A GENERAL ANTI-ABUSE RULE: A RESPONSE TO THE CONSULTATION DOCUMENT PUBLISHED 12 JUNE 2012

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Executive Summary

Author's summary of main conclusions and recommendations.

1 While I do not impeach the objectives sought to be attained, the draft legislation proposed is not fit for the purpose of attaining those objectives and there is a fundamental flaw at the core of the draft clauses, namely in draft clause 2(2). While it may be stated at 5.14. of the Consultation Document "the legislation … is targeted only at artificial and abusive schemes" it could catch much, much more.

2 If a GAAR is enacted in the form proposed in the Consultation Document the very objectives which all agree are desirable will not be attained. There will be decades of uncertainty and litigation before the law becomes anything like clear. The cost to business, as well as to taxpayers who do not carry on business, will be enormous, as will the administrative strains imposed on an already overworked Revenue. And those who have a choice where to locate their businesses and / or where to live will find the United Kingdom a much less exigible option.

3 I have very serious objections, which every lawyer and everyone concerned with the Rule of Law and in particular the rules of natural justice and / or the doctrine of separation of powers will share, to the

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inclusion of members of HMRC in, and its relationship with, the Advisory

Panel, given the special status which guidance and of opinions of that Panel is intended to have in litigation to which HMRC will be itself a party.

4 I have serious concerns as to whether self-assessment is appropriate to the GAAR. Instead, I propose that the procedure established in 1960 in relation to what is now Income Tax Act 2007 Part 13 Chapter 1 (Tax Avoidance - Transactions in Securities) should be followed. The Advisory Panel should perform a role corresponding to that of the section 697 tribunal.

5 My alternative proposal is for a TAAR (or mini-GAAR) for Income Deductions.

6 In the alternative, I proposed my own draft GAAR. This builds on the decision of the House of Lords in *Willoughby v IRC*. In my submission, the only sort of tax planning a GAAR should catch is that which is inconsistent with the hypothetical intention of Parliament, that is, what Parliament would have enacted had it been served by rather more skilful Revenue officials and draughtsmen. If, and only if, we can we sure - because it is "evident" - that, if Parliament had realised the effect of its words, as contained in the statute, it would have altered them so as to ensure that the tax advantage would not have accrued in the circumstances stated, can the GAAR operate. All of the cases mentioned in Annex B to the Consultation Document would have fallen foul of a GAAR couched in these terms.

7 It is not enough for the GAAR to provide that counteraction should be "on a just and reasonable basis." The counteraction ought to be such as, having regard to any consequential adjustments which fall to be made, any person who has entered into the abusive arrangements and obtained a tax advantage is in the same position as he would have been in had he not done so.

8 It should be made clear that a Double Taxation Arrangement would override the GAAR. Thus, in those cases where, consistently with the provision of the Double Taxation Arrangement in question, the GAAR could operate, it would still do so. (If HMRC's view were correct, that would be in every case.)

9 In order that justice can be done - and be seen to be done - no present or former official of HMRC (or, indeed, for that matter, no present or former civil servant or Treasury minister) should be a member of Advisory Panel.

10 The combined effect of the proposals relating to Guidance are worthy of Sir Humphrey Appleby. The combination does not accord with the requirements of natural justice that justice should not only be done but be seen to be done and in an impartial way.

11 I therefore propose that the Guidance be produced by HMRC and that in any subsequent litigation, the Guidance could then be relied on but only by the taxpayer, as against HMRC, without prejudice to right of HMRC to repeat their Guidance by way of legal submission.

12 The GAAR should not apply to inheritance tax, as it is a fundamentally unprincipled and technical tax and the extension would lead to a wholly disproportionate amount of litigation.

The Aaronson Report

13 On 11th November 2011 there was published a report by Graham Aaronson QC ("the GAAR Study") entitled "GAAR STUDY", described as "A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system."

Graham Aaronson Q.C.

14 Graham Aaronson Q.C. was an interesting choice as the author of the GAAR Study. As the Senior Silk of Pump Court Tax Chambers, Graham Aaronson Q.C. ought to know all about tax avoidance. And as one who has spent most of his professional life acting for taxpayers, one might expect him to exhibit that detached and dispassionate approach which clients are, in my view, entitled to expect from their barrister.

15 It was therefore with something which went beyond astonishment that I read in *The Times* June 19th 2012, Page 1, bottom right hand corner:

> "Graham Aaronson Q.C., a tax barrister who has written new

rules for the Government to combat aggressive, albeit legal, tax

> schemes said that schemes like K2 made his blood boil.[2] "People ask me how much tax I pay," Mr Aaronson said. "At the moment it's 50 per cent. I feel absolutely furious when people tell me they pay 3 per cent because of some artificial scheme.""

16 The "K2" scheme, so far as one can judge from the inexpertly written report in *The Times*, appears to have been a piece of vanilla planning involving in substance nothing more artificial than a worker agreeing to take a reduction in salary now, coupled with a loan from a trust to help make good his reduced cash flow. So far as one can tell, if the loan is made on favourable terms as to interest, i.e. at less than the "official rate", as defined in Income Tax (Earnings and Pensions) Act 2003 section 181, he will have to pay income tax on the benefit in kind; and if and when he is ever given additional benefits from the trust, he will then be taxable as when he receives them. A strategy like that certainly does not make my blood boil. Indeed, in my view, it falls firmly on the side of legitimate tax planning (or tax mitigation) and is not tax avoidance. And I am sure that even Lord Templeman, the arch-enemy of tax avoidance, would agree with me.[3] There is a reduction in the income tax liability simply because, and only for so long as, there is a genuine reduction in the income of the taxpayer. If and when he becomes entitled to or receives deferred remuneration, he will be then be taxable on it. That principle is a familiar one and lies at the heart of our tax law. That is why, for example, a person, e.g. a civil servant working in the Revenue or a Judge hearing tax appeals, does not pay tax on benefits when he earns them but only if and when he receives them. If, for example, he earns part of his pension in Year 1 but does receive it until Year 20, he is not

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2 As a barrister, I conceive it to be my duty to give *dispassionate* legal advice to any client who may care, in accordance with the cab-rank rule, to consult me. My duty is to advise not with blood boiling but, literally, with "sang froid" (i.e. "cold blood"). I must abandon all feelings of fury and keep any emotions I may feel firmly under control. I must apply my skill, energy and intellect to give the best possible advice I can on the law. I am not a spiritual or moral adviser. I am not the keeper of my client's conscience. It is for my client to decide how to act (or abstain from acting) having heard my advice on the law. (Those of us who are a Christians may well find the decision a very easy one, given that we believe we have divine guidance on the sinfulness of tax evasion and the propriety of tax planning, whether or not involving tax avoidance: see *St Matthew's Gospel* Chapter 22 verse 21.)

3 See *Commissioner of Inland Revenue v Challenge Corporation* LTD. [1987] A.C. 155 at page 167: "Income tax is mitigated by a taxpayer who reduces his income … which reduce(s) his assessable income …" Lord Templeman was there contrasting "tax mitigation" with "tax avoidance".

taxable until Year 20. And that is still the case where in Year 1 he has a

contractual entitlement accruing - a stronger case than, it would appear, than "K2", where there would appear to be no present right to future enjoyment.[4]

17 One appreciates, of course, that the Murdoch Press have had access to information which is not available to the rest of us. Anyone who has followed the Leveson Enquiry will know all about that. Yet it is also true that the press in general - and the Murdoch Press is no exception - does not always report matters with complete accuracy. I, for one, find it difficult to believe that a man of the experience and wisdom of Graham Aaronson Q.C. can actually have made the remarks ascribed to him.

18 Whatever Graham Aaronson Q.C. may or may not have said, the series of articles in *The Times*, beginning on June 21st is an important reminder that views can differ enormously on what amounts to unacceptable tax avoidance. And the fact that even the Prime Minister, who, as a politician, ought to know better, so rashly and so imprudently - and so ignorantly - intruded into the debate, shows just how the Rule of Law, which we have enjoyed since the Glorious Revolution of 1688, can suffer when journalists and politicians rush in where wise men would tread only with the utmost circumspection.

19 **That is why any legislation implementing a GAAR must be in objective terms which do not allow any room for the intrusion of unpredictable and varying individual value judgments. As will be seen, both the draft legislation proposed by Graham Aaronson Q.C. and that proposed in the Consultation Document fails to meet that basic requirement.**

The GAAR Study Group

20 It is only on reading the GAAR Study that one appreciates the Graham Aaronson did not act alone but was the "Study Leader" of a group referred to in the GAAR Study as "The GAAR Study Group". The rest of the GAAR Study Group is referred to the "Advisory Committee". The full membership of the GAAR Study Group is set out in Annex II to this

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4 Of course, if the taxpayer had continue to be entitled to the same income but had somehow definitively reduced his income tax liability on that income, then the case would be very different and the question would arise whether he had indeed indulged in more than

Response.

21 No one can deny that the Advisory Committee was most distinguished. Yet I would respectfully ask whether they were really the most suitable *cross-section* of persons. The main failing is that only one of them is in private practice advising the economically productive who subsidise the rest of society, i.e. taxpayers, and none is, or has been, to my knowledge, a non-corporate tax practitioner advising taxpayers.. Thus, while I have no criticism to make of any of the distinguished members of the Advisory Committee, taken individually, my main criticism is that it was not well-balanced it that it did not contain anyone who advises on non-corporate tax or any member of the Revenue Bar, experienced as we are with all the problems, including expensive litigation, thrown up by ill-conceived legislation.

Conclusions of the GAAR Study

22 Few, I imagine, would disagree with the broad thrust of the most important conclusions of the GAAR Study. I certainly would not. They are:

> "1.5 I have concluded that introducing a broad spectrum general anti-avoidance rule would not be beneficial for the UK tax system. This would carry a real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning. Such tax planning is an entirely appropriate response to the complexities of a tax system such as the UK's.
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> 1.6 To reduce the risk of this consequence a broad spectrum rule would have to be accompanied by a comprehensive system for obtaining advance clearance for tax planning transactions. But an effective clearance system would impose very substantial resource burdens on taxpayers and HMRC alike. It would also inevitably in practice give discretionary power to HMRC who would effectively become the arbiter of the limits of responsible tax planning.
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> 1.7 However, introducing a moderate rule which does not apply to responsible tax planning, and is instead targeted at abusive arrangements, would be beneficial for the UK tax system. Such a rule could bring a number of significant benefits -
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> (i) First and foremost, it would deter (and, where deterrence

legitimate tax planning and had crossed the line into tax avoidance.

fails, counteract) contrived and artificial schemes which

are widely regarded as an intolerable attack on the integrity of the UK's tax regime. Such schemes make a mockery of the will of Parliament. In discussions with various representative bodies of the tax profession there has been unanimity of view that such schemes are wholly unacceptable.

(ii) Introducing such a targeted rule should contribute to providing a more level playing field for business: enterprises which conduct responsible tax planning would no longer have their competitiveness undermined by others which seek to reduce their tax burden by contrived and artificial schemes. Likewise tax professionals who are not willing to recommend or implement such schemes will not have their client base eroded by those who are prepared to do so.

(iii) At the moment, in the absence of any such anti-abuse rule, the task of judges in the Tax Tribunals and the Courts in dealing with abusive schemes is confined to deciding whether such schemes succeed or fail by applying the normal principles of statutory interpretation to the tax provisions concerned. Judges inevitably are faced with the temptation to stretch the interpretation, so far as possible, to achieve a sensible result; and this is widely regarded as producing considerable uncertainty in predicting the outcome of such disputes. In practice this uncertainty spreads from the highly abusive cases into the centre ground of responsible tax planning. A GAAR specifically targeted at abusive schemes would help reduce the risk of stretched interpretation and the uncertainty which this entails.

(iv) The UK's tax legislation is notoriously long and complex. In many places it is virtually impenetrable. A significant contributing factor to the length and complexity is the need for the drafting of any given set of rules to anticipate attempts by some taxpayers to avoid the application of those rules, or exploit their application, in a way that Parliament could not rationally have contemplated.

Enacting an anti-abuse rule should make it possible, by eliminating the need for a battery of specific anti-avoidance sub-rules, to draft future tax rules more simply and clearly. Also, fewer schemes would be enacted and so there will be less call for specific remedial legislation.[5]

(v) In time, once confidence is established in the effectiveness of the anti-abuse rule, 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. This would lead to a significant improvement in the certainty of operation of the existing body of tax rules.[6]

(vi) An anti-abuse rule which is targeted at contrived and artificial schemes will not apply to the centre ground of responsible tax planning. Consequently there will be no need for a comprehensive system of clearances, with the resource burdens which such a system would require.

(vii) The centre ground will of course have its outer limit; and taxpayers who wish to test the location of that limit by their tax planning will remain free to do so. A mechanism such as an independent advisory panel would be a quick and cost-effective way of helping taxpayers and HMRC identify the location of this outer limit, without running the risk of giving greater discretionary powers to HMRC.

In this particular context it is important to note that at present the effectiveness of some tax planning is uncertain, given the willingness of HMRC to challenge such schemes and the unpredictability of the response of the Tax Tribunals and Courts to such cases. Accordingly,

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5 While this is an important consideration, I am sceptical as to whether simpler and clearer legislation will in fact result.

6 While this is an important consideration, I am sceptical as to whether simpler and clearer legislation will in fact result. In particular, the "Office of Tax Simplification" is a title worthy of *1984*. The Office has so far at least been concerned principally with the abolition of reliefs. I note that its work is expected to cause revenue receipts to increase dramatically! A prime example is the phasing out of age-related allowances which were described by the Office as "a source of complexity in the tax system"! (I note that no one who finds them too complex has to claim them!) See paragraph 1.199 of the Budget Report. laid before the House of Commons by the Chancellor of the Exchequer when opening the Budget on March 21st 2012. I mention too below its brilliant idea for taxing the proceeds of sale of minerals - inherently capital - as though they were income.

a specifically targeted anti-abuse rule should not

significantly increase the area of uncertainty.

(viii) It should help and inform the public debate about tax avoidance and abusive practices; and it should help build trust between taxpayers and HMRC, as the boundaries between acceptable and unacceptable behaviours are clarified."

23 Thus, it is proposed that the new GAAR should be targeted at only "contrived and artificial" and "abusive" schemes, which "make a mockery of the will of Parliament" and exploit rules "in a way that Parliament could not rationally have contemplated". It should not apply to "the centre ground of responsible tax planning." Again, I do not dissent from that conclusion

24 The devil is, as always, in the detail. Any GAAR legislation must

(a) catch only those "contrived and artificial" and "abusive" schemes, which "make a mockery of the will of Parliament" and exploit rules "in a way that Parliament could not rationally have contemplated"

(b) be sufficiently certain in its application and in particular

(c) not depend on value judgments to be made, in the first instance by HMRC, and in the last resort by the Courts.

25 The illustrative draft GAAR in Appendix I to the GAAR Study did not, in my respectful view, pass muster. The fact that the Consultation Document has proposed, in Annex D, a different draft GAAR, gives me the impression that the Government shares my view.

The Consultation Document

The 2012 Budget Report

26 In his Budget Report. laid before the House of Commons by the Chancellor of the Exchequer when opening the Budget on March 21st 2012, he stated:

"The Government's ambition is to create the most competitive tax

> system in the G20. Budget 2012 announces reforms that will lower
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> headline tax rates to support enterprise, aspiration and growth, while ensuring that tax revenues from the best-off are higher in each year. The Government will:
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> > …
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> > accept the recommendation of the Aaronson Report that a General Anti-Abuse Rule (GAAR) targeted at artificial and abusive tax avoidance schemes would improve the UK's ability to tackle tax avoidance while maintaining the attractiveness of the UK as a location for genuine business investment.
>
> The Government will consult with a view to bringing forward legislation in Finance Bill 2013."

Publication of the Consultation Document

27 On June 12th 2012 there was published by David Gauke, the Exchequer Secretary, and Her Majesty's Revenue and Customs a Consultation Document entitled "A General Anti-Abuse Rule" ("the Consultation Document") to which responses are invited by September 14th 2012.

28 The subject of this consultation is stated as "Proposals to introduce a general anti-abuse rule ("GAAR") targeted at artificial and abusive tax avoidance."

29 The scope if the consultation is stated as "This consultation seeks comments on the details of the proposal to introduce a GAAR, including draft legislation."

30 While the Consultation Document builds on the GAAR Study, it by and large supersedes it. In particular, it proposes, in Annex D, a rather different draft GAAR, which is admittedly, on balance, an improvement on the one contained in the GAAR Study.

Overview of Consultation Document

31 **I do not impeach the objectives sought to be attained. Instead, I conclude that the draft legislation proposed is not fit for the purpose of attaining those objectives.** I do not wish to appear critical of the GAAR Study Group or of the authors of the Consultation Document.

Having myself considered what form a draft GAAR should take, the best I can come up with, although, in my respectful view, a substantial improvement on that contained in Annex D to the Consultation Document, itself on the whole an improvement on the Illustrative GAAR contained in the GAAR Study, is still, frankly, not entirely satisfactory. Thus, although I make my own proposal below, I am driven to the conclusion that an entirely different approach is needed, one which would in the vast majority of cases - and, quite possibly, in all cases, deal with the problems which have hitherto been encountered, yet which would not create any real uncertainty in the law or be inimical to HMRC, to business or, indeed, to taxpayers who do not carry on a business. That is an income tax TAAR or, if you like, a sort of mini-GAAR. I discuss that below.

32 **While the views expressed in the Consultation Document (as in the GAAR Study) are very reasonable and will no doubt command general approval, my great fear is that if a GAAR is enacted in the form proposed in the Consultation Document (and *a fortiore*, in the form proposed in the GAAR Report, or, indeed, in some mixture of the two), the very objectives which all agree are desirable will not be attained.** There will be decades of uncertainty and litigation before the law becomes anything like clear. The cost to business, as well as to taxpayers who do not carry on business, will be enormous, as will the administrative strains imposed on an already overworked Revenue. And those who have a choice where to locate their businesses and / or where to live will find the United Kingdom a much less exigible option. The only winners will be members of the Revenue Bar Association (of England and Wales), whose workload will increase immensely, as they will be best placed to predict which way judges would be likely to "jump".

33 **I also have very serious objections, which every lawyer and everyone concerned with the Rule of Law and in particular the rules of natural justice and / or the doctrine of separation of powers will share, to the inclusion of members of HMRC in, and its relationship with, the Advisory Panel, given the special status which guidance and of opinions of that Panel is intended to have in litigation to which HMRC will be itself a party.** I therefore make proposals which I believe should circumvent what I regard as these very serious objections.

34 I also have serious concerns as to whether self-assessment is appropriate to the GAAR. Instead, I propose that the procedure established in 1960 in

relation to what is now Income Tax Act 2007 Part 13 Chapter 1 (Tax

Avoidance - Transactions in Securities) should be followed. If HMRC wished to invoke the GAAR, they should first give the taxpayer an opportunity to refer the matter to a special tribunal (in effect, the Panel, but not containing any members from or connected, now or previously, with HMRC) which could prevent an assessment. Only if the Panel was not invoked or refused to prevent the assessment could one be issued.

35 I am concerned at what I see as a proposal that "Perfidious Albion", more strictly, the United Kingdom, should dishonour its international treaty obligations.

36 I have other, relatively minor, concerns, set out in this response.

37 Inevitably, this response concentrates on the matters on which I find myself unable to agree with the Consultation Document and passes over very quickly the considerable number of matters with which I do agree. The author of the Consultation Document has obviously put a great deal of work into its preparation, as has Graham Aaronson Q.C. and the rest of The GAAR Study Group, of which I am most appreciative.

The Views and Objectives of the Government

38 David Gauke sets out clearly in his Forward to the Consultation Document the Government's position:

> "This Government has made a firm commitment to tackling tax avoidance. As part of our new approach to tax policy-making, we set out proposals to take a more strategic approach to the risk of avoidance by building in sustainable defences against avoidance opportunities. Through collaborative consultation and well-designed legislation, our aim is to prevent avoidance at the outset, reducing the need for counteraction.
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> Consideration of a general anti-avoidance rule to tackle avoidance was a key element of those proposals. Since 2010 we have engaged extensively with businesses and tax professionals on the implications of such a rule. In December 2010, I asked Graham Aaronson Q.C. to lead an independent study that would consider whether a general rule could deter and counter tax avoidance, whilst retaining a tax regime that is attractive to businesses. The rule would have to provide sufficient certainty about the tax

> treatment of transactions without resulting in undue costs for
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> businesses and Her Majesty's Revenue & Customs (HMRC).
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> In his independent report, Graham Aaronson concludes that a general anti-abuse rule would deter artificial tax avoidance schemes that can only be regarded as wholly unacceptable. Furthermore, it would contribute to providing a more level playing field for business.
>
> The Government accepts Graham Aaronson's conclusion, and also agrees that a "broad spectrum" anti-avoidance rule would not be beneficial for the UK tax system. Such a rule would risk compromising the certainty that is vital to provide the confidence to do business in the UK. That is why the Government announced at Budget 2012 that it would consult on a General Anti-Abuse Rule (GAAR) targeted at artificial and abusive tax avoidance with a view to bringing forward legislation in Finance Bill 2013.
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> This consultation document sets out concrete proposals for tackling the continued risk of artificial and abusive tax avoidance schemes. Through constructive consultation I am confident that these proposals will result in legislation that effectively tackles such schemes whilst minimising the impact on the vast majority of compliant taxpayers and on HMRC."

39 He rightly stresses that:

(i) a GAAR must not come at too great a price in that:

(a) it must not "risk compromising the certainty that is vital to provide the confidence to do business in the UK"

(b) it must ensure we must retain "a tax regime that is attractive to businesses"[7]

(c) the rule must provide sufficient certainty about the tax treatment of transactions without resulting in undue costs

(ii) the GAAR must be narrowly targeted in that it should be aimed

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7 This is amplified, rightly, at paragraph 1.6 of the Consultation Document: "The Government has been clear that any GAAR must ensure that sufficient certainty about the tax treatment of transactions could be provided without undue costs for businesses, *individuals* and HMRC." (Italics added by R.V.) Individuals are entitled to fair treatment, just as much as businesses.

only at "artificial" and "abusive" "tax avoidance" schemes that

can only be regarded as wholly unacceptable[8]

40 As to (ii), the body of the Consultation Document sometimes uses slightly different language. For example, at 1.8 it is stated: "Chapter 2 describes the target of the GAAR; that is, abusive *and* artificial tax avoidance schemes." (Italics added by R.V.) Then again, it is stated at paragraph 2.1. that the Government agrees with the Report's recommendation to introduce a rule which is targeted at "artificial and abusive arrangements (those that the Report refers to as "*egregious*", "*very aggressive*" or "*highly abusive contrived and artificial*"). I do not myself consider that "contrived" or "aggressive" add much, if anything, to the basic concept. The sort of tax planning which might be regarded as"abusive" "tax avoidance" is very unlikely not to be regarded as "contrived" or "aggressive".

41 What is lacking in the draft clauses in the Consultation Document is any reference to "Parliament". That is, in my view, unfortunate. For if it is possible to enact a GAAR which will satisfy the agreed requirements, in my view that can only be done by reference to the (hypothetical) will of Parliament.

The Consultation Document Draft GAAR

The Proposed Filter(s)

42 The draft GAAR is set out in Annex D to the Consultation Document. It is commendably short, consisting of just seven clauses, with one Schedule concerning procedural requirements to be added.

43 **Unfortunately, it is in my view fundamentally flawed at the core, namely draft clause 2(2). While it may be stated at 5.14. of the Consultation Document "the legislation … is targeted only at artificial and abusive schemes" it could catch much, much more.**

44 We are told, in clause 1(1), that "This Part has effect for the purpose of counteracting tax advantages arising from tax arrangements that are

8 See also paragraph 1.7 of the Consultation Document: "The Government therefore agrees with the Report that a rule targeted at *abusive tax avoidance arrangements* would be the right approach for the UK tax system." (Italics added by R.V.)

abusive."

45 Clause 2(1) defines "tax arrangements" as follows:

> "(1) Arrangements are "tax arrangements" if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements."

46 This takes us on a (short) paper chase to clause 3 (Meaning of "tax advantage"), which provides:

> "A "tax advantage" includes-
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> (a) relief or increased relief from tax,
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> (b) repayment or increased repayment of tax,
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> (c) avoidance or a reduction of a charge to tax or an assessment to tax,
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> (d) avoidance of a possible assessment to tax,
>
> (e) a deferral of a payment of tax or an advancement of a repayment of tax, and
>
> (f) avoidance of an obligation to deduct or account for tax."

47 This is the widest possible partial definition. Although the word "includes" is used, it is difficult to see what else could fall within the meaning of "tax advantage". It includes tax advantages obtained in all sorts of circumstances, including the vast majority of circumstances where there will be nothing which could possibly be described as "contrived", "artificial" or "abusive". It could include, for example, the situation where a woman gives up her job to spend more time with her family. Thus, this definition in itself does nothing to limit the GAAR to egregious cases of abusive tax avoidance.

48 The rest of the definition of "tax arrangements" in clause 2(1), cited above, imposes some further restriction on the scope of the GAAR, but again, by itself, not much. The vast majority of situations where the obtaining of a tax advantage was one of the main purposes of arrangements will not be egregious cases of abusive tax avoidance. Indeed, in some of them the taxpayer may be responding to a freedom from tax offered by Parliament in order to encourage him to act in a certain way, for example, to give to charity or to invest in an enterprise

zone, and his taking up that offer can only be regarded as commendable.

49 So it is left to clause 2(2) to enact the only real filter to distinguish egregious cases of abusive tax avoidance from other forms of tax planning. It provides:

> "(2) Tax arrangements are "abusive" if they are arrangements the
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> entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action, having regard to all the circumstances including-
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> (a) the relevant tax provisions,
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> (b) the substantive results of the arrangements, and
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> (c) any other arrangements of which the arrangements form part."[9]

50 **My fundamental objection to the draft GAAR contained in the Consultation Document[10] is that no effective attempt is made to define "abusive, artificial and contrived tax avoidance" and that the so-called "double reasonableness" test is inherently vague and relies on value judgments which the reader is asked to make for himself, on a non-objective basis and without any sufficient guidance. It thus fails the certainty test which is a basic requisite for any GAAR.[11]**

51 What I find amazing is that, neither in the GAAR Study nor in the Consultation Document is there any definition of "tax avoidance". Indeed, in the draft legislation contained in neither does one find the term. In my view, it is necessary to go back to first principles and first define

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9 While subsections (3) - (5) are meant to provide some further elucidation, they hardly assist. See below.

10 While I do not consider the one contained in the GAAR Study will pass muster, either, it was in this respect nearer to what, in my view, is the only possible effective filter, namely one based on the evident or manifest (hypothetical) intention of Parliament. Indeed, it is possible that by referring to "a reasonable exercise of choices of conduct " in his Illustrative GAAR, Graham Aaronson Q.C. was influenced, if only subliminally - he does not refer to it in the GAAR Study - , by the speech of Lord Nolan in *IRC v Willoughby*, which has been the inspiration of my GAAR. (I respectfully agree with the criticism of the precise approach of Graham Aaronson Q.C. made in the Consultation Document at paragraph 3.12.)

11 It brings to mind the old Latin tag "*Quot homines, tot sententiae*" ("There are as many views as there are men" or "Each man has a different view") and reminds me when, in the early days of the development of Equity, the Lord Chancellor sought to decree what was "right", the result was inconsistency and it was said "Equity varies with the length of the Chancellor's foot."

that which one wishes to proscribe. That, I shall now attempt to do.

The First Question: "What is "Tax Avoidance"?"

52 With my background as an Oxford analytical philosopher,[12] I myself would have started by seeking to define, as closely as might be, what was meant by the expression "tax avoidance". For as every philosopher knows,[13] many of the disputes which have plagued mankind could easily have been resolved had the parties simply defined their terms. And even the layman who is not a philosopher can readily appreciate the folly of hurtling into a long discussion of how something can be counteracted without first ascertaining and defining what that something is.

53 Surprisingly, Graham Aaronson Q.C. did not think it necessary to embark on this, to my mind, vital preliminary step. And neither did HMRC in producing the Consultation Document. No doubt they all thought they knew exactly what was meant by "tax avoidance" and could easily dispense with that preliminary enquiry. Yet as any student of philosophy knows, and most competent lawyers know, terms in everyday use can means different things to different people and can even mean different things to the same person, dependent on their context.[14]

54 If this had been my study group, I would have first addressed the question what was meant by "tax avoidance", given that it was something regarded as objectionable and to be counteracted, provided that could be done without too great a cost. Now anyone who knows me will be able to tell you what a naturally humble person I am. So, I would not have attempted to answer this question *a priore* by my own unaided efforts but would have sought inspiration and guidance from those awfully clever and experienced judges who have gone before us and expatiated in their judgments on the matter. And I would have tried to build upon their wisdom and reflections. If only Graham Aaronson Q.C. and the Study Group had not been so clever or, despite being so clever, had been more diffident about their own abilities than I am, they might well have followed

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12 before I became an Oxford lawyer and then an Oxford Law Don. (I retired as a full-time Don in 1980.)

13 or at least, any analytic philosopher, who are the philosophers worth rating.

14 A classic (and classical) illustration is the First Book of Plato's *Republic* in which Socrates asks "What is justice?" He receives a variety of answers and, through his apparently naive cross-examination, shows his interlocutors how unjustified is their self-confidence in the rightness of their own (divergent) views.

that course. Yet they did not.[15] So I have myself undertaken the task which

they have shirked and now set out the results. And if the reader doubts whether it was worthwhile, let me state at the outset that a consideration of what is meant by "tax avoidance" has lead me to what I consider a possible solution to the problem of how to legislate for a GAAR which will, unlike the draft legislation set out in the GAAR Study and the Consultation Document, in fact meet the objectives set out by the Exchequer Secretary.

"Tax Avoidance" and Value Judgments

55 In this context, there comes to mind an irregular verb, which conjugates:

"I engage in entirely legitimate tax planning."

"You engage in some flaky tax schemes."

"He is a blatant tax avoider."

56 A statement that someone is "avoiding" tax often carries with it a connotation that he ought not to do so. It thus goes beyond a mere statement of fact, which can be shown to be true or false by empirical enquiry, and involves a value judgment or a prescriptive statement. Value judgements and prescriptive statements cannot be verified or falsified by empirical enquiry. While we can demonstrate that they are logically inconsistent with other value judgments or prescriptive statements which the speaker holds or with which he agrees, ultimately, they cannot be right or wrong. We simply agree with them or disagree with them. As analytical philosophers sometimes put it,[16] "You cannot prove an "ought" from an "is"".

57 So, for example, a person who

gives up smoking or drinking alcohol because he finds the excise and value added tax charges too expensive

makes a contribution to a recognised pension scheme rather then investing the money much more efficiently himself because he is offered an income tax deduction

when creating and funding a trust, excludes himself (and other

15 Ironically, there is more reference - and apt reference, too - to decided case law in the Consultation Document than in the GAAR Study.

16 for those uncomfortable with words of more than one syllable.

> relevant persons) from benefit in order to avoid having the income or chargeable gains of the trust deemed to be his for income tax or capital gains tax purposes

is in each case in a sense "avoiding" tax. He is taking steps which are entirely "tax driven" i.e. his sole - never mind "main" - purpose in either taking the steps at all or, at least, in taking steps of the precise description taken, is to reduce his liability to tax. Yet no one would call him a tax avoider.[17]

58 So the question arises: what form of deliberate action the main purpose, or one of main purposes of which, is to reduce or defer a liability to taxation, constitutes "tax avoidance"?

59 As already stated "tax avoidance" is often used to mean "improper or unjustifiable tax planning". And when ignorant politicians bandy the phrase around, that is usually what they mean. Of course, it is accepted that there is nothing illegal about such tax planning. Yet, a moral - in some cases, a sanctimonious - judgment is being expressed. And just as beauty is in the eye of the beholder, so, too, morality is highly subjective. You may regard it as totally appropriate that a politician should be able to bribe his way to power by promising to enact legislation which would, through the medium of the tax system, transfer wealth from the economically productive and give it to scroungers and spongers who vote for him. I may regard that as highly immoral and a perversion of the democratic process and that, in consequence, every victim of such legislation is morally - as well as legally - entitled - to take advice so that he can so arrange his affairs as to defeat the effect of such immoral and pernicious legislation.

The Search for an Objective Standard

60 Is it then possible to resort to some objective standard to determine what conduct amounts to unacceptable tax avoidance?

61 A likely candidate, indeed the only legitimate candidate, if the Rule of

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17 If anyone is tempted to call anyone in the third category a "tax avoider", he should consider the words of Lord Templeman in Inland Revenue v. Challenge Corporation Ltd. [1987] AC 155 at page 168. Lord Templeman was, at least once he became a judge, a crusader who exhibited an almost evangelical zeal those whom he supposed to be against tax avoiders. So if even he held that a course of action was not "tax avoidance" but merely "tax mitigation", only a bigot would disagree.

Law is to be respected, is avoidance which Parliament wishes to defeat or, rather, would wish to defeat, were it aware of the possibility of it occurring.

62 I shall use the term "Unacceptable Tax Avoidance" to refer to tax avoidance which Parliament wishes to defeat or, rather, would wish to defeat, were it aware of the possibility of it occurring. Any GAAR would need to be so drafted so that it caught only such tax avoidance and nothing further.

"The Intention of Parliament"

63 So how does one identify Unacceptable Tax Avoidance? The simplistic approach is that Unacceptable Tax Avoidance is tax avoidance which is contrary to the intention of Parliament. While that looks very promising to the layman, the GAAR Study Group was far too knowledgeable to be seduced into following that approach.

64 The first problem is that Parliament is not one person and does not and cannot have any real intention, whether actual or hypothetical. Parliament is a large number of persons who debate - or fail to debate - bills put before them and, acting by majority, and from a variety of motives, vote for their passage into law. The individual members of Parliament may have different "intentions", whether in the sense of different motives or purposes or whether in the sense of different notions as to what the laws for which they are voting mean.[18] In some cases, a bill may be drafted "diplomatically" so that its passage is secured only because it can be interpreted differently be different persons.

65 A money bill, typically a Finance Act, is in effect the product of only one part of Parliament, the House of Commons. Its members usually know a fair amount about politics, about being elected and remaining elected, attaining and holding on to high political office and (lawfully) milking the system for their own benefit.[19] Yet it will be highly exceptionable for members of the House of Commons to have any but the most superficial

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18 I would imagine that in many cases, they have little idea of the meaning of the legislation they are enacting and their purpose is simply to follow the party line.

19 When the M.P.'s expenses scandal broke, I was one of the few people to have considerable sympathy with those M.P.'s who had played by the rules to secure maximum advantages by way of expense claims. For an M.P. who does his job properly is worth far more than he is paid by way of salary and deserves some additional perquisites, such as a duck house on his moat.

understanding of the United Kingdom tax system, the meaning of what they are voting should be enacted or its effect on the existing tax system.

66 An excellent example is Finance Act 2011 Schedule 2 (Employment Income Provided Through Third Parties). Substantial parts of this Schedule impose charges to income tax on persons who have never received any income or benefit and who may never receive any income or benefit or impose charge to income tax on amounts which are totally disproportionate to the amount of value of any income or benefit obtained. If the members of the House of Commons had realised the true effect of this Schedule and how morally repugnant it was, they would never have voted for it. Yet it is clear that no one understood anything. The Members of the House were told by David Gauke at the Public Bill Committee stage of the then Finance Bill on Thursday 19 May 2011:

> "The legislation is complex; I do not deny that in any way, and I think that all hon. Members would agree. I get the impression that every member of the Committee spent their lunchtime reading through the amendments, and I think that there is unanimity on the point that the proposals are complex. We would argue, however, that they are necessary." (Hansard 19th May 2011 Col 280) and
>
> "Schedule 2 is needed to maintain a fair tax system." (*ibidem* Coll 290)

67 I was much amused by the refreshingly frank comment of Ian Murray (Edinburgh South) (Lab) in the same debate:

> "I read the 88 amendments four times during lunch and after my face inserting itself into the bowl of soup I was having because I fell asleep, I still could not understand them. Is there not a danger that the complication that has been inserted into the legislation to deal with tax avoidance could in fact open up more loopholes as a result of the legislation being too complicated?" (*ibidem* col 268)

68 Mr Murray also made the very pertinent observation:

> "My right hon. Friend the Member for Delyn made the point about how complex the regulations are, and 88 amendments are proposed to an already complex piece of the Bill. We are seeing over-complex regulation for a good cause. That essentially just sets hares running when it comes to avoiding this complex legislation. Once all those layers are put on top of each other, a

> very smart QC and an accountant will ensure that large businesses can avoid the regulations through loopholes, while small businesses will be completely drowned in paperwork with no
>
> support from HMRC to help them through." (*ibidem* Col 285)

How true!

69 Then there is another consideration, which is facet of the Rule of Law. The Rule of Law does not guarantee that laws are always effective or just or moral. What it does require is that, however imperfect our laws may be, they are made by the constitutional due process and should be known to all. The man in the street, or even the Q.C. in Lincoln's Inn, can readily read the text of a statute and other permissible aids to its construction, all of which will be publically available and can make his mind up what it means. It can be difficult enough when lawyers or even judges differ, as they sometimes do, as to the meaning of a statute. It would be intolerable and quite unworkable if, to know what a statute meant, what had to interrogate each and every one of the persons who voted for it.

70 So when we lawyers (including judges) speak of "the intention of Parliament", we mean its "intention" as determined, normally, only by reference to the Act of Parliament in question and, exceptionally, by taking into account any other legitimate aids to construction.[20] The classic authority is the decision of the House of Lords in *Regina v Secretary of State for the Environment, Transport and the Regions, Ex parte Spath Holme Ltd* [2001] 2 AC 349. Lord Nicholls put the matter so very well:

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20 Unless expressly or impliedly (as in the case of ratification of an international treaty such as a double taxation convention) referred to in the Act of Parliament in question, such external aids to construction are extremely limited. The decision of the House of Lords in *Pepper v Hart* [1992] STC 898 introduced only a very limited departure from the principle that statements made during the discussion of a bill cannot be taken into account at all in constructing an Act of Parliament. The House of Lords decided in that case that what is known as "the exclusionary rule" (which thitherto had been absolute) would be relaxed so as to permit reference to parliamentary materials where (a) legislation was ambiguous or obscure, or led to an absurdity; (b) the material relied on consisted of one or more statements by a Minister or other promoter of the Bill together if necessary with such other parliamentary material as was necessary to understand such statements and their effects; and (c) the statements relied on were clear. It is possible that Explanatory Notes might in some very limited circumstances be legitimate aids to construction, as against the government department which produced them. For my own part, all that I tend to learn from Explanatory Notes to Finance Bills published by the Treasury is how their authors do not understand the actual meaning of the legislation in question or the tax background into which it is being inserted.

> "Statutory interpretation is an exercise which requires the court to identify the meaning borne by the words in question in the particular context. The task of the court is often said to be to
>
> ascertain the intention of Parliament expressed in the language under consideration. This is correct and may be helpful, so long as it is remembered that the "intention of Parliament" is an objective concept, not subjective. The phrase is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not the subjective intention of the minister or other persons who promoted the legislation. Nor is it the subjective intention of the draftsman, or of individual members or even of a majority of individual members of either House. These individuals will often have widely varying intentions. Their understanding of the legislation and the words used may be impressively complete or woefully inadequate. Thus, when courts say that such-and-such a meaning "cannot be what Parliament intended", they are saying only that the words under consideration cannot reasonably be taken as used by Parliament with that meaning."

71 So the Courts ascertain the "intention of Parliament" by construing the Act of Parliament itself and (save in exceptional cases) nothing else.[21] When construing a taxing statute, they decided that "the intention of Parliament" either was or was not to impose a charge to tax in the circumstances under consideration. Now tax planning does not need to be counteracted if it does not work. And if it does work, it is because it was "the intention of Parliament" that there should be no charge to tax. How, therefore can we even begin to determine that successful tax planning is Unacceptable Tax Avoidance on the grounds that it is contrary to the intention of Parliament? That this is a problem is common ground. See, for example, the GAAR Study at paragraph 5.17:

> "5.17 At first blush one might think this could be achieved by asking whether the arrangement is designed to achieve a tax result which Parliament, or the legislation, did not intend. The insuperable problem here, though, is the established principle of

21 This response is not a treatise on statutory construction. The canons of construction have altered over the years. In the 21st century, the "golden rule", that the words should bear their ordinary and natural meaning, is understandably subject to the rider "considered in the context in which they are found" and courts are more likely to adopt a "purposive" construction. However, changes over the years in the weight given to the various aids to construction does not affect the point I am making.

> statutory interpretation in the UK which holds that the intention of Parliament can be discerned only from the language of the legislation itself. Ex hypothesi the GAAR is designed to deal with
>
> cases where the language of the legislation would, under normal principles of interpretation, indeed achieve a favourable tax result (e.g. as in the SHIPS 2 scheme). So this question could never be answered in the affirmative."

72 It was no doubt that for this reason the GAAR Report and the Consultation Document each propose a quite different solution (as well as different solutions from each other). To anticipate my conclusion, the solutions they purport to provide are, with respect, no solutions at all, if all the desiderata are to be achieved. In my view, it is possible, to solve the problem by ascertaining the intention of Parliament, not in the sense of what Parliament has actually enacted in a taxing statute but in the *hypothetical* sense of what it *would* have gone on to enact had it appreciated the effect of its actual legislation, where that "intention" is evident and manifest.

73 Now, in order for a GAAR to be acceptable, it must be clear in its operation. In many, probably most, cases, one will not find universal agreement as to what Parliament would have gone on to enact had it appreciated the effect of its actual legislation. Yet in certain extreme cases there will be real doubt at all. And it is, I apprehend, with exactly those cases that a GAAR of the kind proposed would be expected to deal.

74 I now put on hold for a moment my enquiry as to whether we can satisfactorily define Unacceptable Tax Avoidance for the purposes of a GAAR and consider the, in my view, unsatisfactory test proposed in the Consultation Document.

The "Double Reasonableness" Test

75 The core test in the Consultation Document draft clauses is contained in draft clause 2(2). Tax arrangements are "abusive" if they are arrangements "the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action …"

76 **This test will not pass muster. It depends on matters of opinion, pure value judgements, which will vary from person to person and judge to**

judge. It is offensive to the Rule of Law to make the financial position of individuals and businesses depend on discretion and thus to be inherently uncertain.

77 My experience of Revenue reaction to *Ramsay v IRC*, decided in 1981, was that often Revenue officials took an impossibly over-optimistic view of the scope of the decision. Some of them actually took the view that anything done to secure a tax advantage was on that account ineffective to achieve its object, i.e. the only form of tax planning permitted was of the "accidental" variety. **I fear that they might equally take an impossibly over-optimistic view of the scope of a GAAR couched in these terms.**

78 The word "reasonable", together with cognate words such as "reasonably", has many meanings. Some of them are obviously not in point in this context.

79 Let me, following the Cartesian method, focus first on what I perceive to be the core of the test, that involving the second "reasonable". What is a "reasonable" course of action? Clearly, in this context, "reasonable" does not mean "rational". Engaging in the most outrageous tax avoidance can be an utterly rational act. Instead, it imports a value judgement. Behaviour is "reasonable" if we approve of it and "unreasonable" if we do not. Precisely because it is a value judgment, its meaning is inherently subjective and cannot be established by objective, empirical, evidence. You cannot derive an "ought" from an "is".

80 And so it is that the core of the test is fundamentally flawed. What may appear reasonable to one man may appear to be unreasonable to another and *vice versa*. And there is no means of resolving the disagreement. Ultimately, provided each of them is consistent, and does not contradict himself, there is no means of resolving the dispute. The best they can do is to agree to disagree.

81 So if the matter came before a court - and the courts would be swamped with GAAR disputes if a GAAR were to be enacted in anything like this form - what does the judge do? In the first instance, he can simply impose his own, highly subjective, view, in the light of what precious little guidance he is given by the rest of the GAAR as to the "intention" of Parliament in enacting it. No doubt, in many cases, all would agree that a course of action is or is not "reasonable". But those are not the cases which would come before and swamp the courts. There would be myriad

cases where different people took a different view as to what was a reasonable course of action, and not the less so because the parameters of reasonableness were, inevitably, so ill-defined.

82 Judges would, of course, disagree amongst themselves. GAAR cases would be very likely to finish up in the Supreme Court, the voice of infallibility, speaking by majority. The Supreme Court would have to fill the yawning gap left by Parliament in what was referred to in one famous judicial utterance (in another context) as "the supineness of the legislature". Legislation by Parliament would be replaced by legislation by the Supreme Court or what one Law Lord has called "the naked usurpation of the legislative function". **It would not be democratic.**

83 **More importantly, it would be utterly inefficient.** For each decision could give only limited guidance, as it would depend on its own facts. **I predict that it would take decades of prolonged and expensive litigation before we had anything like a clear idea which way the courts were likely to jump in any particular case and the law could be regarded as having settled down.** Indeed, it might even be the best part of a decade before even the first Supreme Court decision was available. And in the meantime taxpayers would be left in enormous uncertainty and the United Kingdom would have shot itself in the foot.

84 It might be objected that there are other parts of the law, where the concept of "reasonableness" is used. And indeed there are. Yet in virtually all those cases, "reasonableness" is all about proportionality. For Parliament to enact, for example, that where expenditure is incurred partly for one purpose and partly for another then it is to be apportioned "on a just and reasonable basis", the criteria of apportionment are manifest, practical problems will but rarely arise and, when they do, they will ones of fine-tuning.

85 There are, admittedly, parts of the common law where we encounter a concept of "reasonableness" somewhat nearer to that under consideration. Obvious examples are the torts of negligence and nuisance. The basic law of negligence might be summed up in the statement: "One is under a duty to take reasonable care to avoid causing reasonably foreseeable physical damage or personal injury, as well as any reasonably foreseeable loss consequential on either." What is "reasonable" care depends, admittedly, partly on value judgments. The greater the risk of harm and the more serious that harm should it happen, the greater the care must be taken.

That is a question of proportionality. Yet whether we should restrict road traffic to a maximum speed of 5 m.p.h., and perhaps require a man with a red flag to walk in front, which would undoubtedly decrease injury and

death on the roads, has to be considered in the light of the concomitant economic loss and general inconvenience. That, admittedly, involves a value judgment. Yet the law of negligence has been developed by the courts only by many, many decades of case law, and is not finally settled even now. This country simply cannot afford the luxury of decades of judicial development of the true scope of a GAAR.

86 **So the question of what is a "reasonable course of action" is inherently vague and ambiguous, because it depends on subjective value judgements.**

87 What of the final words of the draft clause 2(2):

> "having regard to all the circumstances including.
>
> (a) the relevant tax provisions,
>
> (b) the substantive results of the arrangements, and
>
> (c) any other arrangements of which the arrangements form part."

88 I do not see how (b) and (c) advance the matter any further. They state only what would be implied. Presumably, the judge is simply being invited to ask himself whether it was "reasonable" to enter into the particular arrangements in all the circumstances of the case. That would in any case have been implied. The exercise in itself involves the making of further value judgements as it would appear that tax planning which is abusive in one context may not be abusive in another. Yet we are given no criteria to distinguish the two.

89 There is a reference to "(a) the relevant tax provisions". Obviously, the judge must take into account the relevant tax law. That goes without saying! Yet there is an extended meaning of "the relevant tax provisions" in draft clause 2(3), which I find not very helpful.

90 It will be recalled that is provides:

> "(3) In subsection (2)(a) the reference to the relevant tax provisions includes.

(a) any principles on which they are based (whether express or implied),

(b) their policy objectives, and

(c) any shortcomings in them that the arrangements are intended to exploit."

91 What are "the principles on which they [presumably the relevant tax law] are based (whether express or implied? The word "principles" is not one used by practising lawyers or practising judges, unless, perhaps they are also academics. The notion of "principles" stems from modern academic jurisprudence. Sometimes, academics will speak of "principle based legislation". The general idea, so far as I can gather, is that a principle is something wider and thus less detailed than an actual rule of law. In "principle based legislation", Parliament sets out the principle. I believe even academics appreciate that just setting out a principle would be too vague and impractical, so in its more realistic format, "principle based legislation" contains first a statement of principle and then a set of detailed, specific rules, which fall to be interpreted in the light of the principle. That form of principled based legislation obviously has a lot to be said for it. The less ambiguity, the better.

92 Unfortunately, we have virtually no principle based legislation in our tax code and what little we have is less than fortunate. We have opening statements in legislation which the courts could interpret as principles yet they have often failed to do so. Perhaps the most notorious example is the decision of the Court of Appeal in *Page v Lowther* (1983) 57 TC 199, which, incidentally, points out the huge dangers of leaving to judges to decide, without any proper guidance, what is meant by "tax avoidance". The decision concerned Part XVII of the Taxes Act 1970, which bore the wide heading "Tax Avoidance". The section in question, section 488, appeared in Chapter IV of that Part and had a side note reading "Artificial transactions in land". Sub-section (1) expressly stated the purpose of the section was follows: "This section is enacted to prevent the avoidance of tax by persons concerned with land or the development of land." Slade LJ, delivering the judgment of the Court said: "[The judge in the court below] said this:" I do not doubt that the provisions of s 488, and those of s 489 that are supplemental to it, must be interpreted in the light of the purpose 488 as stated in subs (1). After all, any legislation must be interpreted in the light of its purpose in so far as that purpose is discernible from the legislation itself, and it would be perverse to refrain

from applying that principle where the legislature has taken the trouble expressly to state its purpose at the outset. I do not, however, think that entitles one to treat as ambiguous, with a view to bending their meaning,

words in subs (2) that are in themselves clear. What constitutes tax avoidance is, as was pointed out by Lord Wilberforce in *Mangin v IRC* [1971] AC 735 at 739 in a passage cited by Vinelott J. in *Chilcott v IRC* [1982] STC 1 at 24 4, very much a matter of opinion, and it would, in my judgment, be dangerous in the extreme for a Judge to take it upon himself to modify the meaning of words in subs (2), or in any subsequent provision that was relevant to the case before him, according to his own conception of what does and does not constitute tax avoidance." The Court of Appeal agreed with him.

93 Just as "What constitutes tax avoidance is … very much a matter of opinion", so, too what is a "reasonable course of action" is very much a matter of opinion.

94 The reason we have very little principle based legislation in our tax code is that the tax code is shot through with technicalities. It is not rational. It is not "principled". In order for the legislation to be principle based it would have to be re-written - and I do not mean simply put into different words, but root and branch. Indeed, fundamental changes would be needed, such as abolishing the distinction between capital gains and income gains and coalescing, as best one might, the income tax code and the capital gains tax code - a political impossibility. If it were really "principled", there would be precious little scope for tax planning of any sort, let alone tax avoidance.

95 Let us consider the traditional distinction between capital and income - crucial if we are to determine which profits or gains are to be treated as of a capital nature and which of an income nature. The homely example is given of the tree which produces fruit. The tree is the capital and the fruit is the income. I own a tree and each year I harvest the fruit. The tree is capital and the fruit is income. So far, so good. Yet what of a mine and the minerals extracted from it? Surely they are not income, or not just income, as my capital is being diminished?[22] And suppose I buy a tree

22 During my working life, the legislation in force involved a compromise under which mineral royalties were treated as partly capital and partly income. The Office of Tax Simplification ("OTS") pointed out that that was anomalous. As they are clearly capital, the reader might expect that they are now treated as such. Only if he is naive! The recommendation, enacted in Finance Act 2012 schedule 39 paragraphs 45 - 47 was that they

bare of fruit in winter and sell it (with the land on which it stands) just before its fruit is ripe for picking? That is usually a capital profit.

96 Nowhere has this problem been more difficult to resolve than in the context of what might be termed "loan relationships". What is the difference in substance between (a) a bond issued for £1,000 which bears interest at 5 per cent per annum to be compounded annually, the whole (i.e. £1,276.28) to be redeemed, with interest in five years time and (b) a zero-coupon bond for £1,276.28 payable in five years time issued at a discounted price of £1,000? In substance, there is none at all. Yet, specific legislation apart, the former profit is income and the latter capital. Unless we have a principle that all profits from loan relationships are to be treated as income - and we do not have such a principle in the case of income tax - then there is no scope for principled legislation. One can look only to the technical rules.

97 Where there is express principle-based legislation, and the principle is clear and helpful, all well and good. Yet what of "implied" principles? Here again, we are in very dangerous territory. The "intention" of Parliament will, ex hypothesi, be silent, although it may be possible to rely on the "mischief" rule of construction, which, although of some antiquity, has enjoyed something of a resurgence as of late (albeit in the guise of "purposive" construction of statutes).

98 Wise judges have long-since recognised the dangers inherent in courts trying to discern what they consider the "policy" behind a statute or its "purpose". A modern example is the tax case of *Marshall (HM Inspector of Taxes) v Kerr* (1994) 57 TC 66. In the Court of Appeal (which was approved on this point by the House of Lords), Gibson J, in delivering the judgment of the Court said:

> "Mr. Venables submitted that Harman J., in failing to construe the statutory provisions literally, had adopted the wrong approach to construction and had given no reason why he deduced from the Act that [FA 1965] s 24(7) had only the limited purposes found by him.
>
> …
>
> But I do not read the authorities as requiring in the case of a deeming provision the abandonment of what is sometimes called the golden rule of construction, that is to say that in construing a statute the grammatical and ordinary sense of the words is to be

be taxed in their entirety as income!

> adhered to, unless that would lead to some absurdity or some inconsistency, in which case the grammatical and ordinary sense of the words may be modified so as to avoid that absurdity and inconsistency but no further.
>
> …
>
> Of course, if the policy of the Act or the purposes of the statutory fiction can be ascertained *from the wording of the Act*, it is permissible in construing the Act to adopt a purposive approach to try to give a meaning that accords with that policy or those purposes. But as Harman J. himself recognised, it is only too often that the purposes of a fiscal provision are not apparent, and **there is a real danger that, if a court in every case feels bound to commence its construction of a statutory provision by finding that purpose, it will make a self-fulfilling assumption of what the purpose is.**"[23]

99 Draft clause 2(3)(b) refers to the "policy objectives" of the relevant tax legislation. But how are such policy objectives to be determined? The debate on this point has much in common with that on implied "principles". What was said in *Marshall v. Kerr* is very much in point. In short, it will be but rarely that "policy objectives" of a taxing can be ascertained.

100 Draft clause 3(2)(c) refers to "any shortcomings in them that the arrangements are intended to exploit". One cannot determine whether there is a "shortcoming" unless one knows what, if anything, Parliament was trying to do which it failed to so. In the rare case where there is an express statement of principle or policy or in the even rarer case where such principle or policy is implied but obvious, one may be able to. Yet in the vast majority of tax legislation, that will not be the case.

101 Draft clause 2(4) is intended to be helpful in setting out a list of factors which are indications that tax arrangements "might" be abusive. Yet draft clause 2(5) makes it clear that the list is not exhaustive. So the factors mentioned in draft clause 2(4) may be relevant or maybe not. And the fact that none of them is present is not conclusive that they are not abusive. What, might one ask, is the point, then of draft clause 2(4)?

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23 Italics and emboldening added by the author.

102 Some of the factors mentioned in draft clause 4 are unobjectionable. Others are ambiguous or even misleading. What is the "amount of income, profits or gains" "for economic purposes"? If you asked an economist, he would tell you that that was highly debatable and that you

ought to ask an accountant or a lawyer. And they might well give you quite different answers.[24] I have mentioned above the distinction between capital and income - inherently vague on the edges. And I have pointed out that there is no economic difference between the two bonds there mentioned, although, specific legislation apart, their tax treatment would be very different.

103 The most alarming part of draft clause 4(4) is:

> "(d) the arrangements involve a transaction or agreement the consideration for which is an amount or value significantly different from market value or which otherwise contains non-commercial terms."

104 Does that mean that every gift or transaction for less than full consideration is to be a hallmark of abuse? Outside the commercial sphere, that is patently absurd. And, even within the commercial sphere, what of discretionary bonuses awarded (for no consideration) to employees?

"Cannot reasonably be regarded as"

105 I shall now return to the first part of the so-called "double-reasonableness" test. Given that a test that arrangements were not "a reasonable course of action", having regard to all the circumstances, would not act as an adequate filter, does the addition of the other reasonableness test come to the rescue by adding anything useful which could save the day? **It in fact adds very little indeed.** "Reasonable" in "reasonable to conclude" is full of ambiguity. Cannot reasonably be regarded by whom? By HMRC? Clearly not. By the taxpayer? Clearly not. It can only mean by the judge (or tribunal member). In which case it simply refers to drawing a permissible conclusion in the circumstances of the case, something which

24 If an employer makes a contribution to an employee benefit trust under which it is excluded from benefit, the lawyer will tell you that it has sustained a real loss in that it has suffered a diminution in its net asset value. The accountant, drawing up the accounts on generally accepted accountancy principles, will tell you that that is not necessarily the case and that, unless further conditions are satisfied, the employer should still include the contribution as an asset in its balance sheet.

judges do all the time.[25] In this case, of course, there is the vital difference that whether the course of action was "reasonable" is not a

question of fact, to be determined by evidence,[26] but a value judgement and a question of opinion.[27]

106 Now can one imagine any judge saying: "In my view, the arrangements were not a reasonable cause of action. However, in my view, they could reasonably be regarded as a reasonable course of action"? I very much doubt it.

107 **So the second filter is probably no filter at all.[28]**

My Alternative Proposals

108 So, having rubbished the draft clauses 2 and 3 in the Consultation Document, it is time for me to propose my own version, which I do with enormous diffidence.

A TAAR (or mini-GAAR) for Income Deductions

109 I have to say at the outset that drafting a GAAR which achieves all the desiderata is likely to be a super human task and I am only human. I have therefore looked at the examples of egregious tax avoidance set out in Annex B, Examples of abusive schemes, of the Consultation Document. What they have in common is that the objective is that the taxpayer reduces his taxable income by more than the amount of the reduction in his actual income and does so in circumstances where there is no indication that that is what Parliament intended.[29]

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25 And if their conclusion is "unreasonable", then they have made an error of law.

26 *pace* the author of the Consultation Document who seems confused on this point. See 7.14.

27 By contrast the words "it would be reasonable to conclude in draft clause 2(1) are entirely acceptable because the conclusion is as to a fact, namely the purpose(s) of the arrangements.

28 It might just come into play where the judge is not 100% convinced that the arrangements are an unreasonable course of action but on balance considers that they are. In that case, given that he himself has some doubts, he might hold that they could reasonably be regarded as a reasonable cause of action. However, such cases are likely to be marginal.

29 An example of Parliament intending there to be a reduction in taxable income is where it gives allowances against income in respect of capital expenditure.

110 I would suggest that a TAAR - or, if you like, a sort of mini-GAAR - would catch all these problem cases without any of the difficulties inherent in a GAAR.

111 Consider Taxation of Chargeable Gains Tax Act 1992 section 16A (Restrictions on allowable losses)

> "(1) For the purposes of this Act, "allowable loss" does not include a loss accruing to a person if-
>
> (a) it accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements, and
>
> (b) the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.
>
> (2) For the purposes of subsection (1)-
>
> "arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and
>
> "tax advantage" means-
>
> (a) relief or increased relief from tax,
>
> (b) repayment or increased repayment of tax,
>
> (c) the avoidance or reduction of a charge to tax or an assessment to tax, or
>
> (d) the avoidance of a possible assessment to tax,
>
> and for the purposes of this definition "tax" means capital gains tax, corporation tax or income tax.
>
> (3) For the purposes of subsection (1) it does not matter-
>
> (a) whether the loss accrues at a time when there are no chargeable gains from which it could otherwise have been deducted, or
>
> (b) whether the tax advantage is secured for the person to whom the loss accrues or for any other person."

112 It is simple, it is clear, it is workable, it is constitutional. It does not

offend the Rule of Law, the principles of natural justice or the doctrine of separation of powers. It does not seek to overthrow the fruits of the Glorious Revolution. And it is highly effective!

113 Why not simply introduce a similar TAAR for the purposes of income tax (and corporation tax on income)? While I leave the precise wording to others, I would suggest, for consideration, something along these lines:

> "(1) For the purposes of [the relevant Acts] a person shall not be entitled to an allowance, deduction in computing profits or gains or relief against income if-
>
> (a) the allowance, deduction or relief would otherwise be available to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements,
>
> (b) the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage and
>
> (c) this section is not excluded by contrary intention in the case of the provision giving rise to the allowance, deduction or relief.
>
> (2) [as in Taxation of Chargeable Gains Tax Act 1992 section 16A(2)]"

114 Subsection (1)(c) is needed to oust the case where a person takes a step he might not otherwise have taken in response to an invitation of freedom from tax made by Parliament on condition that he takes that step (e.g. incurring of capital expenditure giving rise to income tax reliefs or gift aid donations to charity). While I appreciate that it might be thought to need further refinement, the onus would effectively be on the taxpayer to shown that it was clear that (c) was not satisfied.

My Proposal for a GAAR

115 The starting point, in my view, is to attempt to define that which one is attempting to proscribe. When does tax planning become "tax avoidance" and when does it become such Unacceptable Tax Avoidance that one would wish a GAAR to counter it?

116 I refer the reader to my comments above on the difficulty of defining "tax avoidance", given that it is often a matter of subjective opinion and value judgment. The best definition one can find is useless for a GAAR: "Tax

planning of which I disapprove." At this point I shall continue my search for an objective test of Unacceptable Tax Avoidance, such as might be caught by a GAAR.

117 As I mentioned above, unlike Graham Aaronson Q.C. and the authors of the Consultation Document, I consider it worthwhile paying attention to what very wise judges have said. I shall limit my remarks to two cases only, as they contain quite enough wisdom for present purposes.

118 *Commissioner of Inland Revenue v Challenge Corporation* LTD. [1987] A.C. 155 was an appeal to the Privy Counsel on the New Zealand Income Tax Act 1976 section 99, which provided that any "contract" shall be "absolutely void as against" the appellant Commissioner of Inland Revenue "if and to the extent that, directly or indirectly … its purpose or effect" is to reduce "any liability to income tax."

119 The judgment of the majority[30] of the Privy Council was delivered by Lord Templeman. Lord Templeman first stated, in a passage beginning at page 167, some basic distinctions:

> "There are, however, discernible distinctions between a transaction which is a sham, a transaction which effects the evasion of tax, a transaction which mitigates tax and a transaction which avoids tax."

He was concerned, as we need to be between the third and the fourth. In his language, any form of tax planning which is not "tax avoidance" is tax mitigation, notwithstanding that, of course, its purpose is to avoid a liability to taxation.

120 He went on:

> "Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. Section 99 does not apply to tax mitigation because the taxpayer's tax advantage is not derived from an "arrangement" but from the reduction of income which he accepts or the expenditure which he incurs.
>
> Thus when a taxpayer executes a covenant and makes a payment

30 The differences of Opinion between the judges in New Zealand and those in the Privy Council well illustrates the uncertainties inherent in a widely targeted GAAR, which has been quite properly dismissed.

> under the covenant he reduces his income. If the covenant exceeds six years and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the payment under the covenant.[31]
>
> When a taxpayer makes a settlement, he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income.
>
> Where a taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitles the taxpayer to reduction of tax liability. The tax advantage results from the expenditure on the premium.
>
> A taxpayer may incur expense on export business or incur capital or other expenditure which by statute entitles the taxpayer to a reduction of his tax liability. The tax advantages result from the expenditure for which Parliament grants specific tax relief.
>
> When a member of a specified group of companies sustains a loss, section 191 [of the New Zealand Act] allows the loss to reduce the assessable income of other members of the group. The tax advantage results from the loss sustained by one member of the group and suffered by the whole group.
>
> Section 99 does not apply to tax mitigation where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability.
>
> Section 99 does apply to tax avoidance. Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had."

121 There are thus three strands to Lord Templeman's comments. First, if as

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31 His Lordship was referring to the then United Kingdom law concerning charitable donations, which pre-dated the Gift Aid regime.

the result of tax planning there is a genuine reduction in a taxpayer's income, and the taxpayer claims that his taxable income should be reduced accordingly, that is normally tax mitigation.

122 Second, there may be circumstances where Parliament has made it clear that in order for his taxable income to be reduced, the taxpayer must satisfy certain additional conditions in addition to reducing his actual income. He gives two examples, both based on the United Kingdom income tax Settlement provisions (one of which is now obsolete in United Kingdom law).

123 Third, even where a taxpayer does not reduce his real income but merely his taxable income, that will still be only tax mitigation if that deduction is afforded by the statute. His examples are ones of investments of various kinds.

124 Like all judicial utterances, Lord Templeman's comments must be read in context. For my part, I find them to have been a most valuable and lucid contribution to the debate. Yet that does not mean that they are the last word. The point which Lord Templeman did not need to consider in *Challenge* was how to distinguish the case where, on a true construction of the statute, Parliament had, as it were, by accident, rather than by design, conferred the relief (i.e. the tax planning worked), yet that was not the "intention" of Parliament, using the word "intention" otherwise than in the way it is used by lawyers. The distinction is easy to grasp but not easy to describe accurately in words. Where Parliament has said that if a man incurs "qualifying expenditure" on shares in a company of a certain type, he will obtain an income tax deduction, we can all see that, if he does so, that is tax mitigation. Yet where the tax advantage arises from what is obviously a flaw in the drafting or the failure of two sets of provisions to dovetail properly into each other, we would often call that "tax avoidance".

125 The judicial debate was taken further in the United Kingdom case of *Commissioners of Inland Revenue v. Willoughby* (1997) 70 TC 57 which concerned one of the places in the United Kingdom tax code where reference is made to "tax avoidance" or rather, the cognate expression "avoiding liability to taxation", which must bear the same meaning. (The House of Lords clearly considered that it did.)

126 The case concerned the Transfer of Assets Abroad Provisions. Professor

Willoughby had taken out offshore insurance policies. The Revenue sought unsuccessfully to assess him under the Provisions on the income arising year by year within the linked fund of the insurer. For present

purposes, it should be assumed that they would have succeeded but for the motive defence which then read:

> "[The Provisions] shall not apply if the individual shows in writing or otherwise to the satisfaction of the Board either-
>
> (a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected …"

127 Lord Nolan said, at page 116:

> "Mr. Henderson [Counsel for the Revenue, submitted that] … tax avoidance was to be distinguished from tax mitigation. The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option. Where the taxpayer's chosen course is seen upon examination to involve tax avoidance (as opposed to tax mitigation), it follows that tax avoidance must be at least one of the taxpayer's purposes in adopting that course, whether or not the taxpayer has formed the subjective motive of avoiding tax.
>
> My Lords, I am content for my part to adopt these propositions as a generally helpful approach[32] to the elusive concept of "tax avoidance", the more so since they owe much to the speeches of Lord Templeman and Lord Goff of Chieveley in *Ensign Tankers (Leasing) Ltd. v. Stokes* 64 TC 617, [1992] 1 AC 655 at pages 675C-676F and 681B-E. One of the traditional functions of the tax system is to promote socially desirable objectives by providing a

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32 It will be appreciated that the earlier comments of Lord Templeman did not really fit the circumstances of the case. Professor Willoughby had no taxable income in respect of the bonds. He had decided to invest in an asset which, it was hoped, would show capital appreciation, buy yield no income

> favourable tax regime for those who pursue them. Individuals who make provision for their retirement or for greater financial security are a familiar example of those who have received such
>
> fiscal encouragement in various forms over the years. This, no doubt, is why the holders of qualifying policies, even those issued by non-resident companies, were granted exemption from tax on the benefits received. In a broad colloquial sense tax avoidance might be said to have been one of the main purposes of those who took out such policies, because plainly freedom from tax was one of the main attractions. **But it would be absurd in the context of s 741 to describe as tax avoidance the acceptance of an offer of freedom from tax which Parliament has deliberately made. Tax avoidance within the meaning of s 741 is a course of action designed to conflict with or defeat the evident intention of Parliament."**[33]

128 Lord Nolan relied on the fact that Parliament had expressly decreed that any profit on an offshore insurance policy should be liable to income tax on redemption. The "intention" of Parliament was indeed "evident". All the taxpayer had done was to bring himself within that regime. That could hardly be described as "tax avoidance". It was thus not surprising that the House of Lords dismissed the appeal of the Revenue without even hearing counsel for the taxpayer.

129 I would propose to build on Lord Nolan's statement: "Tax avoidance … is a course of action designed to conflict with or defeat the evident intention of Parliament." It is clear that in speaking of the "evident intention" of Parliament, Lord Nolan was not speaking of "the intention of Parliament" in the way it which it is understood by lawyers. See above. Given that the tax avoidance has otherwise worked, then, *ex hypothesi*, the result is in accordance with "the intention of Parliament" in that sense.

130 Rather, we should consider not the actual but the hypothetical intention of Parliament. **In my submission, the only sort of tax planning a GAAR should catch is that which is inconsistent with the hypothetical intention of Parliament, that is, what Parliament would have enacted had it been served by rather more skilful Revenue officials and draughtsmen.** If, and only if, we can we sure - because it is "evident" - that, if Parliament had realised the effect of its words, as contained in the statute, it would have altered them so as to ensure that the tax advantage

33 Emboldening added by the author.

would not have accrued in the circumstances stated, can the GAAR operate. All of the cases mentioned in Annex B to the Consultation Document would have fallen foul of a GAAR couched in these terms.

131 This suggestion is not so revolutionary as it may seem. It is stated in the Consultation Document:

> "3.15. The GAAR is intended to be capable of altering the tax consequences of abusive arrangements if the consequence claimed is one that manifestly would not have been countenanced by Parliament, had it foreseen the arrangement and the claimed tax consequences. …"

I entirely agree. And, for the avoidance of doubt, I would add the word "only", so that this read:

> "3.15. The GAAR is intended to be capable of altering the tax consequences of abusive arrangements *only* if the consequence claimed is one that manifestly would not have been countenanced by Parliament, had it foreseen the arrangement and the claimed tax consequences. …"

132 **Yet the draft legislation contained in the Consultation Document bears no resemblance to this admirable statement of principle.**

Author's suggested new draft clause 2[34]

133 I would propose that draft clause 2 contained in the Consultation Document be amended in the following way:

> "(1) Arrangements are "tax arrangements" if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements.
>
> (2) Tax arrangements are "abusive" if *the tax advantage falling within subsection (1) is, in the all the circumstances, such that it is manifest that Parliament would have not have permitted it to be obtained if it had appreciated that such tax advantage could be obtained in*

34 This builds on draft clause 2 in the Consultation Document. It assumes that draft clause 3 in the Consultation Document will remain unchanged. In this article words added to draft clauses are in italic and words deleted are ~~struck through~~.

such circumstances.

~~they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action,~~

~~having regard to all the circumstances including.~~

~~(a) the relevant tax provisions,~~

~~(b) the substantive results of the arrangements, and~~

~~(c) any other arrangements of which the arrangements form part.~~

~~(3) In subsection (2)(a) the reference to the relevant tax provisions includes.~~

~~(a) any principles on which they are based (whether express or implied),~~

~~(b) their policy objectives, and~~

~~(c) any shortcomings in them that the arrangements are intended to exploit.~~

~~(4) Each of the following is an indication that tax arrangements might be abusive.~~

~~(a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,~~

~~(b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes,~~

~~(c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid,~~

~~(d) the arrangements involve a transaction or agreement the consideration for which is an amount or value significantly different from market value or which otherwise contains non-commercial terms.~~

~~(5) Subsection (4) is not to be read as limiting in any way the cases in which tax arrangements are regarded as abusive.~~

(3) In determining whether it is manifest that Parliament would have not have permitted the tax advantage to be obtained, all

circumstances may be taken into account except that the views of HMRC may be taken into account only to the extent that that

would tend to show that the arrangements were not abusive."[35]

Other Matters in the Draft Clauses

Counteraction of the Tax Advantages

134 Clause 4 of the draft clauses contained in the Consultation Document provides:

"**4 Counteracting the tax advantages**

(1) If-

(a) there are tax arrangements that are abusive, and

(b) the procedural requirements of [the Schedule] have been complied with,

the tax advantages arising from the arrangements are to be counteracted on a just and reasonable basis.

(2) The counteraction may be made in respect of the tax in question or any other tax to which the general anti-abuse rule applies.

(3) An officer of Revenue and Customs must[36] make such consequential adjustments in respect of any tax as are necessary to ensure to which the general anti abuse rule applies as are appropriate.

(4) These consequential adjustments.

(a) may be made in respect of any period, and

(b) may affect any person (whether or not a party to the arrangements)."

135 It is stated in paragraph 3.28 of the Consultation Document, after

35 I have added the final words to avoid a court taking into account self-serving statements by HMRC

36 The text of Consultation Document misrepresents, at paragraph 3.32, the effect of this subclause bu giving the impression that HMRC has merely a power (but is not under a duty) to make consequential amendments. That is presumably just a slip.

disagreeing with the comments in the GAAR Study:

> "HMRC considers that it is sufficient to provide for counteraction on a just and reasonable basis."

136 With respect, that is not enough. I would add at the end of subclause (1)

> "so as to put, as near as may be, in particular having regard to any consequential adjustments made under the following provisions of this section, any person who has entered into the abusive arrangements and obtained a tax advantage in the same position as he would have been in had he not done so."

137 A consequential adjustment would then be needed to draft clause 5(1)(b) (onus of proof on appeal).

138 It is not specified in clause 4 who is to make the counteraction or what is to happen if they do not do so. What if two or more persons have power to make the counteraction and do so in different ways?

139 I would suggest that the well-tried procedure in what is now Income Tax Act 2007 Part 13 Chapter 1, which has been law, in one form or another, since 1960, should be adopted in the context of the GAAR. See in particular section 698, which could be adapted with the necessary modifications. The legislation in question has resulted in a fair degree of case law, including the permitted methods of counteraction.

140 I find clause 4(2) very odd. It is not at all clear to me - and the text of the Consultation Document does not enlighten us - as to why the counteraction may be made in respect of a tax which is *not* the tax (or one of the taxes) in question.

141 Clause 4(3) is fine so far as it goes but too limiting. I would impose the duty on the officer who makes the counteraction and make it a condition of a valid notice of counteraction being served. I do not see why the consequential adjustments should be only in respect of a tax to which the GAAR applies. For example, a tax avoidance strategy might involved an (increased) value added tax charge. (Value added tax will not be a tax to which the GAAR will apply.) The tax avoider might have been prepared to tolerate that increased value added tax charge in order to gain some other tax advantage. It is only right that he is put back in the position he would have been in put for the abusive arrangement.

142 I therefore suggest that subclause (3) should read:

> "(3) An officer of Revenue and Customs must make such consequential adjustments in respect of any tax *or duty* ~~to which the general anti abuse rule applies~~ as are ~~appropriate~~ *necessary to put any person who has entered into the abusive arrangements and obtained a tax advantage in the same position as he would have been in had he not done so."*

143 I have expanded this subclause partly because **I am very concerned at the statement at paragraph 3.32 of the Consultation Document "The adjustments … could, in appropriate circumstances, increase or create a tax charge." I do not see why they should.** That is function of the counteraction, not the consequential adjustments.

144 I am sure that HMRC are not suggesting that the innocent should be penalised. I would therefore, for the avoidance of doubt, amend subclause (4) of clause 4 as follows,

> "(4) These consequential adjustments.
>
> (a) may be made in respect of any period, and
>
> (b) may affect any person ~~(whether~~ *except that a person who is* ~~or~~ not a party to the arrangements *shall not be adversely affected by such consequential adjustments*."

Clause 5 of the Draft Clauses

145 Apart from the consequential amendment to clause 5(1)(b) which would arise if my proposed amendment of clause 4(1) were to be accepted, I have no problems with draft clause 5.

Other Substantive Matters

Commencement

146 The question of commencement is dealt with in paragraphs 3.37 to 3.42 of the Consultation Document.

147 While the proposals seem at first blush quite fair, there is one element of

uncertainty. The aim appears to be not to catch a tax advantage which accrues post March 31st 2013 provided the abusive arrangements were "fully completed" by then. My understanding is that this will apply

provided no element essential to the abusive arrangements is put in place after that date but that it will be irrelevant that abusive arrangements already put in place only work themselves out - and produce the tax advantage - after that date.

148 Further elucidation would be helpful.

Taxes to which the GAAR should be Applied

149 It is suggested in paragraphs 2.11 to 2.20 of the Consultation Document that the GAAR should be extended to a wider range of taxes than suggested in the GAAR Study. In general, I can see no objection to the proposed list. The one exception is inheritance tax. Inheritance tax does not rest on sound intellectual or moral principles and lacks a sound theoretical basis. Like its predecessor, Estate Duty,[37] it is highly technical. One is either caught or one is not. There is little justice, equity or morality about it. Indeed, it can operate most inequitably. I do see both immense practical, as well as theoretical, problems in extending the GAAR to a tax of this nature. **If the GAAR is indeed extended to inheritance tax, I would predict a wholly disproportionate amount of litigation (having regard to the amounts raised by the tax) would result.**

Double Taxation Agreements

150 This is discussed in paragraphs 2.20 - 2.25 of the Consultation Document.

151 It had been proposed in the GAAR Study (Appendix II paragraph 17):

> "the expression "relevant double taxation arrangements" is used to make it clear (by reference to the definition provisions in section 15) that the GAAR does not operate in respect of double taxation arrangements (or articles in double taxation arrangements) in any case where the provisions of section 2 of the Taxation (International and Other Provisions) Act 2010 would prevent its application. This may depend upon the precise terms of the double

37 As we all know, capital transfer tax was simply inheritance tax under another, more accurate and less misleading, name.

taxation arrangement and of the relevant OECD commentaries applicable to the arrangement"

152 (Taxation (International and Other Provisions) Act 2010 section 2 is the section which (in conjunction with section 6) gives any Double Taxation Arrangement specified by an Order in Council effect in United Kingdom law.

153 The statement in the Consultation Document at 2.21 is thus highly misleading:

> "2.21. The Report recommended that the GAAR should apply to abusive arrangements where tax advantages have been obtained under "relevant" double taxation agreements ("DTAs")."

154 It is stated in the Consultation Document:

> "2.22. Some views have been expressed that if the GAAR were to disapply the effect of DTAs, this would conflict with the UK's duty to abide by the terms of its agreements with other countries.
>
> 2.23. The proposed GAAR would be consistent with the Organisation for Economic Co-operation and Development (OECD) commentary on the Model Tax Convention. Paragraph 9.4 of the OECD commentary on Article 1 of the Model Tax Convention confirms that:
>
> > States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into.
>
> 2.24. Therefore, the Government considers that the GAAR should apply to artificial and abusive arrangements where UK tax advantages have been obtained through rights or benefits under any DTA, and there is no requirement to distinguish between different DTAs (i.e. "relevant" DTAs or otherwise)."

155 This is a complete *non sequitur*. In certain cases, the United Kingdom would not be in breach of its international obligations in enacting that a GAAR should apparently override a Double Taxation Arrangement. In others, it clearly would. First the current OECD commentary may not be a permissible aid to construction of the Double Taxation Arrangement in question. (The view of HMRC to the contrary set out in Annex C

paragraph 6 of the Consultation Document is simply wrong. However, my proposed solution, set out below, fully takes into account the possibility of their being right.)

156 Second, what amounts to an "abuse" within the meaning of the OECD commentary may not at all be the same thing as what amounts to "abuse" within the meaning of a United Kingdom GAAR. Indeed, a close consideration of the quotations from the commentary in Annex C of the Consultation Document will show that that is the case.

157 It follows that I find draft clause 6(4)(b), which would give priority to the GAAR over Taxation (International and Other Provisions) Act 2010 section 6(1), objectionable.

158 **My solution is that it should be made clear that a Double Taxation Arrangement would override the GAAR. Thus, in those cases where, consistently with the provision of the Double Taxation Arrangement in question, the GAAR could operate, it would still do so. Indeed, if HMRC's view were correct, that would be in every case. Yet if HMRC's view were wrong, then Parliament would not be legislating in breach of the international obligations of the United Kingdom.**

Administration

Self Assessment

159 It appears to be proposed in the Consultation Document, at paragraphs 5.1 to 5.3, that the effect of the GAAR should be self-assessed in the case of taxes which are already self-assessed.

160 Given that the method of counteraction is discretionary (see clause 4 of the draft clause contained in the Consultation Document), I do not see how this can be the case. The discretion should be not that of the taxpayer but, I suggest, that of HMRC.

161 Further, if my recommendation is followed, counteraction should be conditional on consequential adjustments being made, which are again discretionary and can affect third parties.

162 I have suggested that the method of counteraction already contained in

Income Tax Act 2007 Part 13 Chapter 1 should be followed. That is not self-assessed either.

163 That said, I can quite see that consideration should be given as to whether some further form of disclosure should be imposed on taxpayers in making the self-assessment return. That, however, is a somewhat different matter.

Other Administrative Issues

164 While I agree with the general principle, articulated at paragraph 5.5. of the Consultation Document, that "as far as possible, any action needed to recover tax as a result of applying the GAAR should fit within existing tax administration procedures", I can see, as can the authors of the Consultation Document (in Question 11), that there will inevitably have to be some tweaking, if only to take into account the cross-regime range of the GAAR.

The Advisory Panel

165 It is proposed that the opinions of the Advisory Panel should have special weight when the application of the GAAR is in issue before a court or tribunal. See paragraph 4.8 of the Consultation Document:

> "4.8. The provision above [draft clause 5(2), a compared with 5(3)] follows the approach taken in the Illustrative GAAR that the GAAR guidance and the opinion (or opinions, if not unanimous) of the Advisory Panel should carry more weight than the other matters or materials specified in subsection (3) of the provision (i.e. they "must", rather than "may", be taken into account)."

166 It is then proposed at paragraph 6.3 of the Consultation Document:

> "The Government also agrees that the Panel should involve members from HMRC and from outside HMRC. One of the purposes of the Panel is to develop a body of knowledge and guidance about the GAAR – HMRC has an important role to play in bringing its knowledge and experience of developing and applying tax law."

167 **Of all the proposals in the Consultation Document, this must be the**

staggering - and none the less so because its effect does not become apparent on reading paragraph 6.3 alone but only in conjunction with paragraph 4.8, to which no reference is made. **It offends one of the most**

basic principles of natural justice: *nemo iudex in causa sua*. That one party to prospective litigation should be able to take part in a judicial or at least, quasi-judicial, capacity in a decision-making process the product of which will carry special weight in that litigation (even if it is not conclusive), beggars belief.

168 **In order that justice can be done - and be seen to be done - no present or former official of HMRC (or, indeed, for that matter, no present or former civil servant or Treasury minister) should be a member of Panel.**

169 I have recommended that the procedure for assessment by HMRC contained in Income Tax Act 2007 Part 13 Chapter 1 (Tax Avoidance - Transactions in Securities) be followed, *mutatis mutandis*, rather than self-assessment. In my view, there are excellent arguments for the Panel being given the role the special tribunal is given by Income Tax Act section 697. In effect, it could prevent the application of the GAAR in a particular case. That would be relatively simple and inexpensive. Or it could allow the proposed assessment to be made, in which case the taxpayer would retain his normal appeal rights. A taxpayer need not invoke it and, if it was obvious that HMRC had a good arguable case that the GAAR applied, would be unlikely to waste time and costs in doing so. The Panel would thus provide a useful filter, especially in the early days. My experience of Revenue reaction to *IRC v Ramsay* in the 1980's was that often some officers took an impossibly over-optimistic view of the scope of the decision. I fear that they might equally take an impossibly over-optimistic view of the scope of the GAAR.

Guidance

170 It is proposed in the Consultation Document

(a) that guidance be produced on the application of the GAAR

(b) that guidance should carry special weight in any litigation on the GAAR (see draft clause 5(2)(a)) of the Consultation Document draft clauses)

(c) the Advisory Panel should have responsibility for reviewing and approving the guidance, with the drafting work handled within HMRC: see paragraph 7.6 of the Consultation Document.

171 **The combination of these three factors does not accord with the requirements of natural justice that justice should not only be done but be seen to be done and in an impartial way.**

172 We do not know how the members of the Panel would be appointed or by whom. There is a risk that they will include the sort of persons who sit on quangos. A greater risk is that, even if they consist only of persons of unimpeachable ability, independence and integrity, they who possess those characteristics will have but a limited amount of time to attend to devote to the affairs of the Panel.

173 I note the ominous statement at paragraph 7.6 of the Consultation Document:

"7.6. the Advisory Panel is not expected to be a standing body but will be drawn on each occasion from a range of different individuals."

174 Who will do the selecting? Although it is not articulated, I think we all know: some member of the civil service.

175 Inevitably, there will be a perceived risk that HMRC proposals will be rubber-stamped by hand-picked members of the Panel who will not have the time or expertise properly to consider them.

176 **In short, Sir Humphrey Appleby would have been proud of this batch of proposals in the Consultation Document.**

177 **My proposal is that the guidance be produced by HMRC.** They should be entitled to call on the expertise of the panel and would normally be expected to do so. However, the only authority for the guidance would be that of HMRC.

178 **In any subsequent litigation, the guidance could then be relied on but only by the taxpayer, as against HMRC.** (That follows the existing position with Explanatory Notes to e.g. a finance bill.) HMRC would, of course, be fully entitled to repeat their guidance in litigation, but only by way of submission.

179 If my proposals were adopted, we would have all the advantages of a published body of guidance yet without the procedure being deeply offensive to the rules of natural justice and the Rule of Law.

Author's responses to specific questions

By way of summary, I append my replies to specific questions raised in the Consultation Document. Some of these state in slightly different language my comments in the main body of this response.

Question 1 - Do you agree that the GAAR should be limited to these taxes and duties initially? Are there any particular issues relating to how the GAAR would function in relation to the taxes (including NICs) that are proposed to be included?

This is the wrong question. The question should be:

Do you agree that the GAAR should be *extended* ~~limited~~ to these taxes and duties initially? Are there any particular issues relating to how the GAAR would function in relation to the taxes (including NICs) that are proposed to be included?

My response: Yes, to all but inheritance tax.

Question 2[38] *- Do you agree that the GAAR should be capable of counteracting UK tax advantages obtained under double taxation agreements?*

Only where the Double Taxation Arrangement in question on its true construction permits the United Kingdom tax advantage to be so counteracted, but not otherwise.

Question 3 - Do you agree that: (1) the proposed "main purpose" rule serves as a useful filter, when coupled with the concept that arrangements must also be "abusive"; and (2) a specific exclusion for arrangements without tax intent is not required? If you think a specific exclusion is required, please explain why.

My response:

As to (1), No. The proposed filters are useless and will be productive of enormous uncertainty for decades and thus the GAAR will damage the economic well-being of the United Kingdom. To parody what was said about the Statute of Frauds "Every line will cost a subsidy".[39]

As to (2), Yes. A properly crafted GAAR should not need a specific exclusion

38 Post paragraph 2.26 of the Consultation Document.

39 i.e. a fortune.

for arrangements without tax intent.

Question 4[40] *- Do you agree that the proposed "double reasonableness" test*

operates as intended to counteract only artificial and abusive schemes (such as those described in Annex B)?

My response: **Definitely not. It will be capable of being applied to a wide and uncertain range of tax planning and will be productive of much mischief to the economy and unfairness to businesses and individuals who ought to be able to rely on the law being as clear and certain as possible so that they can make informed choices.**

Question 6 – The Government is continuing to develop its analysis regarding the appeals processes in relation to counteraction and consequential adjustments under the GAAR, and welcomes views which may inform detailed proposals to be published later in the year.

My response: it is premature to comment at this stage. However, procedures should allow any person adversely affected by counteraction and (if my recommendation is not followed,) consequential adjustments to have an effective right to challenge them in legal proceedings.

Question 7 – The Government would welcome views on these commencement options, how transitional arrangements should be dealt with, and whether there should be different rules for different taxes where appropriate.

My response. Further elucidation would be appreciated of what is meant by "arrangements" being "fully completed".

Question 8 – The Government welcomes views on clause 5(1) of the Draft GAAR.

My response: Clause 5(1)(b) should be altered, consequential on the alteration I have suggested to clause 4(1).

Question 9 - Do you agree that it is appropriate for particular weight to be given in the legislation to the GAAR guidance and the opinion(s) of the Advisory Panel on the arrangements?

My response: No, except to the extent that (a) the GAAR guidance is produced or agreed by HMRC and (b) it is in favour of the taxpayer.

Question 10 – The Government welcomes comments on whether particular issues

40 Post paragraph 3.17 of the Consultation Document.

arise in relation to Self Assessment (where the relevant taxes operate within a Self Assessment regime) or within the existing administrative rules for those taxes that do not operate within a Self Assessment regime.

My response: the operation of the GAAR cannot be self-assessed because (a)

counteraction is discretionary and (b) if my recommendation is followed, counteraction should be conditional on consequential adjustments being made, which are again discretionary and can affect third parties.

Question 11 – The Government invites comments on the general proposal that the GAAR should as far as possible operate within existing administration rules for the taxes involved; and on what adaptations may be necessary to existing administrative rules to ensure that the GAAR operates with as little as possible additional administration cost and burden for taxpayers, advisers and HMRC. Is there a case for having a new type of assessment given the cross-regime range of the GAAR?

While I agree with the general principle, articulated at paragraph 5.5. of the Consultation Document, that "as far as possible, any action needed to recover tax as a result of applying the GAAR should fit within existing tax administration procedures", I can see, as can the authors of the Consultation Document (in this Question 11) that there will inevitably have to be some tweaking, if only to take into account the cross-regime range of the GAAR.

Question 12 – The Government invites comments on whether time limits should be set for each of stages two, three and four and if so what those time limits should be.

My response: while basic time limits could be set, many cases involving the GAAR are likely to be of some degree of complexity. Both sides may well need more time than is allowed for in the basic time limits. There therefore ought to be considerable flexibility. HMRC and the taxpayer ought to be able to agree between themselves extension of time limits without troubling the Panel. The Panel should be given full discretion to extend the time limits on an *ex parte* application (where agreement as to their extension cannot be reached by the parties).

Question 13 – The Government welcomes comments on the proposals relating to the Advisory Panel.

My Response: **If opinions of the Panel are to carry special weight in subsequent litigation, then it would be offensive to the most basic principles of natural justice that one party to the prospective litigation should be able to**

take part in a quasi-judicial capacity in the decision-making process of the Panel. In order the justice can be done - and be seen to be done - no present or former official of HMRC (or, indeed, for that matter, no present or former civil servant or Treasury minister) should be a member of Panel.

Question 14 – The Government would welcome views on the proposals for producing and updating the guidance.

My response: My proposal is that the guidance be produced by HMRC. They should be entitled to call on the expertise of the panel and would normally be expected to do so. However, the only authority for the guidance would be that of HMRC. In any subsequent litigation, the guidance could then be relied on but only by the taxpayer, as against HMRC. HMRC would, of course, be fully entitled to repeat their guidance in litigation, but only by way of submission.

ANNEX : THE GAAR STUDY GROUP

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