TAXREP 6/13

(ICAEW REP 10/13)

ICAEW TAX REPRESENTATION

GENERAL ANTI-ABUSE RULE

Comments submitted on 6 February 2013 by ICAEW Tax Faculty to introduce a General Anti-Abuse Rule (GAAR) and HMRC's draft GAAR Guidance published on the same date. The draft clauses to be included in Finance Bill 2013

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the draft Finance Bill clauses for a General Anti-Abuse Rule (GAAR) published on 11 December 2012 and HMRC's draft GAAR Guidance published on the same date. We have contributed to the development of the GAAR since the establishment of the GAAR study group under Graham Aaronson and latterly with HMRC's anti avoidance team. We also submitted written and oral evidence on the GAAR to the House of Lords Economic Affairs Finance Bill Sub-Committee in January 2013.

2. On 16 January 2013 we attended a meeting with HMRC at which we were able to put forward some key comments and concerns and discuss aspects of the draft clauses and draft GAAR Guidance.

3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

5. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

OUR COMMENTS

General

7. Any anti avoidance provision needs to be properly targeted, and a balance needs to be struck between the need for taxpayers to have certainty and the need to counter abusive tax arrangements. The approach of the GAAR throughout has been to counter egregious tax schemes while leaving tax planning in the centre ground. While we have consistently supported the proposed GAAR, there remains considerable uncertainty as to whether particular arrangements will actually be caught. This potential uncertainty could have been addressed by adopting a clearance procedure within the GAAR. However, the GAAR does not include a clearance procedure because it is believed that the GAAR is sufficiently targeted only at abusive schemes.

8. In practice, it remains unclear as to whether particular arrangements will fall within the GAAR and, for example, whether the GAAR would have countered the various tax avoidance schemes that have come before the courts in recent years. Further, the scope of the GAAR has been extended to include IHT and, while in principle we can appreciate why this step was taken, in practice IHT planning will often be undertaken for personal/family reasons with little or no commercial rationale, thus potentially triggering the GAAR.

Guidance

9. In the main we believe these concerns about the scope of the GAAR can be addressed by suitable examples in the Guidance. However, it will be some years before we will be able to tell

if this is the case. HMRC needs to continue working with stakeholders to add more examples to the guidance of what will be caught by the GAAR.

10. In relation to the draft Guidance we set out below the points that we made in the meeting with HMRC on 16 January 2013.

11. The example at 4 deals with IHT and gifts with reservation in the context of a deferred lease scheme. At 4.1.5.3 the question is asked whether the arrangements intend to exploit any short comings in the relevant tax provisions. There is then the statement that 'the failure of the rules to cover a situation where an individual creates two different interests in a property is a shortcoming that the scheme is intended to exploit'. We suggested at the meeting that this wasn't quite right. These rules were based on the Estate Duty provisions from the last century, and all of the estate duty cases about these rules were based on a minute dissection of whether two separate classes of assets had been created; these rules were then introduced for inheritance tax purposes so that this distinction was well understood. We made the point that a high level of tax knowledge was required in order to make sense of the guidance. The Pre-owned assets tax (POAT) would, in any event, apply in the circumstances outlined which meant that no one would ever do a deferred lease now. HMRC noted at the meeting that they were aware that the IHT rules had changed so the idea would not be put into practice. We recommend the replacement of the current example by a different one.

12. We also recommended that the example in 7.2.2 needed to be changed. There was a suggestion that after the share for share reorganisation a loan note holder having sold his shares moved to Spain and redeemed his or her loan notes tax free. The text simply says ' Some time after the exchange'. We recommended that it should be clear that the intention to emigrate should not exist at the time of the share for loan note swap, because under HMRC practice this might cause share for share treatment to be withheld.

13. Finally we also suggested that the example of putting a farm in a trust in section 8 was weak; we would not consider that such a step was egregious tax planning or that putting a farm into a trust was contrived.

Clearance

14. The current draft clauses do not include a specific clearance measure. We remain concerned that the GAAR will impose considerable extra administrative burdens on those responsible businesses engaged in the centre ground of tax planning in that they will wish to be satisfied that any tax planning arrangements, however unexceptional, will still need to be tested against the GAAR.

15. We understand that CBI is preparing a number of specific corporate examples of standard and acceptable tax planning to demonstrate what the GAAR is not intended to catch for prospective inclusion in the Guidance. We believe the guidance should also include standard examples of transfer pricing in relation to acceptable international arrangements so that there is a clear perception of what is acceptable international tax planning.

International legality

16. Aside from the administrative burdens we are also concerned about whether the GAAR is lawful in relation to its application to the UK's tax treaties. The UK ratified the Vienna Convention on the Law of Treaties on 25 June 1971 and Article 26 states that 'Every treaty is binding upon the parties and must be performed by them in good faith' and Article 27 further states that 'A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. The proposed GAAR will effectively over-ride the UK's international obligations already written into its double tax treaties and could therefore be held to be unlawful.

17. We accept that in relation to treaties with fellow OECD members this concern is probably addressed by specific OECD agreements, but this still leaves about 100 treaties with non-

OECD countries where the GAAR may be unlawful as it stands. Amendments to the nature and scope of double tax treaties need to be agreed bilaterally not unilaterally and it is essential that the UK honours its international treaty commitments.

18. We believe this concern could be addressed relatively easily by amending the draft clauses to make it clear that where the context so requires the GAAR will not be regarded as overriding the UK's treaty obligations. Such a statement was included in the draft illustrative GAAR produced by Graham Aaronson and we believe that this provisions (or something similar to it) should be reinstated.

Transitional rules

19. The operation of the proposed transitional rules, where part of the planning is before Royal assent and part after is not clear. The problem is mainly in the private client area where actions can be taken many years in advance and there could then be actions, and consequences, after Royal Assent.

20. For example what would happen where A had undertaken a home loan plan and simply decided to pay pre-owned assets tax to preserve the IHT advantages and then dies after Royal Assent; would death mean that the completion of the home loan plan would be considered to have taken place, so that the GAAR would apply. At the meeting on 18 January 2013 HMRC confirmed that death cannot be an avoidance step.

21. We then gave a further example of B who establishes some pilot Will Trust before Royal Assent in conjunction with his Will. Under his Will his shares in his private company will be transferred to the Pilot Will trust in some fractional amounts; the reason being that their value would be significantly fragmented as compared to the value of a 100% holding. The question was - assuming the GAAR could apply in any event - would B's death be treated as an avoidance step in its own right; or would the Will be treated as speaking from the date of death, and therefore be treated as being post Royal Assent. HMRC said that death would not be treated as an avoidance step, and that they were currently minded to treat the date of execution of the Will as being the material date. We then queried what would happen if the Will was altered by a later Codicil or if some other step was taken? HMRC said that it might bring the GAAR into play.

22. We also asked about growth shares; was it enough that the growth shares were owned before Royal Assent or would they be caught if the growth in value event took place after Royal Assent. HMRC said if they were caught, growth could be apportioned to the periods before and after Royal assent.

23. We also asked about base cost shift in partnerships, where the partner giving up the right to capital was not taxable but the recipient might be (but had a higher base cost). Is the arrangement grandfathered at the time the partnership was set up, or is it the time of the base cost shift that matters? At the time of the 16 January meeting HMRC were not sure but seemed to think it is the time of the base cost shift.

The future

24. It is too early to tell whether the GAAR will lead to any meaningful simplification of the tax system - indeed in the short to medium term it is likely to add to existing complexity. Over time, it may counter abusive arrangements for which specific anti avoidance provisions exist so that they could be repealed. Further, if it is found to be effective, it should reduce the need in the future for additional targeted anti-avoidance measures. However, the experience of other countries (for example Ireland) is that it could take 20 years for the GAAR to be tested in the courts, so the Government will have little choice but to continue with its existing legislative approach to countering avoidance.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)