The Deficiencies in the General Anti- Abuse Rule

1. The General Anti-Abuse Rule

The Finance Act 2013 will, for the first time, introduce a General Anti-Abuse Rule into UK tax law. The TUC has campaigned against tax avoidance for many years, and yet we have real problems welcoming this new measure. That is because it is likely to be wholly inadequate in tackling the tax avoidance abuse that we still think costs the UK at least £25 billion a year in lost tax revenue.

In our opinion the UK needs a General Anti-Tax Avoidance Principle. Two words differentiate what we want from what the government is delivering in 2014, but they are critical. The first is that we want to tackle tax avoidance and not just tax abuse. The second is that we want a principles based approach to tax avoidance, and not a rules based one. Both points are fundamental, but there are other pragmatic reasons for thinking that the General Anti-Abuse Rule will simply not deliver the clamp down on tax avoidance that the government claims for it[1].

There are as a result two purposes to this briefing. The first is to highlight what is wrong with the government's General Anti-Abuse Rule. The second is to argue that we need a broader based General Anti-Tax Avoidance Principle if we are really to tackle the problem of tax avoidance in the UK.

2. What's wrong with the General Anti-Abuse Rule?

We believe that the government's General Anti-Abuse Rule is seriously deficient making it unsuitable to deliver many of the claims made of it. Our concerns are:

a. The Rule only tackles tax abuse which is so narrowly defined that the number of occasions on which the Rule will be used will be few and far between;
b. The test for deciding when the Rule can be used is so perverse that the Rule will be hard to use;
c. The Rule requires the agreement of a panel of experts, all of whom will be drawn from the tax avoidance industry, before it can be used by H M Revenue & Customs. Given the composition of the panel expert consent is unlikely in most cases;
d. The burden of proof on whether or not an arrangement is abusive rests with HM Revenue & Customs and not with the taxpayer;
e. There are no penalties for using a scheme to which the Rule might be applied, meaning there is little or no disincentive to tax avoiders as a result;
f. There is no arrangement where a taxpayer can ask HM Revenue & Customs whether or not the transactions they are proposing are within the scope of the Rule in advance of them undertaking transactions, meaning that the Rule creates unnecessary uncertainty in the UK tax system.

Each of these problems needs to be considered in turn as they will all have to be addressed and corrected by any government that is serious about tackling tax avoidance in the future.

a. The Rule only applies to tax abuse and not tax avoidance

The General Anti-Abuse Rule defines tax abuse as[2]:

> 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.

This is a tortuous definition, the 'reasonableness' element of which we return to below. That apart there are still problems. The principle one is that it is clear that there must be an 'arrangement' relating to tax provisions. A 'tax arrangement' is defined as any course of action 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.

That then means that it is necessary to consider what a tax advantage is, which is defined as a situation where, when compared with the apparent intention of legislation, one of the following might happen[3]:

> (a) an amount of income, profits or gains is declared for tax purposes that is significantly less than the amount for economic purposes,
>
> (b) deductions or losses are claimed for tax purposes that are significantly greater than the amount for economic purposes, and
>
> (c) a claim for the repayment or crediting of tax (including foreign tax) is made that has not been, and is unlikely to be, paid.

Taken in isolation these provisions suggest the welcome possibility that the Rule might be wide ranging, but the General Anti-Abuse Rule has a dimension unique so far in UK tax law within it, which is that its Guidance Notes have legal authority when it comes to interpretation of this law. Those notes say[4]:

> It is apparent … that the definition of "tax arrangements" is widely drawn and deliberately sets a low threshold. Accordingly, it is likely that many transactions that would achieve some tax advantage will fall within this definition.

To this, however, is added an important caveat:

> However, this does not mean that all those transactions would fall to be counteracted by the GAAR. The main filter, which separates transactions that are liable to counteraction by the GAAR, is in the requirement that the tax arrangement must be shown to be abusive. This sets a much higher test.

And with regard to abuse the Guidance notes say when commenting on the legislation that the key elements that define abuse are:

- whether the arrangement can be considered a reasonable course of action in relation to the relevant tax provisions;
- comparing the substantive results of the arrangements with that which might be expected based on the principles on which the relevant tax provisions are based, and with the policy objectives of those provisions;
- seeing whether there are contrived or abnormal steps in the arrangement;
- seeing whether the arrangements are intended to exploit any shortcomings in the relevant provisions; and
- the 'double reasonableness' test – i.e. whether the arrangements cannot reasonably be regarded as a reasonable course of action.

The first four elements of this Guidance still offer hope that the General Anti-Abuse Rule might be useful, but the last abruptly curtails it, for reasons noted below. However, this is not the sole constraining factor because it is also made very clear in the Guidance that the abuse must be exceptional, and the securing of a reduced tax bill does not mean that any arrangement is by definition abusive. This is most clearly noted with regard to international tax arrangements where the Guidance Notes say:

> Many of the established rules of international taxation are set out in double taxation treaties. These cover, for example, the attribution of profits to branches or between group companies of multi-national enterprises, and the allocation of taxing rights to the different States where such enterprises operate. The mere fact that arrangements benefit from these rules does not mean that the arrangements amount to abuse, and so the GAAR cannot be applied to them. Accordingly, many cases of the sort which have generated a great deal of media and Parliamentary debate in the months leading up to the enactment of the GAAR cannot be dealt with by the GAAR.

What this means is that the vast majority of the tax abuse by large and multinational companies is completely outside the scope of the Rule. That is because while there is no doubt that many companies do abuse the principles and provisions of such agreements (which form a part of UK law) the very fact that many do so means that such abuse is not exceptional and as a result it is reasonable to think it is accepted practice, and for that reason the General Anti-Abuse Rule does not apply.

As a result transfer mispricing, the use of tax havens, putting intellectual property offshore solely for tax reasons, making use of loan arrangements to strip profit from the UK and other such activities commonly used by multinational corporations to abuse the UK tax system have all been ruled to be beyond the scope of the Rule. In addition a great deal of domestic tax avoidance, such as the long established practice of using small companies to avoid national insurance by the self employed and the use of many inheritance tax planning schemes that make no sense but for tax avoidance, are also out of the reach of the Rule because they are deemed to be normal established practice and so not exceptional, As a result they are not deemed to be abusive.

We think this an extraordinary definition of abusive. In effect, it says that if abuse has become habitual it is by definition acceptable. By the same logic sexism and racist abuse would have been acceptable at the time they were necessarily tackled by legislation because they were at that time normal behaviour in society (precisely why a change in the law was needed to change behaviour on these abuses).

Tax avoidance is now habitual and ingrained. That is precisely why a change in the law is needed to stop it, but what this law does instead is say that this is precisely why such abuse should be allowed to continue. What this means is that at the heart of this supposed rule to stop tax abuse there is a tacit acceptance of all existing abusive behaviour, which means the Rule cannot ever succeed in stopping tax abuse.

The result is that the Rule only really tackles pre-packaged tax abuse schemes. Whilst these still exist there is no doubt that the market for them has been falling in recent years, odd exceptions such as the notable arrangement used by Jimmy Carr apart. With this initiative the government is thus tackling a quite small and potentially diminishing part of the tax avoidance problem, condemning the Rule to ineffectiveness from the outset and undermining the claim that this legislation will prevent tax abuse, let alone tax avoidance.

b. The test that the Rule applies to tax abuse is so perverse that the Rule will be hard to use

As noted above, before H M Revenue & Customs can make use of the General Anti-Abuse Rule to tackle any arrangement to which it thinks it might apply that scheme must fail what is called the 'double reasonable test'. The guidance notes to the Rule say of this test that[5]:

> It is essential to appreciate that, so far as the operation of the GAAR is concerned, Parliament … has imposed an overriding statutory limit on the extent to which taxpayers can go in trying to reduce their tax bill. That limit is reached when the arrangements put in place by the taxpayer to achieve that purpose go beyond anything which could reasonably be regarded as a reasonable course of action.

The reality is that this 'double reasonableness' test is intensely subjective. Whilst the Guidance notes also say that the reasonableness test should be that of the ordinary person and not, for example, that of a specialist tax judge, the chance that this will be the case in practice is remote in the extreme, not least because of the involvement of an advisory panel of experts who are drawn heavily from the tax avoidance industry (discussed in more detail below). .

The result is that the use of the Rule will be highly subjective.

c. The Rule requires the agreement of a panel of experts, all of whom will be drawn from the tax avoidance industry

Graham Aaranson QC, the main architect of the General Anti-Abuse Rule, recommended from the outset that the Rule should only be used by HMRC if an independent panel of experts approved HMRC's intention to do so. The TUC has advocated for one of the three panel members should have the status of a judge and also supports the suggestion that an HMRC official should be included. However, under the Rule as it has become law no one on the panel (which will offer advice on the use of the Rule before an action can proceed) may come from HMRC and none need sit in a judicial capacity. The only qualification is that they must be tax experts.

The inevitable consequence of these requirements is that this panel will be drawn from the upper echelons of the private sector tax profession and from the tax departments of big business. These are, of course, also the people who are by far the most likely to create, sell or use complex tax abuse schemes. Despite this the panel's task is to determine whether it is reasonable to think the scheme the Revenue wish to challenge is abusive or not – which is the first part of the double reasonableness test. The consequence is that an incredibly select view of what is reasonable will be applied to any attempt to use the General Anti-Abuse Rule and that select view will be based on the opinion of those who will, almost inevitably, be most inclined to think tax avoidance is a reasonable course of action.

While it is the case that the opinion of this panel will only be considered advisory, given the status afforded to it the chance that HMRC would proceed with a case if even one member of the panel thought the taxpayer's actions reasonable, especially given that the taxpayer and any subsequent appeal hearing will have to be told about the panel's view, is very low indeed. In effect this gives any member of this panel the chance to veto any action to stop tax abuse. The chance that HMRC will take the risk of being found to get their judgement on this issue wrong very often is also very low. As a result they will be very risk averse in making any decision to use the Rule and risk seeking a ruling from the panel. The structure of and power afforded to this panel is a clear obstacle to the effectiveness of the General Anti-Abuse Rule.

d. The burden of proof that an arrangement is abusive rests with HM Revenue & Customs and not with the taxpayer

Given all the obstacles put in the path of HMRC using the Rule it would logically be presumed that once they had overcome these hurdles the burden of proof that an arrangement was not abusive would rest with the taxpayer, but that is not the case in the Rule. Instead the burden of proof that an arrangement is abusive falls upon HMRC. As the Guidance notes on procedure for the Rule say[6]:

> In proceedings before a court or tribunal in connection with the GAAR, the burden of proof is on HMRC to show that:
>
> - there are tax arrangements that are abusive; and
> - the counteraction of the tax advantages arising from the arrangements is just and reasonable.

This is different to most tax appeals (apart from some penalty appeals) where the burden of proof in an appeal is on the appellant.

No satisfactory explanation for this reversal of normal practice, where it is customary for the taxpayer to be required to show that they have complied with the law, and not vice versa, has been provided. What is certain is that it places yet another obstacle in the path of HMRC using the Rule in practice. We believe that it is for a taxpayer to show that they did not intend to commit tax abuse by adopting a course of action rather than for HMRC to show that they did. The latter is a substantially more difficult standard to meet given that the taxpayer will hold all the evidence.

e. There are no penalties for using a scheme to which the Rule might be applied, meaning there is little or no disincentive to tax avoiders within it

Extraordinarily for a UK tax provision, the General Anti-Abuse Rule has no penalty regime attached to it. The TUC believe that a penalty should apply if a person made use of a scheme knowing that the Rule was likely to apply to it, but the Rule contains no penalty provision that can be directly applied to those committing the most extreme forms of tax abuse to which it applies. As such the General Anti-Abuse Rule provides no financial disincentive to those seeking to abuse tax law.

f. There is no arrangement where a taxpayer can ask whether or not the transactions they are proposing are within the scope of the Rule in advance of them undertaking the transactions, meaning that the Rule creates unnecessary uncertainty in the UK tax system

It is often said that the UK tax code is too complex and that it leads to uncertainty for taxpayers in the UK tax system. That is not a sentiment we entirely agree with: the complexity of the UK tax system appears to the TUC to match the complexity of the transactions that are undertaken in the modern business world. Without complex tax laws many of the arrangements that business might create would otherwise fall out of tax altogether. We did, however, have hope that there was scope for the GAAR to reduce the complexity of the UK tax system. However that could only happen if businesses were encouraged by any such rule to seek prior agreement for the transactions they proposed to undertake, so that the certainty they say is essential would be available to them before they proceed.

The General Anti-Abuse Rule does not, unfortunately, provide such a clearance system; the Guidance Notes state boldly[7]:

> The GAAR does not provide for a clearance system of its own.

This is unfortunate, because even the Prime Minister said[8] in January 2012:

> "We need strong frameworks that people can understand, not endless but ineffective box-ticking red tape. That's what lies behind the new anti-tax abuse rule that the Chancellor is examining, which will make the tax code simpler, not more complex, but stop abuse at the same time."

Without a clearance system there is almost no chance of any delivery on this promise. With a clearance system being available – where the details of transactions would be submitted to HM Revenue & Customs before they were undertaken, for advance approval – a complete General Anti-Tax Avoidance Principle could massively simplify tax law, not least because failure to apply for a clearance for a scheme offering a clear tax saving would be one of the criteria for determining whether a scheme was potentially to be considered tax avoidance.

Such clearances would, of course, impose a genuine cost on HM Revenue & Customs. However, if HMRC charged for the clearance, based perhaps on a proportion of the tax involved in the matter, those costs would be recoverable in full from business who already pay fees, for assessments which come with somewhat less certainty, to barristers and lawyers engaged in the private sector on tax matters. As such we think that this idea is not only cost effective, but would be welcomed by business, although perhaps not by its advisers.

3. What we need from a General Anti-Tax Avoidance Principle

For all the reasons noted above it is our belief that the UK has not got the General Anti-Tax Avoidance Principle it needs from the General Anti-Abuse Rule.

We are not alone in thinking so. In December 2012 the European Commission published a plan to tackle tax avoidance and tax evasion. Among its recommendations was one that EU member states should adopt a general anti-avoidance rule[9]. The suggested approach was significantly different from that adopted by the UK's General Anti-Abuse Rule, as was clear from the introduction to the idea in the EU's publications, which said:

> To counteract aggressive tax planning practices which fall outside the scope of their specific anti-avoidance rules, Member States should adopt a general anti-abuse rule, adapted to domestic and cross-border situations confined to the Union and situations involving third countries.

What is immediately apparent is that the EU thinks that such a rule should apply to international transactions of the sort that have been highlighted as abusive in so many press reports of late, but which are specifically *excluded* from consideration by the UK's Rule.

The approach to the legislation that the EU propose is also very different to that adopted in the UK. In their suggested legislation they say such a rule should be based on the following principle:

> An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored. National authorities shall treat these arrangements for tax purposes by reference to their economic substance.

This is a principles based test: it is also objective. An assessment criteria for determining action is specified. This provided considerably greater certainty than

the Rule, which omitted to spell out any such guidance[10].

The EU considered economic substance the key criteria for assessing whether tax avoidance was taking place or not, saying:

> For the purposes of [this law] an arrangement means any transaction, scheme, action, operation, agreement, grant, understanding, promise, undertaking or event. An arrangement may comprise more than one step or part.
>
> An arrangement or a series of arrangements is artificial where it lacks commercial substance. In determining whether the arrangement or series of arrangements is artificial, national authorities are invited to consider whether they involve one or more of the following situations:
>
> (a) the legal characterisation of the individual steps which an arrangement consists of is inconsistent with the legal substance of the arrangement as a whole;
>
> (b) the arrangement or series of arrangements is carried out in a manner which would not ordinarily be employed in what is expected to be a reasonable business conduct;
>
> (c) the arrangement or series of arrangements includes elements which have the effect of offsetting or cancelling each other;
>
> (d) transactions concluded are circular in nature;
>
> (e) the arrangement or series of arrangements results in a significant tax benefit but this is not reflected in the business risks undertaken by the taxpayer or its cash flows;
>
> (f) the expected pre-tax profit is insignificant in comparison to the amount of the expected tax benefit.

Its proposal was also far more objective with respect to determining whether or not abuse had taken place than the intense subjectiveness of the UK 'double reasonableness' test. The EU's suggested law says:

> For the purposes of [this law], the purpose of an arrangement or series of arrangements consists in avoiding taxation where, regardless of any subjective intentions of the taxpayer, it defeats the object, spirit and purpose of the tax provisions that would otherwise apply.

The EU also agreed that if these criteria were met then it would be up to the tax

authority to take action to stop the abuse, without any need to seek approval from a panel of tax industry experts being required.

The right of the taxpayer to appeal against the tax authorities' actions is, of course, included in the EU proposal, but it is for the taxpayer to prove that the tax authority was wrong to take action, and not for the tax authority to prove that it was right to do so. This is the normal standard of proof required in taxation cases.

The result is that the UK government rejected and the EU endorses legislation that:

- tackles tax avoidance in all its forms;
- does not exempt existing and established abuse from action being taken;
- includes within its scope international tax abuse;
- gives the right to a tax authority to take action against tax avoidance, which defines in an objective fashion capable of being numerically assessed, without the consent of any unelected authority;
- places the burden of proof on this issue on the taxpayer.

In addition that the TUC believe that UK legislation should include:

- penalties for someone seeking to use schemes that they knew might be barred by a General Anti-Tax Avoidance Principle;
- a paid for binding clearance scheme linked to a General Anti-Tax Avoidance Principle that would provide taxpayers with the certainty they say they need when undertaking complex financial transactions with serious tax implications.

We believe that in combination these proposals firstly expand the scope of the current General Anti-Abuse Rule to cover tax avoidance, whether domestic or international, and secondly, by providing an objective test for what is and is not within the scope of the measure, provide a principles based approach to tackling this issue. We believe this would remove the deeply subjective elements of the Rule that will in practice make it almost impossible to use.

The consequence is that while the TUC welcomed the General Anti-Abuse Rule as a first step towards the General Anti-Tax Avoidance Principle we need, we believe that it needs to be radically updated to reflect the need for a real tool to tackle all forms of tax avoidance that undermine the revenue of the government. That is why we argue for reform now, and suggest that a General Anti-Tax Avoidance Principle featuring the ideas noted here is the only progressive way forward on this issue.

[1] See, for example, http://www.taxjournal.com/tj/articles/anti-abuse-rule-would-make-tax-code-simpler-says-cameron-39211

[2] http://www.publications.parliament.uk/pa/bills/cbill/2013-2014/0018/14018.pdf

[3] Based on http://www.publications.parliament.uk/pa/bills/cbill/2013-2014/0018/14018.pdf

[4] http://www.hmrc.gov.uk/avoidance/gaar-part-abc.pdf page 17

[5] http://www.hmrc.gov.uk/avoidance/gaar-part-abc.pdf

[6] http://www.hmrc.gov.uk/avoidance/gaar-parte-procedure.pdf

[7] http://www.hmrc.gov.uk/avoidance/gaar-part-abc.pdf page 13

[8] http://www.taxjournal.com/tj/articles/anti-abuse-rule-would-make-tax-code-simpler-says-cameron-39211

[9] http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/c_2012_8806_en.pdf

[10] The same was also true of the General Anti-Tax Avoidance Principle Bill that Michael Meacher MP proposed in the UK parliament in opposition to the government's General Anti-Abuse Rule in September 2012 and which was rejected by the government.