MIND THE GAAR

The GAAR lays down a marker for unacceptable tax avoidance which advisers need to work with, not against, says Peter Rayney

HMRC's general anti-abuse rule (GAAR) became law on 17 July 2013, when the Finance Act (FA) 2013 received Royal Assent. Its main aim is to deter and stamp out abusive tax planning. The GAAR was spawned out of a study led by Graham Aaronson QC about the feasibility of introducing a GAAR. Aaronson's report recommended the adoption of a narrowly targeted anti-avoidance rule to counter artificial and egregious tax avoidance schemes, which would not interfere with 'responsible tax planning'. Aaronson was also conscious of the need to provide an attractive and competitive UK tax regime for business and therefore decided against a widely drawn anti-avoidance rule.

Against a backdrop of unfavourable government opinion and public sentiment on tax avoidance issues, the GAAR proposals were accepted. The final GAAR legislation adopted in Part 5 of FA 2013 retains the thrust of Aaronson's original recommendations. However, many would argue that the scope of the final statutory version is broader than that contemplated by Aaronson. Nevertheless, HMRC maintains that the FA 2013 GAAR is aimed at highly abusive arrangements and should therefore be a narrow rule of limited impact. It should be remembered that the GAAR is only one of many anti-avoidance weapons at HMRC's disposal and many expect it to be used quite sparingly.

However, anyone giving tax advice will need to have a reasonable understanding of the main GAAR rules. Under the GAAR, we now have a clear statutory limit to the tax minimisation principles that were first enshrined in the legendary 1936 *Duke of Westminster* case. Consequently, tax planning arrangements should now be subject to a 'GAAR-assessment', even if the GAAR's application will frequently be ruled out.

The GAAR applies to a wide range of taxes, which includes income tax, corporation tax, capital gains tax, inheritance tax, and stamp duty land tax. Unfortunately, in contrast to similar regimes in other countries, HMRC has not offered any advance clearance mechanism to confirm whether or not a proposed arrangement or transaction would fall within the GAAR.

ABUSIVE ARRANGEMENTS

The GAAR will operate to counter tax advantages arising from tax arrangements that are abusive (s206, FA 2013). For these purposes, 'tax arrangements' will exist if, '…having regard to all the relevant 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' (s207 (1), FA 2013). 'Tax advantage' is defined widely in s208, FA 2013.

Tax arrangements that are carried out would be considered 'abusive' if they cannot reasonably be regarded as a reasonable course

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of action in relation to the relevant tax provisions, having regard to all the circumstances – this is commonly referred to as the double reasonableness test (s207 (2), FA 2013). HMRC's guidance notes state that this test recognises '…there are some arrangements which some people would regard as a reasonable course of action while others would not'.

The application of this double-reasonableness test presents one of the main difficulties for tax advisers. It is very subjective and anecdotal evidence clearly shows that there is a wide spectrum of what is considered to be a 'reasonable course of action'. While HMRC's guidance provides some helpful insight into its 'thinking', this cannot be expected to provide the answer to the vast array of transactions that are encountered by tax professionals.

On a practical level, the GAAR will impact on the work of the vast majority of tax advisers who work within the centre-ground of so-called 'responsible tax planning'. They will need to evaluate the potential application of the GAAR before implementing any transaction that has substantive tax consequences – thus increasing time costs.

Some would argue that this element of subjectivity would be inherent in any type of GAAR. Government has decided to introduce a GAAR – so advisers will simply have to apply their professional judgment and skill, and work with it. We probably have to accept that this is part of the 'deal' for getting rid of egregious and highly artificial tax schemes and those that seek to promote them.

REASONABLE ACTION

To assist in determining whether the taxpayers have followed a reasonable course of action, the legislation provides examples of the key questions that should be taken into account. These include:

- Is the outcome consistent with the principles and policy objectives of the relevant tax legislation?
- Do the arrangements include any contrived or abnormal steps?
- Are the arrangements intended to exploit any shortcomings in the tax law?
- Does the outcome result in taxable income, profits or gains that are significantly less than the corresponding economic income, profits or gains – or conversely, a tax allowable loss that is significantly greater than the economic loss?

Importantly, arrangements are unlikely to be considered abusive (and hence would fall outside the GAAR) if they accord with established practice and HMRC has indicated its

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HMRC EXAMPLES OF 'ACCEPTABLE TAX PLANNING'

- Choosing appropriate legal structure to carry on a business (eg, sole trader v limited company)
- Owner managers paying dividends rather than a large salary (in normal trading circumstances)
- Salary sacrifice for enhanced pension rights
- Electing to treat a 'holiday home' (assuming it is occupied long enough to qualify as a residence) as the taxpayer's principal private residence for CGT purposes on the basis that it is likely to be sold at a substantial profit in the future
- Drafting commercial loan notes to ensure that they are non-qualifying corporate bonds
- Complying with the appropriate 'bed and breakfast' time limits when selling and buying listed shares to generate a capital loss.
- Reducing the donor's taxable estate for IHT purposes by giving away assets to their children (provided they do not retain any benefit)
- Using statutory reliefs in a 'straightforward way', such as the enterprise investment scheme, IHT business property relief, capital allowances and the patent box. However, where taxpayers have entered into contrived arrangements to access the relief but without incurring any equivalent economic risk, they will be vulnerable under the GAAR.

acceptance of that practice. HMRC has also helpfully confirmed that the GAAR would not be invoked where a taxpayer is forced to take 'contrived' steps to avoid paying tax on more than their economic gain.

HMRC GUIDANCE

Given that the test of 'reasonableness' takes into account HMRC's acceptance of established practices, HMRC's guidance (approved by the GAAR advisory panel with effect from 15 April 2013) takes on an important role. This explains that, under the UK tax code, there will be many cases that present 'different courses of action that a taxpayer can properly choose from'. HMRC stresses that the GAAR has therefore been carefully drafted to include various safeguards, which should ensure that 'any reasonable course of action' falls outside its scope.

Some important examples of 'acceptable' tax planning given in HMRC's guidance are summarised in the box on previous page. Many would consider these arrangements to be of the 'plain vanilla' variety and thus, does not really test the 'acceptable' boundaries of everyday tax planning. HMRC confirms that where the legislation specifies a precise set of conditions, taxpayers can assume that they would be safe from attack provided they had adhered to these conditions. On the other hand, arrangements that were highly contrived or against the spirit of the law, would be vulnerable to the GAAR.

COUNTERACTION OF TAX ADVANTAGES

Where the GAAR applies, the 'tax advantages' will be counteracted on a just and reasonable basis (s209, FA 2013). Thus, for example, where the arrangements are entirely self-cancelling (with the taxpayer's economic position remaining (virtually) unaltered), they would be taxed as if they had never occurred. This would invariably mean that any 'artificial' loss would be disallowed.

It is expected that HMRC will normally invoke the GAAR in appropriate cases, following an enquiry or 'discovery' in relation to a tax return. However, the GAAR is part of the self-assessment regime. Consequently, tax professionals will need to consider whether any transactions entered into by clients should be reported under GAAR. Failure to report an arrangement that is clearly subject to the GAAR would lead to penalties. Thus, if there is any doubt about the application of the GAAR, suitable disclosure should be made in the 'white space' on the return.

The GAAR is subject to the normal appeals process, with the GAAR advisory panel providing an important safeguard for taxpayers. The panel is composed of (independent) tax experts and will consider GAAR cases that HMRC wishes to take to tribunal. The panel's key function is to opine on the potential application of the GAAR and, in particular, provide evidence of the 'reasonableness' of the taxpayer's behaviour.

Because HMRC will not want to lose cases and generate adverse opinions, most tax advisers expect HMRC to take few cases to tribunal.

UNCERTAINTY

In my view, HMRC's GAAR has strayed from the precisely targeted proposals laid down in Aaronson's report. Aaronson skilfully targeted abusive and egregious tax schemes and arrangements. In FA 2013, we have ended up with a widely drawn GAAR; its scope lacks clarity since the application of the double reasonableness test is highly subjective. Businesses will generally wish to ensure that their commercial transactions are structured on a tax-efficient basis. But, they cannot now be confident about whether the GAAR will apply (unless they can obtain a suitable informal tax clearance from HMRC). This is bad for business. We must therefore rely on HMRC's assurances that the GAAR would only be reserved for 'highly abusive' arrangements.

Rules

To read HMRC's guidance on the GAAR go to: www.hmrc.gov.uk/avoidance/gaar.htm

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