999), page vii (Response to IR Consultative Document).

⁶² Response to IR Consultative Document (n. 90), vii.

⁶³ Seely, *Tax Avoidance: A General Anti-Avoidance Rule (GAAR) – Background History* (n. 51), 1.

⁶⁴ Ashley Greenbank, 'Finance Act notes: sections 206-215 and Schedule 43: the general anti-abuse Rule' [2013] BTR 505, 506.

⁶⁵ Judith Freedman, 'GAAR as a process and the process of discussing the GAAR' [2012] BTR 22, 23.

Additionally, since *Barclays Mercantile*⁶⁶ and subsequent case law, the previously held belief, that *Ramsay*⁶⁷ had introduced judicial anti-avoidance doctrine, was no longer valid.⁶⁸ Without the doctrine further reliance had once again been placed on legislation; something which did not garner much support from the business community. In a 2008 survey of large businesses, the majority of respondents expressed concern at the complexity and unpredictability of the current state of anti-avoidance rules,⁶⁹ with all but one believing that the situation was hindering the competitiveness of the UK economy.⁷⁰ Politically this was of grave concern, so much so that the impact of any proposed rule was deemed *the* most critical factor in determining whether its introduction would be a positive step.⁷¹

Of greater concern to the public however was the amount being lost to avoidance. The tax gap in the year 2009/10 was estimated to be £35 billion, of which approximately £5 billion was attributed to tax avoidance.⁷² As the Government attempted to reduce the deficit via widespread public cuts; a spotlight was shone on the apparent, pervasive avoidance techniques of large corporations and wealthy individuals.⁷³ Government would not only have to address the concerns of business, but also appease growing public unrest.

The Aaronson Report

It was, therefore, of no real surprise when, in December 2010, Graham Aaronson QC was asked to head a study into whether the introduction of a general anti-avoidance rule would be beneficial for the UK tax system, and to propose how this might be framed. Completed in November 2011, the report was largely critical of a broadly framed general anti-avoidance rule such as that previously proposed, as it felt this would “carry a real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning.”⁷⁴ It suggested that the only way such a rule could be workable

⁶⁶ *Barclays Mercantile* (n. 75).

⁶⁷ *Ramsay* (n. 65).

⁶⁸ Antony Seely, *Tax Avoidance: A General Anti-Abuse Rule* (SN6265, House of Commons note, 11 October 2013), 22.

⁶⁹ Judith Freedman, Geoffrey Loomer, John Vella ‘Alternative approaches to tax risk and tax avoidance: analysis of a face-to-face corporate survey’ (Oxford University Centre for Business Taxation 2008), 18 (Tax Avoidance Survey).

⁷⁰ *Ibid.* 18.

⁷¹ GAAR Study (n. 58), para. 1.3.

⁷² Mark Thackray, ‘The UK Tax Gap’ (HMRC January 2012)

<www.imf.org/external/np/seminars/eng/2012/asiatax/pdf/thackray.pdf> accessed 1 February 2014.

⁷³ Greenbank (n. 94), 505.

⁷⁴ *Ibid.* para. 1.6.

would be through the additional introduction of a comprehensive advance clearance system, however this would prove costly for taxpayers and HMRC alike.⁷⁵ It was also feared that a broad rule would increase the discretionary power available to HMRC, “who would effectively become the arbiter of the limits of responsible tax planning.”⁷⁶

Although most of the discussion leading up to the report had considered the creation of an anti-*avoidance* rule (as had been proposed in 1997), the report recommended that a more moderate rule, aimed at tackling highly abusive, contrived and artificial schemes should be enacted; something which would not affect the large centre ground of responsible tax planning.⁷⁷ The resultant terming of the rule as general anti-*abuse* rule is somewhat indicative of the narrowing in scope which had occurred.

In addition to the rule itself, Aaronson recommended two “unconventional approaches” to securing the aims of the rule:

1. Guidance Notes indicating the types of case to which the GAAR would apply. These could be included within a schedule to the Finance Act itself;⁷⁸ and
2. Where disputes arise, all material which may help to determine whether a particular arrangement falls within the intended target area of the GAAR or, conversely, falls within the unaffected centre ground, should be made available and this should be admissible even if it would not otherwise be so under the normal rules of evidence.⁷⁹

Additionally, in order to deal with uncertainty surrounding the limits of the GAAR, the setting up of an Advisory Panel to advise HMRC was recommended, one that would be comprised of “a *majority* of non-HMRC members.”⁸⁰ This panel could provide an element of impartiality; improve understanding by the publication of its conclusions; and could be responsible for the updating of the Guidance Notes mentioned above.⁸¹

⁷⁵ Ibid. para. 1.6.

⁷⁶ Ibid.

⁷⁷ Ibid. para. 1.7.

⁷⁸ Ibid. paras. 5.9-5.10.

⁷⁹ Ibid. para. 5.11.

⁸⁰ Ibid. para. 5.25. (emphasis added)

⁸¹ Ibid. para. 5.25.

Taking account of the aims, objectives and recommended protections set out within the report, an illustrative draft GAAR, stretching to 16 sections was appended to the report.⁸² There was much support for the inclusion of comprehensive guidance, such as practical examples, particularly in relation to personal tax planning and inheritance tax (IHT),⁸³ and broad support for an Advisory Panel, however there was also strong feeling that HMRC's presence on the Panel could compromise its authority and independence.⁸⁴ Some felt that IHT should be excluded from the scope, as the indicators of abuse included in the draft appeared inappropriate for IHT purposes.⁸⁵

Based on the principles contained within Aaronson's report, with some minor revisions to take account of the formal consultation findings, the GAAR came into force on 17 July 2013 via the Finance Bill 2013,⁸⁶ and then enacted as the Finance Act 2013.⁸⁷

The GAAR

Scope

In addition to some minor taxes and duties, the main exceptions to the GAAR's scope are VAT, customs and excise duties, stamp duty, and stamp duty reserve tax.⁸⁸ It is therefore far wider in scope than Aaronson's recommendation that it only cover the main direct taxes, including income tax, corporation tax, capital gains and petroleum revenue tax, plus national insurance contributions.⁸⁹

Aaronson's reasoning behind a more restricted approach had been to ensure that the GAAR would be more manageable during its introduction, but with the proviso that additional taxes could be added at a later stage, when confidence had increased.⁹⁰ In its consultation document however, the Government claimed this reduced scope posed a

⁸² Ibid. Appendix i.

⁸³ Ibid.

⁸⁴ Ibid.

⁸⁵ Ibid.

⁸⁶ HMRC, 'HMRC's GAAR Guidance Parts A-C' (Approved by the Advisory Panel with effect from 15 April 2013), para. B1.4 (GAAR Guidance Parts A-C).

⁸⁷ Part 5 and Schedule 43.

⁸⁸ Finance Act 2013, s. 206(3).

⁸⁹ GAAR Study (n. 58), paras 5.44–5.46.

⁹⁰ Ibid. para. 1.9.

significant avoidance risk and considered that its expansion would not add significant complexity to the GAAR.⁹¹

Although Aaronson's concerns seem cogent, the majority of respondents agreed with the proposals for an extended scope.⁹² This seems reasonable; if the GAAR really is to be as narrowly focussed as is claimed, then a wider range of qualifying taxes is unlikely to prove unmanageable or overly burdensome. It does also seem appropriate that a general rule should apply to a more general body of taxes.

Inheritance Tax Considerations

Of particular concern to respondents, however, was the inclusion of IHT within the GAAR's scope. As IHT arrangements are often entered into many years before liability arises (usually on death!), it was felt that establishing when the requisite abusive element takes place would prove to be difficult.⁹³ Additionally, the draft legislation indicators of 'abusiveness' included a test of commerciality, which many felt would never be relevant to IHT arrangements.⁹⁴ The House of Lords (HOL) Select Committee on Economic Affairs raised similar concerns during their report into Draft Finance Bill 2013.⁹⁵

Government had acknowledged the peculiarities of IHT compared to other tax planning, however its inclusion was deemed necessary due to potential difficulties in interactions with other taxes such as capital gains tax (CGT).⁹⁶ It was also feared that its exclusion would leave IHT exposed to abuse.⁹⁷ In response, a variety of specific examples of both abusive and non-abusive IHT planning were provided. Whitehouse is clearly unconvinced of the value of the IHT examples. His criticism is typical of that aimed at the examples as a whole;⁹⁸ however, specific attention had been drawn to the peculiarities of IHT from the very early stages. It does not seem that the examples provided will be capable of alleviating the widespread concern in this area. Already a particularly complex area of

⁹¹ HMRC, 'A General Anti-Abuse Rule' (Consultation Document, Publication date 12 June 2012), paras. 2.16-2.1 (GAAR Consultation).

⁹² GAAR Consultation Responses (n. 115), para. 2.1.2.

⁹³ Ibid.

⁹⁴ Ibid. para. 2.1.2.

⁹⁵ HOL Select Committee on Economic Affairs, *The Draft Finance Bill 2013* (HL Paper 139, 2013), paras. 149-154.

⁹⁶ GAAR Consultation (n. 124), para. 2.17.

⁹⁷ GAAR Consultation Responses (n. 115), para. 2.1.4.

⁹⁸ Peter Rayney, 'Mind the GAAR' (2013) 151 *Accountancy* 8, 10.

tax planning, as suggested by Aaronson and others, perhaps more time should have been dedicated to the specific considerations attached IHT before its inclusion within the scope of the GAAR.

Meaning of 'Abusive' and the Double Reasonable Test

In line with Aaronson's report, the GAAR is intended to target abusive schemes only. It "has effect for the purpose of counteracting tax advantages arising from tax arrangements that are abusive."⁹⁹ The term "tax arrangements" is broadly defined and includes arrangements where "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."¹⁰⁰ The term "tax advantage" is deemed capable of encompassing any arrangements, which have *any* tax motive,¹⁰¹ and is therefore also very broadly defined. It is therefore the requirement that the tax arrangement is 'abusive' that is set to ensure the aim of achieving a narrowly focussed GAAR.¹⁰²

Regarded as the first of four safeguards for the taxpayer, the onus is on HMRC in the first instance to establish the abusiveness.¹⁰³ Tax arrangements are deemed to be 'abusive' if their utilisation "cannot reasonably be regarded as a reasonable course of action in relation to the relevant taxation provisions having regard to all the circumstances."¹⁰⁴ This, dubbed the "double reasonableness test,"¹⁰⁵ is the second taxpayer safeguard and has become one of the most controversial sections of the GAAR.

Relevant circumstances are deemed to include: whether the results of the arrangements are consistent with any principles and policy underlying the provisions; whether achieving these results involved contrived or abnormal steps, and whether the arrangements are intended to exploit any shortcomings in those provisions.¹⁰⁶

⁹⁹ FA 2013, s. 206(1).

¹⁰⁰ FA 2013, s. 207(1).

¹⁰¹ Greenbank (n. 94), 506.

¹⁰² Ibid. 507.

¹⁰³ GAAR Guidance Parts A-C (n. 119), pt. B12.1.

¹⁰⁴ FA 2013, s. 207(2).

¹⁰⁵ GAAR Guidance Parts A-C (n. 119), pt. B 12.1.

¹⁰⁶ FA 2013, s. 207(2).

Further indications that arrangements might not be reasonable are given as: a significantly lower income/profit for tax purposes than that arrived at for economic purposes; significantly higher deductions/losses for tax purposes than that arrived at for economic purposes; and a claim for the repayment or crediting of tax that has not been, and is unlikely to be, paid.¹⁰⁷

Greenbank has questioned whether this goes far enough in ensuring that the rule is indeed narrowly focussed. In finding that the factors to be considered when identifying abuse “include consistency with the underlying principles and policy of the legislation and whether or not the economic consequences are in line with the tax result,”¹⁰⁸ he proposes that the GAAR is in fact not dissimilar to earlier judicial doctrines which had been criticised for their inability to foster certainty. He also claims that the rule resembles a general anti-avoidance rule, and not one focussed on the most egregious and abusive schemes.¹⁰⁹ He expresses concern that “mission creep” will occur as the courts, tribunals and opinions of the GAAR Advisory Panel are left to set the true scope of the double reasonable test.¹¹⁰

Chris Bates, partner at Norton Rose Fulbright, shares the view that the GAAR is more an anti-avoidance rule than one targeting the most egregious and abusive schemes.¹¹¹ He believes that Aaronson’s illustrative draft had been far better equipped to ensure that a more narrowly focussed GAAR was achieved. This he attributes to the fact that Aaronson’s illustrative GAAR required that the transaction in question either had no significant purpose other than tax abuse, or its main purpose was that of obtaining an abusive result, before then seeking to remove from this already much reduced list transactions which fall into the acceptable middle ground. This, he claims, is more indicative of the purpose of the GAAR, “separating the reasonable from the egregious.”¹¹² The biggest concern is the subjective nature of establishing ‘what is reasonable?’ and the uncertainty that this is seen to bring. As we have heard, it is a fundamental tenet of the

¹⁰⁷ FA 2013, s. 207(4).

¹⁰⁸ Greenbank (n. 94), 507.

¹⁰⁹ Ibid.

¹¹⁰ Ibid.

¹¹¹ ‘Special Focus: The proposed GAAR’ (Tax Journal 28 June 012) <www.taxjournal.com/tj/articles/special-focus-proposed-gaar-48711> accessed 19 January 2014 (The Proposed GAAR 1).

¹¹² Ibid.

rule of law that that laws should be guided by open, general and clear rules.¹¹³ This undoubtedly requires clarity and certainty, something which seems unattainable through any general rule. Certainty is only really achievable via specific, prescriptive rule making, yet we have already heard of the problems inherent in this method.

The Organisation for Economic Co-operation and Development (OECD) Committee on Fiscal Affairs has stated that taxpayers have a right to a high degree of certainty regarding the tax consequences of their actions.¹¹⁴ As a result, legislating and rulemaking in the realms of taxation is seen to require “adherence, equity and efficiency” as well as the principles attached to the rule of law. The Committee did, however, recognise that such certainty might not always be possible in circumstances involving the application of anti-abuse legislation aimed at tax-payers seeking to circumvent the intent of the legislation.¹¹⁵ However, as Orow has stated, it should undoubtedly be Parliament’s goal to ensure that honest taxpayers are able to anticipate the consequences of their actions in the field of tax.¹¹⁶

Freedman has long been a proponent of the introduction of a general anti-avoidance rule into the UK, and has written extensively on the matter. She believes that certainty is not the right test for such a rule. What it should seek to embody is a practical, fair test which does not impinge on the compliant majority; one that is not liable to manipulation, as would likely be the case with an entirely certain test.¹¹⁷ Writing in 2007, she proposed that the introduction of a general anti-avoidance rule would not increase uncertainty, but increase clarity, transparency and legitimacy. It would allow courts to go beyond the normal rules of statutory interpretation, with the backing of Parliament.¹¹⁸

At that time however, the idea of a narrowly focussed GAAR had not been proposed. What Freedman was effectively advocating was the legitimisation of the early judicial doctrine seen to emanate from the likes of *Ramsay*. Such a rule would be far wider in scope than

¹¹³ HOL Committee on the Constitution, *Relations between the Executive, the Judiciary and Parliament* (HL 2006-07, 151), 99.

¹¹⁴ OECD Committee on Fiscal Affairs, *Taxpayers' Rights and Obligations: A Survey of the Legal Situation in the OECD Countries* (1990), 12.

¹¹⁵ *Ibid.*

¹¹⁶ Nabil F Orow, ‘Part IVA: Seriously Flawed in Principle’ (1998) 1 *Journal of Australian Taxation* 57, 66.

¹¹⁷ Judith Freedman, ‘Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle’ (n. 2), 347.

¹¹⁸ Judith Freedman, ‘Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament’ (2007) 123 *LQR* 53, 90.

the current GAAR, however it would undoubtedly have been accompanied by a clearance system. Something ruled out at the proposal stages of the GAAR.

The intended targeting of the GAAR to abusive schemes has been largely welcomed. However, it is questionable whether the use of the double reasonableness test to achieve this aim was wise. Greenbank believes that, by failing to admit that some arrangements characteristic of tax avoidance might not actually be abusive, the GAAR cannot be truly confined to egregious schemes at all.¹¹⁹ Further, practitioners have questioned whether the rule has been dressed up as one that is narrowly focussed, when in actual fact it was always intended to be an anti-avoidance rule. Judging by Government's claim that the GAAR will be used very rarely and that it is to be seen as a deterrent more than anything else,¹²⁰ this seems unlikely. It is also unlikely that they would be willing the risk upsetting the business community in this way. That being said, the inclusion of such a novel test does seem unhelpful, particularly considering the relatively welcome response that Aaronson's test had received.

The Advisory Panel

As discussed, Aaronson's report also recommended the introduction of an Advisory Panel. This Panel, he proposed, should be made up of members with relevant expertise to advise HMRC on whether there was justification in seeking counteraction under the GAAR.¹²¹ Their anonymised opinions could then be published, creating a database which taxpayers and tax professionals could rely upon when carrying out tax planning.¹²² They should also be tasked with writing and updating the proposed accompanying guidance, thus ensuring independence, and avoiding an increase in HMRC's discretionary powers.¹²³

Perceived as an additional taxpayer safeguard,¹²⁴ the Panel was adopted in the final GAAR,¹²⁵ however is comprised entirely of independent members and has been bestowed

¹¹⁹ Greenbank (n. 94), 507.

¹²⁰ GAAR Guidance Parts A-C (n. 117), pt. B.3.

¹²¹ GAAR Study (n. 58), para. 1.11(iv)

¹²² Ibid. para. 4.20(ii).

¹²³ Ibid. para. 4.20(iii).

¹²⁴ GAAR Guidance Parts A-C (n. 117), pt. B12.1.

¹²⁵ FA 2013, Sch.43 para.1.

with only two key functions: to assess the reasonableness of the arrangements referred to it, and to approve and update accompanying guidance written by HMRC.¹²⁶

In terms of its initial role, HMRC will refer to the Panel cases which it feels are appropriate for invoking the GAAR. A sub-panel will then be appointed to consider the position. The sub-panel is to assume that it is looking at tax arrangements which have been entered into with a tax avoidance motive, and must produce an opinion stating whether the transaction was a reasonable course of action in the circumstances.¹²⁷ They are not, therefore, required to apply the double reasonableness test. This fact is seen to differentiate their opinion from that of the court or tribunal.¹²⁸

Once an opinion has been received, HMRC will consider this before writing to the taxpayer advising them of the steps to be taken,¹²⁹ normal procedure then resumes. If the case reaches the court or tribunal stage, then the court or tribunal must take into account “any opinion of the GAAR Advisory Panel about the arrangements.”¹³⁰

Although in favour of the GAAR, Freedman has questioned the Government’s decision to create a purely independent panel, without the HMRC presence envisaged in Aaronson’s report;¹³¹ a move she feels would have encouraged more of a “regulatory conversation.”¹³² She believes the lack of detail in Aaronson’s report regarding the issue, caused by the strict time limits placed upon him, may have led to this, and likens the resultant Panel to “a strange animal, with an odd role constitutionally.”¹³³ This is because, although not judicial, the courts must still take account of the Panel’s opinion. She believes that more time should have been taken to work out the relationship between it and the court, and warns of calls from taxpayers for a right to be heard by the Panel, undoubtedly causing more confusion over its precise role.¹³⁴

¹²⁶ Greenbank (n. 94), 508.

¹²⁷ FA 2013, Sch.43 paras 11(1) and (3).

¹²⁸ Greenbank (n. 94), 509.

¹²⁹ FA 2013, Sch.43 para.12.

¹³⁰ FA 2013, s. 211(2).

¹³¹ Of which she formed part of the consultation panel.

¹³² Judith Freedman, ‘Creating New UK Institutions for Tax Governance and Policy Making: Progress or Confusion?’ (2013) 4 BTR 373, 378.

¹³³ Ibid. 379.

¹³⁴ Ibid.

It seems likely, however, that the decision to have a purely independent panel will be favoured by the majority. Partners of Ashurst and Pinsent Masons had expressed concern at the apparent lack of independence a panel with an HMRC presence would create, particularly due to the weight afforded to their opinions.¹³⁵ Greenbank has also raised concerns about the weight afforded to the Panel's opinion.¹³⁶ Whereas, in Aaronson's report, it had been recommended that its opinions should only be 'admissible' in evidence, the GAAR legislation requires that opinions *must* be taken into account. He believes that gives it a more judicial function, and doubts there will be many situations when opinions are not followed by the courts.¹³⁷

HMRC's opinion is reflected the ARC's opinion on the matter. When considering Aaronson's proposal, they questioned the need for an Advisory Panel at all, deeming it to be purely bureaucratic, neither administrative nor legal in its functioning, and incapable of adding any certainty to the process.¹³⁸

The fact that the Panel is to be completely independent of HMRC may be appealing to the majority, however there is also a risk that these 'independent' industry experts may have a vested interest in the cases that come before them, perhaps due to their involvement with a competitor. Freedman's proposition that HMRC should have retained some presence on the Panel seems perfectly reasonable. As non-HMRC members are potentially more likely to side with taxpayers, it seems only fair that the view is balanced by an HMRC presence. It would appear that government has pandered to public opinion in this case, rather than taking a more reasoned, impartial stance.

Accompanying Guidance

In terms of its second role, to approve and update HMRC's accompanying guidance, Aaronson's report had initially recommended that the guidance be created by the Panel, rather than merely approved by them. It was believed that this would avoid an increase

¹³⁵ The Proposed GAAR 1 (n. 150).

¹³⁶ Greenbank (n. 94), 506.

¹³⁷ Ibid.

¹³⁸ ARC, 'Response to 'A Study to Consider Whether a General Anti-Avoidance Rule [GAAR] Should Be Introduced into the UK Tax System'', para. 21 (ARC Response).

in HMRC's discretionary powers.¹³⁹ Greenbank has expressed concern that this approach was not followed, particularly due to the special status afforded to the guidance.¹⁴⁰ As with the opinion of the Panel, the court or tribunal *must* take the guidance into account. Additionally, it must be taken into account in relation to "any issue" in connection with the GAAR, rather than a limited range of matters at s. 10(2) of Aaronson's illustrative rule.¹⁴¹

The departure from the apparent independence of Aaronson's proposed guidance and the decision not to publish an anonymised digest of opinions have generated suspicion and resulted in accusations of opacity.¹⁴² This concern is understandable. Government had seemed only too eager to ensure the independence of the Panel, yet it has all but counteracted this gesture by allowing HMRC to write guidance that will ultimately have as much authority in a court or tribunal. It certainly gives out a mixed message and does nothing to garner support from the business community and the general public, who are understandably cautious of any perceived increase in HMRC's discretionary powers.

Ability to Tackle Recently Publicised Schemes

It can be no coincidence that Aaronson was commissioned to carry out his report during a period of heightened media coverage and public unrest surrounding avoidance. As the CIOT & Association of Taxation Technicians (ATT) have stated, Government had to at least *be seen* to take action.¹⁴³ Based on the timing, and the GAAR's promotion by politicians, the public could be forgiven for thinking that it will be a cure-all for recent scandal, however this is not so. As stated by Lord MacGregor, Chairman of the HOL Economic Affairs Sub-Committee on the Finance Bill:

"There is a misconception that GAAR will mean the likes of Starbucks and Amazon will be slapped with massive tax bills. This is wrong and the Government need to

¹³⁹ GAAR Study (n. 58), paras 5.9-5.10.

¹⁴⁰ Greenbank (n. 94), 510.

¹⁴¹ GAAR Study (n. 58), 50.

¹⁴² The Proposed GAAR 2 (n. 92).

¹⁴³ CIOT & ATT, 'A General Anti-avoidance Rule for the UK' (January 2012), para. 6.1-2.

explain that to the public. GAAR is narrowly defined and will only impact on the most abusive of tax avoidance.”¹⁴⁴

Therefore although it may be have allowed the courts to reach a more equitable decision in the likes of *Mayes*,¹⁴⁵ its narrowness and apparently high test threshold has made it incapable of dealing with the vast majority of avoidance cases splashed across the press. This is disappointing, but it will be some time before the GAAR can be tested fully; by which time we may already have a new government or a new scandal to fill up column inches.

Conclusion

Despite an initial intention to create a rule to tackle tax avoidance, the Government’s decision to target only egregious and abusive schemes seemed to find favour with taxpayers generally. However, the actual narrowness of the rule has been cast into doubt.

Practitioners are generally of the opinion that the double reasonableness test has resulted in a GAAR that is far wider in scope than it purports to be. From HMRC’s perspective, this is unlikely to be seen as a problem. They have always advocated a wider rule, being of the opinion that a narrow GAAR will lead to an increase in avoidance behaviour due the perception that anything not deemed to be egregious or abusive is acceptable.¹⁴⁶ The two opinions are entirely at odds, perhaps leading to an acceptable middle ground in practice? Only time will tell.

What appears more problematic is the requirement that any rule should be fair and create sufficient certainty about the tax treatment of transactions. The lack of certainty surrounding the double reasonableness test does not lead to such an outcome, and this has caused a great deal of anxiety among practitioners and the business sector. As discussed, the introduction of a general rule was never going to result in a widespread certainty. General rules, by nature, do not create such outcomes. However, the use of the

¹⁴⁴ HOL Select Committee on Finance Act 2013 ‘Lords Committee say General Anti-Abuse Rule ‘Narrow’ and will not deal with Controversial Tax Planning Techniques used by Big Business’ (Press Release 13 March 2013) <www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-finance-bill-sub-committee/news/fbsc-report-press-release/> accessed 1 March 2014.

¹⁴⁵ *Mayes* (n. 77).

¹⁴⁶ ARC Response (n. 179), 11.

test to narrow the GAAR's focus, in the eyes of practitioners at least appears to have failed. Aaronson's illustrative rule appears to have been more clearly focussed and therefore capable of instilling more confidence in the realms of tax planning. Indeed, it appears that a wider rule with an effective clearance system may even have been more effective in this respect.

The uncertainty, coupled with the ambiguous role of the Panel, and the perceived expansion of HMRC's discretion (via the drafting of guidance), certainly seems capable of having a detrimental effect on the perception of the UK tax regime to big business. This surely cannot have been Parliament's intention? The GAAR appears nothing more than a knee-jerk reaction to public's growing unrest, and yet is incapable of dealing with the very type of behaviour that led to its creation. Far from allaying the growing concern over the complexity of the regime, it appears capable of causing more confusion than existed previously.

STEPS TO IMPROVE COMPLEXITY AND UNCERTAINTY

Criticisms of the GAAR are widespread. In terms of its application, only time will tell whether it will be of any real assistance to HMRC and whether it will be applied to the most egregious schemes only. What is apparent, however, is its inability to address the complexity and uncertainty of the pre-existing regime. This chapter will consider whether this may be addressed by other means.

A Common Concern

The UK does not stand alone in its introduction of the GAAR, if anything; it is seen to be lagging behind in this respect. General anti-avoidance rules exist in many countries, with Australia introducing one as far back as 1915.¹⁴⁷ Approaches vary from country to country, along with the associated penalties (if any) and the administrative procedures for appeal and relief.¹⁴⁸ Ernst & Young carried out a survey of 24 countries operating a general rule in 2013. For the majority, simplification of the anti-avoidance regime had been one of the main aims of the rule, however, it was generally found that this had not

¹⁴⁷ GAAR Rising (n. 161), 4.

¹⁴⁸ Ibid.

occurred.¹⁴⁹ In virtually all of the countries surveyed, the rule had not led to any real reduction in pre-existing anti-avoidance legislation.¹⁵⁰

It should be recalled that the most critical factor in determining whether or not a general rule should be introduced into the UK was its likely impact on the tax regime's attractiveness to business.¹⁵¹ A major concern of large business had been the complexity and unpredictability of the current state of anti-avoidance rules, which was seen to hinder the competitiveness of the UK economy. It seems obvious, therefore, that a fundamental aim of the GAAR should have been to reduce this complexity and promote certainty in the regime.

As Michael Cant, partner at Nabarro, has pointed out, HMRC's claim that "the need for further targeted anti-avoidance rules *may* be reduced" on enactment of the GAAR does not give much hope that simplification was seen as a major priority.¹⁵² Indeed, even Aaronson's report was reluctant to guarantee much hope in this respect, stating: "...it is possible that a well-designed GAAR could, in time, lead to simpler tax legislation."¹⁵³

Tax Simplification

It is widely acknowledged that the most effective means of improving the anti-avoidance regime would be to seek to simplify the increasingly complicated body of tax legislation that already exists. Although Aaronson's report had seemed reluctant to confirm this would be a definite outcome, it did earlier state that "in time, once confidence is established...it should be possible to initiate a programme to reduce and simplify the existing body of detailed anti-avoidance rules. The Office of Tax Simplification would be the obvious agency to do this."¹⁵⁴ This seems a promising statement, however, a better understanding of the composition of the Office of Tax Simplification (OTS) casts doubt on this claim.

¹⁴⁹ Ibid. 16.

¹⁵⁰ Ibid.

¹⁵¹ Text to n. 99.

¹⁵² The proposed GAAR 2 (n. 92) (emphasis added).

¹⁵³ GAAR Study (n. 58), para. 3.19.

¹⁵⁴ GAAR Study (n. 58), para. 1.7(v).

Established by the Conservatives in direct response to the problem of complexity in tax law, it had been proposed in the Howe Report that the “OTS would operate in a similar way to the National Audit Office...” making it “an authoritative and independent voice on tax law, creating a powerful institutional pressure for simplification of the tax system.”¹⁵⁵ Unfortunately, what has emerged is something that falls far short of this. As the Public Accounts Committee has found, the OTS is vastly understaffed and underfunded.¹⁵⁶ Although aware of the big problems facing the tax system, it has not been set up in a way to enable it to tackle them.¹⁵⁷ As Freedman has pointed out, much reliance has been placed on seconders from HMRC, HM Treasury, and from the tax professions. It has no formal constitution, has not been created under statute and there is no guarantee that it will continue to exist after the next election.¹⁵⁸ It therefore seems farcical to suggest that it could take on the task of simplifying the tax system.

In an ideal world, a comprehensive rewriting of tax legislation would be carried out. However, the four-year cycle of governments and the sheer size of the task make it an unlikely policy objective. The associated costs, and potential for dispute, also make it a decidedly unattractive undertaking. Therefore, if wholesale simplification is an unrealistic aspiration, would it be possible to improve certainty via less labour intensive means?

Principles Based Approach

In Australia, a “coherent principles approach” to tax provisions was introduced in 1998, whereby any new amendments to existing provisions, and the writing of any new stand-alone provisions, are carried out using a principles based approach.¹⁵⁹ Prior to this, drafting was seen to follow a rules based approach, similar to that followed in the UK, and it too was deemed to be overly complicated.¹⁶⁰ Principles based drafting specifies the outcome at its highest level, rather than the steps taken to achieve it, and does not therefore require a list of every possible outcome for every conceivable case.¹⁶¹ It is seen

¹⁵⁵ Judith Freedman, ‘Creating New UK Institutions for Tax Governance and Policy Making: Progress or Confusion?’ (n. 173), 377.

¹⁵⁶ *Ibid.* 375.

¹⁵⁷ *Ibid.*

¹⁵⁸ *Ibid.*

¹⁵⁹ Greg Pinder, ‘The Coherent Principles Approach to Tax Law Design’ (The Australian Treasury, 2005) 75, 75 <http://tofa.treasury.gov.au/content/downloads/coherent_principles.pdf> accessed 1 March 2014.

¹⁶⁰ *Ibid.* 76.

¹⁶¹ *Ibid.* 78.

to offer the advantage of being more flexible and robust than purpose based drafting and better at adapting to the creation of new avoidance methods.

Such an approach is not completely alien to the UK. The Government has already experimented with Purpose Based Legislation (PBL), and has done so in the realms of tax avoidance. In December 2007 HMRC issued a consultation on a “Principles-based approach to financial products avoidance,”¹⁶² with a view to its inclusion in the Finance Act of the following year. After a brief stay, two examples of legislation following the PBL approach were introduced via the Finance Act 2009, both in the area of avoidance in financial product taxation.¹⁶³

One of these, s. 48 of the Finance Act 2009, introduced provisions to deal with “disguised interest.” Although the rules appear broadly to follow a principles-based approach, Haworth has analysed them and found them to be no shorter or any less complex than the rules which they replace.¹⁶⁴ He also identifies problems with some of the explanatory principles and the boundaries of the rule, which, as a consequence, has resulted in more weight being afforded to HMRC’s supporting guidelines.¹⁶⁵ This is a fundamental concern of PBL; that its generality will always require additional detail to be provided by HMRC, and that this increases HMRC’s discretionary power, whilst failing to reduce complexity.¹⁶⁶ This may be true, however it does allow courts the opportunity to make reasoned judgements where HMRC have yet to close loopholes in the law. If all legislation were to be drafted following a PBL approach, it also seems unlikely that it would result in the same level of complexity that currently exists.

Although PBL trials have so far proved disappointing,¹⁶⁷ it is very early days: far too early to rule it out altogether. As considered above, the chance of any wider scale tax simplification is slim to none. Without a more principles based approach, legislation will continue to become more and more convoluted, as increasingly detailed rules are enacted. A gradual method of introduction also seems to pose a more palatable alternative to a

¹⁶² HMRC, ‘Principles-Based Approach to Financial Products Avoidance: A Consultation Document’ (December 2007).

¹⁶³ Judith Freedman, ‘Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited’ (2010) 6 BTR 717, 732.

¹⁶⁴ Haworth (n. 29), 573.

¹⁶⁵ *Ibid.*

¹⁶⁶ Freedman ‘Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited’ (n. 207), 718.

¹⁶⁷ *Ibid.* 734.

complete overhaul of the tax regime, with less cost and disruption. It is also capable of working alongside the GAAR (as is the case in Australia), thus providing the simplification that the GAAR fails to achieve and, if adopted in relation to the drafting of charging provisions, it may well in time remove any need for a GAAR at all. As we have heard, the Inland Revenue Ordinance of Hong Kong operates a principles based system which is a mere fraction of the size of the UK's code, and is considered to be the most widely admired, efficient and accepted tax system in the world.¹⁶⁸ The evidence cannot be ignored.

GAAR Clearance System

As it stands, simplification of the tax system is, at best, a long way off, and full scale PBL seems just as unlikely in the short term. However, there does exist a relatively simple method of addressing at least the uncertainty seen to stem from the GAAR. It was argued in Aaronson's report that a wide anti-avoidance rule would require a comprehensive system for obtaining advance clearance for tax planning transactions.¹⁶⁹ This was deemed to be an unnecessary consideration for the GAAR due its narrow scope, and its restriction to only the most abusive schemes.¹⁷⁰ However, as we have heard, there is a real feeling among practitioners that the GAAR is capable of extending well beyond this in practice. The recent spate of bad publicity concerning the avoidance tactics of multi-national companies has also made taxpayers more fearful of accidentally drifting into avoidance territory. As Bradley Phillips, a partner at Herbert Smith has made clear, taxpayers seek certainty in their tax planning and would rather know how HMRC intend to treat a transaction, especially in the current environment where any suggestion of tax avoidance can become front page news.¹⁷¹

Clearance systems are already operated by HMRC in some other areas of the anti-avoidance regime. Although Aaronson's report had stated that a general clearance system would not be a requirement of the GAAR, it also stated that, where existing statutory clearances systems were already in operation, these should extend to provide confirmation that the GAAR would not be applicable to the arrangement concerned.¹⁷²

¹⁶⁸ Goldberg (n. 25).

¹⁶⁹ GAAR Study (n. 58), para. 1.6.

¹⁷⁰ Ibid.

¹⁷¹ The proposed GAAR 1 (n. 150).

¹⁷² GAAR Study (n. 58), para. 5.27.

However, it is stated in the GAAR consultation document: “HMRC discusses [with large businesses and wealthy individuals] commercial arrangements and confirms where appropriate that it does not regard particular arrangements as tax avoidance. However, HMRC will not give formal or informal clearances that the GAAR does not apply.”¹⁷³ This indicates that, despite Aaronson’s recommendation, even where clearance systems are already operation, they will not comment on the implications of the GAAR.

Peter Cousins, tax partner at PWC, has stressed the importance of being able to discuss important commercial arrangements that have not been mentioned in the guidance.¹⁷⁴ He believes that to offer no possibility of checking whether a transaction is within the target of the GAAR means that HMRC is failing in its role in ensuring a fair tax system. If the GAAR proves to be more of a general anti-avoidance rule, as has been suggested, then it would seem particularly unfair not to have included one.

It is acknowledged that a clearance system could prove to be costly and is capable of increasing the power of HMRC “who would effectively become the arbiter of the limits of responsible tax planning.”¹⁷⁵ While it cannot be disputed that there would be some increase in HMRC’s discretionary power, it would appear that taxpayers are in favour of the idea, making such an argument redundant.

In terms of its cost, Adam Craggs, partner at RPC, raises a fundamental problem. Recent publicity has made tackling tax avoidance a potential vote winner. HMRC has therefore found itself expected to take on an ever-increasing role in tackling avoidance and evasion, to reduce the much reviled ‘tax gap,’ yet has seen its resources cut year-on-year.¹⁷⁶ It is submitted that, should resources be invested in an effective GAAR clearance system, then its rulings could be published. This would create a body of guidelines for taxpayers, undoubtedly of more relevance than the Guidance Notes in support of the GAAR. The reliance on such a system may be greater in the early stages, but would undoubtedly diminish over time as the published decisions provide a clearer indication of the

¹⁷³ GAAR Consultation (n. 124), para. 5.16.

¹⁷⁴ The proposed GAAR 1 (n. 150).

¹⁷⁵ GAAR Study (n. 58), para. 1.6.

¹⁷⁶ The proposed GAAR 2 (n. 92).

parameters of the rule. This itself, would assist in closing the tax gap and would most definitely provide the certainty that taxpayers seek.

Conclusion

Despite aspiring to improve certainty and confidence in the anti-avoidance regime, the GAAR, as it stands, is simply incapable of reducing the complexity of the current regime and, if anything, creates more uncertainty than the legislative approach that existed before it. It is apparent, however, that the only way to reduce the uncertainty would be to simplify the whole of the tax system. The difficulty of such an operation is acknowledged, particularly during these current times of austerity and civil service cutbacks. Government may therefore be forgiven for failing to embark on a full-scale re-write at present. Perhaps, therefore, its recent foray into PBL should be more widely championed. Early attempts may not have brought about the results which had been anticipated, however it should be seen as a work in progress, where mistakes are learned from and improvements are made. Once a successful model is achieved, a gradual introduction of PBL throughout the tax regime could, in time, bring about the full-scale re-write that is desired.

In terms of the GAAR and the uncertainty that it breeds, it would seem that a general clearance system would easily address this concern. HMRC and taxpayers are both in favour, which counters any argument that its introduction would increase HMRC's discretionary powers. If taxpayers are happy with this, then is there really any problem? In terms of ruling it out on cost grounds alone, this displays a disappointingly narrow-minded approach. A clearer and more certain system would undoubtedly reduce attempts at avoidance, and the reliance on the system would undoubtedly decrease over time. It is also the case that the more certain the anti-avoidance regime is seen to be, the more attractive the UK will be seen to outside investors, which can only have a positive effect on the economy in the long run.

CONCLUSION

The introduction of the GAAR during a time of heightened media and public unrest may have led some to believe that the regime had been operating effectively up until this point. However, as we have heard, this was far from being the case.

Parliament's persistence in enacting tax legislation following a largely prescriptive, rules-based approach has been the norm for some time and the tax system has long been perceived to be unwieldy and confusing. Subsequent attempts to close the loopholes inherent in such a system, via persistent rule changes and TAARs, have further exacerbated the problem. Although the introduction of the DOTAS regime has proved capable of highlighting schemes at an earlier stage, new legislation to tackle these schemes remains a requirement, further exacerbating the problem.

The highly prescriptive method of rulemaking has also proven to be problematic for the courts. Despite, at one point, appearing to have created a judicial doctrine allowing them to tackle schemes that Parliament had so far failed to, the judiciary was forced to pull back from this approach over questions of legitimacy.

The fairness of decisions in cases such as *Ramsay* and *Furniss*, reached during the time of judicial intervention, however, cannot be questioned. Parliament therefore had an opportunity to introduce a rule that would effectively legitimise something akin to the judicial doctrine. They also had an opportunity to create a rule which would be capable of easing the burden of complicated legislation; something capable of allowing for some form of legislative repeal or, at the very least, a scale back on the introduction of further technical legislation.

Instead, in an apparent attempt to appease the concerns of the business community, Parliament chose to enact a general rule, one intended to focus on only the most egregious of avoidance schemes, and one which would not seek to replace pre-existing legislative methods tackling avoidance.

It is acknowledged that there is a difficult balance to be struck in this area. HMRC will understandably seek a rule which is wide enough to allow them to tackle all schemes which they perceive to be abusive, whereas taxpayers will want a narrow rule with clear defining boundaries, so that they may be certain that their planning will fall outside of the boundaries of the rule. Somewhat disappointingly however, the GAAR is neither. HMRC see it as being too narrowly focussed to allow them to deal with all schemes circumventing existing legislation, and practitioners are of the opinion that the terminology used is capable of creating a far wider rule than that which has been claimed. It is also commonly

felt that the double reasonableness test fosters even greater uncertainty than before. Add to these concerns the questions raised over the adequacy of the accompanying guidance and examples, the risk of an increase in HMRCs discretionary powers, and the status and weight afforded to the Advisory Panel's decisions, and it seems that the GAAR is capable of adding very little to pre-existing methods of tackling tax avoidance.

There is always the possibility that, in line with industry concerns, it will prove to be of much wider application than that, which Parliament appears to have intended, in which case HMRC, at least, will be content. Only time will tell in this respect. What is more conclusive is its inability to address the complexity and unpredictability of the pre-existing anti-avoidance regime. This is particularly disappointing considering the detrimental effect that this is seen to have on the competitiveness of the UK economy.

The difficulty of undertaking any comprehensive rewrite of the tax regime is acknowledged; Government should therefore be seeking to implement a more widespread and effective policy of PBL. This could work in tandem with the GAAR, as has been shown to be work well in Australia. It is also recommended that more consideration be given to a GAAR clearance system, which both HMRC and taxpayers have expressed for a desire for. This would undoubtedly alleviate the uncertainty seen to stem from the GAAR and may prove to be a sound investment in terms of the benefits that such certainty can bring to the economy.