SOME PROBLEMS WITH THE GAAR

Patrick Cannon[1]

1 Introduction

1.1 The General Anti-Abuse Rule, or GAAR for short, is contained in 10 admirably short statutory sections and a single schedule at sections 206 to 215 and Schedule 43 to the Finance Act 2013. HMRC's GAAR Guidance is considerably longer at 171 pages (plus 24 pages of non-approved procedural guidance).

1.2 Many problems are likely to arise with the interpretation and application of the statutory provisions and the GAAR Guidance, and this article discusses some of the more important issues.

1.3 Given that the GAAR Guidance has obviously been intended by HMRC to play a pivotal role in administering and applying the GAAR by, for instance, deterring taxpayers from undertaking those types of transactions that are described in Part D of the Guidance as abusive, it is surprising that the Guidance gets only one indirect mention in the GAAR legislation. This occurs in section 211(2)(a), FA 2013 which provides that:

> "(2) In determining any issue in connection with the general anti-abuse rule, a court or tribunal must take into account –
>
> (a) HMRC's guidance about the general anti-abuse rule that was approved by the GAAR Advisory Panel at the time the tax arrangements were entered into, …"

By implication then the legislation provides for there to be official guidance, tellingly referred to expressly as "*HMRC's* guidance" [my emphasis]. And by further implication this is to be approved by the GAAR Advisory Panel (a non-independent body of persons appointed by and

---

1 Barrister and member of Tax Chambers at 15 Old Square, Lincoln's Inn

holding office at the pleasure of HMRC – as the "resignation" of David Heaton from the Advisory Panel on 14th September, 2013 clearly demonstrated).

1.4 A further surprise is that in the face of the enormous uncertainty that the GAAR creates at the margins of tax planning,[2] HMRC refuse to offer even an informal clearance about the GAAR. This text is currently on HMRC's website at hmrc.gov.uk/cap/:

"**Clearances and the General Anti Abuse Rule (GAAR)**

HMRC will not give either formal or informal clearances that the GAAR does not apply.

HMRC has always made it clear that no assurances about the tax treatment of a transaction will be given in any situation where, in HMRC's view, the arrangements constitute tax avoidance. Because the GAAR will only apply to abusive avoidance arrangements this applies equally to any arrangements which might be caught by the GAAR. As part of its model of direct engagement with large businesses and wealthy individuals HMRC discusses commercial arrangements and confirms where appropriate that it doesn't regard particular arrangements as tax avoidance. In these cases HMRC intends that open discussions with taxpayers about commercial transactions should continue.

1.5 The wording quoted above elides the question of whether the proposed transaction is abusive, i.e. GAAR-able, or simple non-abusive tax avoidance by saying that large businesses and the wealthy can benefit from an "open discussion" in which HMRC might confirm that particular arrangements are not "tax avoidance". Of course this is of no help if the taxpayer wants to know whether his tax avoidance (legal) crosses the line and becomes abusive. HMRC will simply say whether or not the proposal is tax avoidance. In reality most taxpayers particularly of the sophisticated variety who are worried about the GAAR will be capable of deciding what is tax avoidance on their own. The more vital question of whether HMRC think that what the taxpayer plans to do or has done is abusive will fall on deaf ears.

1.6 It seems from this that HMRC take the view that if you even have to ask whether the GAAR might apply then you are probably "at it". The lack

2 And it is at the margins that we as tax advisers are often instructed to advise clients if we are honest about it – clients pay us to advise on how far they can go without crossing the line.

of a clearance facility in the context of the uncertainty created by the GAAR may well engage article 1 of protocol 1 of the ECHR (right to peaceful enjoyment of possessions and right not to be deprived of them through arbitrary action),[3] article 6 (right to a fair hearing) and article 7 (no one to be held guilty on account of an act or omission which did not constitute an offence at the time it was done, nor suffer a penalty heavier than existed when the act or omission occurred). Indeed, a tax measure should not unreasonably interfere with the expectations protected by article 1 of protocol 1 and the measure must be reasonably proportionate to the aim sought to be realised.[4]

2 "Tax arrangements"

2.1 For the GAAR to apply there must be a tax advantage which arises from tax arrangements that are abusive.[5]

Strictly speaking therefore, the starting point is to ask whether there are any "arrangements". This is usually a formality because the answer to this question will normally be obvious given that "arrangements" are defined widely so that the term:

> "*includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)*;"[6]

Rarely, if ever, will it be the case that there are no "arrangements" in any circumstances where the applicability of the GAAR is under serious consideration.

2.2 The next step is to consider whether a tax advantage arises from the arrangements. The concept of a "tax advantage" is reasonably objective because it is defined to *include* a relief, repayment, avoidance or deferral of tax[7]and so for most practical purposes will be readily apparent.[8]

---

3 See *OAO N K Yukos v Russia* [2011] ECHR 4902/04 at 559 – domestic laws must be sufficiently precise.

4 *NKM v Hungary* [2013] STC 1104.

5 Section 206(1), FA 2013.

6 Section 214, FA 2013.

7 Section 208, FA 2013.

8 The term "avoidance" is of course rather fuzzy and the subject of much academic discussions but a good working definition is the taking of a course of action "designed to conflict with or defeat the evident intention of parliament": *IRC v. Willoughby* [1997] STC 995. The difficulty of course lies with agreeing whether any parliamentary intention is evident and if so what that was.

Indeed, this definition can be regarded more or less as boilerplate given that if the GAAR is already under serious consideration the client and his tax advisers will already have accepted the practical likelihood that a tax advantage is present.

2.3 Once it is apparent that there are arrangements which give rise to a tax advantage, the tax adviser then faces the more challenging task of advising his client whether or not those arrangements are "tax arrangements". Section 207(1), FA 2013 provides that:

> "*(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*."

2.4 In order for the arrangements to be classed as "tax arrangements" it must be reasonable to conclude that a main purpose of the arrangements was the obtaining of a tax advantage. Although this imposes an objective test in reality and for practical purposes the test as applied by the courts and tribunals is likely to involve a two stage process. The first question is likely to be a subjective test of what was in the taxpayer's and his adviser's minds in planning and carrying out the arrangements in the light of the judge's evaluation of the available evidence presented to him. The second question involves the "reasonable to conclude" test which can be seen as imposing an objective check to safeguard the taxpayer against HMRC seeking to impute a main tax avoidance object to the taxpayer when in reality it was not the case.

2.5 In the case of a marketed tax avoidance scheme it will be obvious that the tax advantage was the main or a main purpose, of the arrangements. In such cases attention will naturally turn to the subsequent question of whether such tax arrangements were "abusive".[9]

2.6 However, given the decline in marketed tax avoidance schemes, the situation most commonly encountered by tax advisers will be those transactions where there is a genuine commercial transaction with a bona fide commercial objective which can be achieved in different ways, some of which involve paying the maximum amount of tax and others which involve paying a reduced amount of tax or even no tax at all.

---

9 For this reason the GAAR probably spells the end of most marketed tax avoidance schemes.

2.7 This dilemma arose in the context of section 28(1), FA 1960 (transactions in securities) which required an examination of the object of transactions to decide whether or not they "had as their main object, or one of their main objects, to enable tax advantages to be obtained …," in *CIR v. Brebner* 43 TC 705. This case concerned a (non-taxable) reduction in the share capital of a company which was intended to allow shareholders to repay part of a loan from a bank that had been made to enable them to purchase their shares. The Special Commissioners found that while a (taxable) dividend could have been declared by the company that would have been a surprising thing for the company to have done and after tax, would not have provided sufficient funds to repay the bank loan. The Special Commissioners went on to hold that the obtaining of the tax advantage by the reduction in share capital was an ancillary result of the main object which was a bona fide commercial one, and that the transactions in question did not have as their main object, or one of their main objects, to enable tax advantages to be obtained. Although that case concerned a statutory provision which used the words "main object" rather than the words "main purpose" which are used in the GAAR's definition of "tax arrangements" there is in practice no difference in the meaning of "object" and "purpose" in this context.[10]

2.8 *Brebner*[11] is authority for the proposition that the question of whether the transactions in question were entered into for bona fide commercial reasons and none of them had as their main object, or one of their main

---

10 The words "purpose" and "object" can however be contrasted with "effect" for as Lord Clyde said in the Court of Session: "The material question is not what was the effect of each or all of the interrelated transactions; the question is what was the main object or objects for which any of them was adopted. Section 28(1) of the Act draws a clear distinction between effect and object.": *CIR v. Brebner* 43 TC 705 at 713D/E. These comments must however be contrasted with the decision of the Privy Council in *Ashton v. IRC* [1975] STC 471 in relation to an earlier New Zealand general anti-avoidance provision which used the phrase "purpose or effect of in any way altering the incidence of income tax …". In that case Viscount Dilhorne said at p478b: "If an arrangement has a particular purpose, then that will be its intended effect. If it has a particular effect, then that will be its purpose …". He also expressly agreed with the statement of Lord Denning in *Newton v. Comrs of Taxation of the Commonwealth of Australia* [1958] 2 All ER 750 in relation to similar Australian statutory wording: "These words [purpose or effect] are in the alternative but they do not appear to me to have any real difference in meaning." Viscount Dilhorne also expressly agreed with the judgment of McCarthy P in the Australian Court of Appeal in *Ashton* which held that the test was objective and that the purpose of an arrangement must be determined by what the transaction effects and that motive was irrelevant. Both of these decisions are however of the Privy Council and while of persuasive authority, are not binding in contrast to *Brebner*. It also appears that *Brebner* was not cited to the Privy Council in *Ashton*.

11 43 TC 705 and above.

objects, to enable tax advantages to be obtained, are questions of fact for the fact-finding tribunal. The test is a subjective one.[12] Lord Upjohn said:

> "*I agree the question whether one of the main objects is to obtain a tax advantage is subjective and, as Lord Greene M.A. pointed out in Crown Bedding Co. Ltd v. Commissioners of Inland Revenue (1946) 34 TC 107, at pages 115 and 117, is essentially a task for the Special Commissioners unless the relevant Act has made it objective (and that is not suggested here).*"[13]

Lord Upjohn also said that the fact that the taxpayer had chosen a way of carrying out a genuine commercial transaction that involved paying only a reduced amount or no amount of tax did not *necessarily* indicate that one of the main objects was avoidance of tax:

> "*No commercial man in his senses is going to carry out a commercial transaction except upon the footing of paying the smallest amount of tax that he can. The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence.*"[14]

2.9 In relation to HMRC's argument in *Brebner*, that the transactions must be divided into two chapters, the first consisting of the purchase of the shares of other shareholders to prevent the threatened takeover bid (which was bona fide commercial) and the second occurring nearly two years later and consisting of the (tax free) reduction in share capital (with one of the main objects being a tax advantage), Lord Upjohn said:

> "*Counsel for the Respondents [the Taxpayers] has, in my view, wisely conceded that the Special Commissioners could have found that there were two separate chapters, one of which was purely commercial, the other of which had as its main object the obtaining of a tax advantage. But this, he has urged, is a matter which must be entirely one for the Commissioners. I agree …*"[15]

---

12 The GAAR Guidance on this point at C3.3 is thought by the author to be incorrect in suggesting that the test is simply an objective one.

13 43 TC 705 at 718E.

14 43 TC 705 at 718I and 719A.

15 43 TC 705 at 718D/E

Lord Pearce said:

> "*But that which had to be ascertained was the object (not the effect) of each interrelated transaction in its actual context, and not the isolated object of each part regardless of the others. The sub-section would be robbed of all practical meaning if one had to isolate one part of the carrying out of the arrangement, namely, the actual resolutions which resulted in the tax advantage, and divorce it from the object of the whole arrangement.*"[16]

That this holistic approach to the overall transactions is the correct one is even more apparent with the GAAR which speaks of "the main purpose, or one of the main purposes, of the *arrangements*",[17] whereas the statutory language in ***Brebner*** referred to "the transaction or transactions".

In this regard the GAAR Guidance directly conflicts with Lord Pearce's remarks quoted above, when it states at C4.3:

> "*The definition of arrangements is important to the consideration of the purpose test determining whether there is a tax arrangement. Arrangements can be viewed both narrowly and widely, so the GAAR can be applied to an arrangement that is part of a wider arrangement or to the wider arrangement as a whole. This prevents the weighting of purposes from being manipulated, such as by combining a tax scheme with a commercial transaction.*"

There seems to be no authority for this statement and the GAAR provisions themselves do not provide for this approach. Superficially, sections 207(3) and 215(2) and (3), FA 2013 could be read as implying that the tax avoidance steps within a set of arrangements could be isolated and treated on their own as "tax arrangements". Section 207(3), FA 2013 provides:

"*(3) Where the tax arrangements form part of any other arrangements regard must also be had to those other arrangements.*"

However, in the author's view this provision simply reinforces the sensible approach that "arrangements" are to be taken as a whole when deciding what the main purpose(s) of the arrangements may be. This is also the

---

16 45 TC 705 at 715D. These remarks will be particularly relevant in the context of a transaction tax such as SDLT if HMRC seek to apply the GAAR to one particular step in a wider commercial transaction, namely the way in which a property transfer has been structured within a larger series of transactions.

17 Section 207(1), FA 2013

more satisfyingly coherent interpretation and accords with Lord Pearce's remarks in *Brebner* set out above.

Section 215(2) and (3), FA 2013 in also referring to tax arrangements forming part of other arrangements has a protective function for taxpayers and allows the parts of the arrangements entered into before commencement of the GAAR to be ignored for the purpose of section 207(3), FA 2013 except to the extent that they would show that the tax arrangements would not be abusive.

The last sentence of the GAAR Guidance quoted appears to pre-judge a commercial transaction into which some tax efficiency has been inserted as in *Brebner*, as being an attempt at manipulation by weighting of purpose. The correct approach in such cases will be to take each case on its merits and let the First-tier Tribunal as the tribunal of fact make its own decision based on case-law authority as to the correct approach.

It is also worth noting that the shareholders in *Brebner* would not have proceeded with the reduction in share capital if the tax saving had not been available so it is a particularly strong example of the tribunal of fact holding that a main object of the transaction was nevertheless not the obtaining of a tax advantage.

3 The Role of Intention in the GAAR

3.1 In considering whether there are "tax arrangements", the tribunal of fact will be the chief judge of whether the main purpose or one of the main purposes of the arrangements was the obtaining of a tax advantage.[18] Although there is an objective element, the test of purpose is at its heart a subjective one and in any particular case the tribunal will examine all the available factual evidence for indications of the purposes of the arrangements. This will normally involve a detailed review of the available written evidence such as discussion papers, correspondence, board minutes and legal documentation and also the hearing of the evidence of witnesses who were involved in the creation and carrying out of the relent arrangements in the form of examination and cross-examination where necessary.

3.2 The subjective intentions of the taxpayers will therefore be relevant but those of the taxpayer's advisers will also be considered. In *Addy v. IRC* [1975] STC 601 a company was liquidated, another company was formed

18 See 2.9 above.

to acquire the assets and business of the first company and a third company under common control stood to benefit from the release of funds from the first company. Goff J held that for the purposes of section 28(1), FA 1960 (transactions in securities) which required an examination of the object of the transactions to decide whether or not they "had as their main object, or one of their main objects, to enable tax advantages to be obtained":

> "*What has to be applied is a subjective test of the intention of those in control.*"[19]

In that case the relevant subjective intention was held to be not only that of the directors of the first and third companies but also that of their professional adviser on whose advice the scheme was carried out.

3.3 In practice the subjective intention of the adviser will often be relevant in ascertaining the purpose of the arrangements. In *Lloyd v. HMRC* [2008] STC (SCD) 681 the question was whether at least one of the main objects of a sale of shares was to enable a tax advantage to be obtained[20]. The Special Commissioner said that the transaction had been a "joint effort" between the taxpayer and his adviser Mr. Childs from the firm of accountants involved in the transaction, "with Mr. Childs seeing the tax benefits of the transaction and the appellant seeing some commercial benefit …"[21] He found that "while the appellant may not have been particularly concerned with tax, Mr. Childs must have been …".[22] He also found that although one of the appellant's main objects was to achieve his commercial ends, the existence and timing of the transaction was driven by a desire to benefit from the intended tax treatment and that the resulting tax advantage "cannot be said to be an effect rather than an object of the transaction [and] was one of the main objects of the transaction."[23]

3.4 A good illustration of how the process of ascertaining whether the main purpose, or one of the main purposes, of the arrangements is the obtaining of a tax advantage is likely to work in practice for the purposes of the GAAR, occurred in the First-tier Tribunal judgment In

---

19 Ibid. at 610d.

20 Under section 703(1), ICTA, the descendent of section 28(1), FA 1960.

21 [2008] STC (SCD) 681 at 686g.

22 Ibid. at 687a.

23 Ibid. at 687b/c.

INML and Others v. Commissioners for Revenue and Customs.[24] The relevant issue in that case was whether or not paragraph 111, Schedule 29, FA 2002 applied to disregard arrangements when determining whether credits or debits should arise under the financial intangibles regime contained within that Schedule. Paragraph 111 read as follows:

"*111-(1) Tax avoidance arrangements shall be disregarded in determining whether a debit or credit is to be brought into account under this Schedule or the amount of any such debit or credit.*

(2) Arrangements are 'tax avoidance arrangements' if their main object or one of their main objects is to enable a company –

(a) to obtain a debit under this Schedule to which it would not otherwise be entitled or of a greater amount than that to which it would otherwise be entitled, or

(b) to avoid having to bring a credit into account under this Schedule or to reduce the amount of any such credit.

(3) In this paragraph – "arrangements" includes any scheme, agreement or understanding whether or not legally enforceable; and "brought into account" means brought into account for tax purposes."

In that case the taxpayers which were subsidiaries claimed debits under the Schedule representing licence fees paid to their parent company for the use of certain newspaper trademarks while the taxpayer parent company argued that it did not have to bring credits into account under the Schedule in respect of the licence fees to which it became entitled from the subsidiaries.

The taxpayer argued that the main purpose of the arrangements was to reduce the commercial profits in subsidiaries and that the transactions would have been carried out even if the tax advantage of a tax free receipt in the parent had not been available. HMRC accepted that the genesis of the arrangements was a (commercial) desire to hide disclosable profits. However, HMRC argued that following the involvement of the group's accounting adviser Ernst & Young, "the pre- existing commercial rationale [was] hijacked and used as a fig leaf" for a tax avoidance scheme. The tribunal carried out a very careful and detailed examination of circumstantial evidence including a handwritten note of a telephone conversation and the answers given by the personnel involved in the arrangements during cross examination by HMRC's counsel. The

24 [2012] UKFTT 696 (TC).

tribunal found that taking into account the subjective intentions of those responsible for carrying out the transactions and also those of Ernst & Young i.e. those in control,[25] Ernst & Young's input turned "the germ of an idea for a non-tax commercial transaction into a complicated scheme which would … also provide a very significant tax advantage by way of the mismatch between the treatment of a capital sum in INML's hands and the tax write-offs for the amortisation charges in the accounts of the subsidiaries".[26] The tribunal also found that Ernst & Young's subjective intention in relation to the transaction was that the firm had as their main object or one of their main objects to enable that tax advantage to be obtained, within the meaning of paragraph 111(1), Schedule 29, FA 2002. Further, the tribunal did not accept the evidence of certain officers of the companies that enabling a tax advantage to be obtained was not also a main object of the transactions. The tribunal concluded that one of the main objectives was enabling the parent company to avoid having to bring the licence fee receipts into account under Schedule 29, FA 2002 while at the same time seeking an entitlement for the subsidiaries to claim debts under the Schedule and that this was an object within paragraph 111(2) of the Schedule. Hence the transactions were "tax avoidance arrangements".

3.5 Within the context of the GAAR, both HMRC (at the enquiry stage) and the tribunal (at the appeal stage) are likely to adopt the same sort of approach as in the *INML* case[27] in order to conclude whether there are "tax arrangements". The taxpayer and his professional adviser should therefore both give careful consideration to their involvement in the planning stage of a transaction, the manner and form in which the advice is expressed and given and the way in which any potential tax advantages are incorporated into a commercially driven transaction.

The aim should be to ensure that wherever possible any such tax advantage is seen to be an ancillary aspect of the transaction and that the available contemporaneous evidence supports this.[28]

---

25 Following *Addy*, see 3.2 above.

26 [2012] UKFTT 696 (TC) at 69/40.

27 Ibid. 3.4.

28 The shrewd taxpayer will also keep in mind the protecting veil of legal professional privilege.

4 What does the "abuse" test add?

4.1 The concept of "abusive" is the most awkward and difficult aspect of the GAAR. The "abusive" test is applied only once there are "tax arrangements".[29] The use of the term "abusive" is misleading because tax arrangements are to be deemed "abusive" if the entering into or carrying out of those arrangements "*cannot reasonably be regarded as a reasonable course of action …*"[30] Hence something which is unreasonable is not to be regarded as simply unreasonable but is deemed to be an abuse. Most people naturally recognise a distinction between a position that might be termed to be merely unreasonable and a position that could be termed to be abusive, with the latter carrying more negative connotations in terms of human behaviour. The equating of unreasonableness with abuse seems to have driven the political case for the GAAR.[31]However, in deciding whether the arrangements cannot reasonably be regarded as a reasonable course of action, the person judging the question is directed to have regard to all the circumstances including:

(a) whether the result is consistent with any principles behind the relevant statutory provisions and their policy objectives;

(b) whether there are any contrived or abnormal steps; and

(c) whether there was an intention to exploit any shortcomings in the relevant statutory provisions.[32]

4.2 Arguably however, one or more of these criteria will already have been

---

29 See above.

30 The so-called "double reasonableness" test in section 207(2), FA 2013.

31 See for instance Chapter 2.1 of the consultation document entitled A General Anti-Abuse Rule published on 12 June 2012 which refers to the "egregious", "very aggressive" or "highly abusive contrived and artificial" schemes referred to in the "GAAR Study" of 11 November 2011. This and other similar public statements issued by HM Treasury, HMRC and ministers at the time are however admissible in evidence under section 211 (3)(a), FA 2013 to demonstrate that there is a high threshold before the GAAR can apply, and see B8.3 of the GAAR Guidance which confirms that there can be arrangements which fall outside the range of acceptable tax planning but which are not abusive. The use of the epithet "double" as in "double reasonableness test" is particularly apt here given that the use of the word "abusive" here to denote mere unreasonableness can be considered a classic exercise in Orwellian "doublespeak" ie., the use of language that deliberately disguises, distorts or reverses the established meaning of words. As Orwell observed: "… the great enemy of clear language is insincerity."

32 Section 207 (2), FA 2013.

engaged in deciding whether there are "tax arrangements" in the first place.[33] There is therefore an overlap between the "tax arrangements" test and the "abusive" test. Where this occurs in practice it may dilute the protective function of the latter test. For example, if a court or tribunal decides that there has been a "tax advantage" due to tax avoidance or arrangements that seek to defeat the intention of Parliament, then they are also going to decide criteria (a) above against the taxpayer. In such a situation the double-reasonableness test therefore adds little, if anything, and appears to be merely a kind of formal step in the process of applying the GAAR which gives the appearance of protecting the taxpayer whilst adding little of substance.

In other words, once arrangements are classified as "tax arrangements" the criteria that they have met will usually mean that they cannot pass the double-reasonableness test assuming that it is not a reasonable course of action to try to defeat the evident intention of Parliament. It may, however, be that the double-reasonableness test has a role in situations where the principles and policy of the statutory provisions are difficult to divine. The apparent protection afforded by the double reasonableness test is of course somewhat undermined by the facility afforded to HMRC of inserting examples of what tax planning is and is not to be regarded as reasonable in part D of the GAAR Guidance, subject only to the approval of the Advisory Panel (a body which is not independent of HMRC). What effective role does the test play when the outcome has already arguably been decided by HMRC via an example inserted in the GAAR Guidance? Here we can see the undermining effect of the GAAR on the rule of law.

5 Role of the Advisory Panel

5.1 There is something counter-intuitive about the role of the Advisory Panel. This arises because the tax adviser might naturally assume that the role of the Advisory Panel was to opine on whether the GAAR applied (and possibly also whether the proposed counteracting adjustments were appropriate). However, the role of the advisory panel is stated to be to opine on whether the entering into or carrying out of the tax arrangements is or is not a reasonable course of action (or that it is

33 For example "tax avoidance" has been judicially explained as the taxpayer taking a course of action "designed to conflict with or defeat the evident intention of parliament": *IRC v. Willoughby* [1997] STC 995.

not possible to reach a view on the matter).[34] This is in marked contrast with the requirement for the GAAR to actually apply which is that the tax arrangements must be "abusive". To be "abusive" the tax arrangements must be such that they "cannot reasonably be regarded as a reasonable course of action".[35] This "double-reasonableness" test has been carefully formulated and deliberately included in the GAAR provisions to protect the taxpayer. Therefore while the Advisory Panel opinion may have found that the tax arrangements were not a reasonable course of action, HMRC will in addition have to show if challenged that the arrangements are "abusive" i.e. that within the range of possible reasonable views on the matter there cannot be a view that the tax arrangements are reasonable. In other words, the fact that the Advisory Panel may have opined that the tax arrangements are not reasonable does not by itself give victory over the taxpayer to HMRC. The GAAR Guidance states that giving the advisory panel this limited role was deliberate.

The statutory wording also does not expressly empower the advisory panel to opine on the counteracting adjustments proposed by HMRC.

5.2 This situation seems to be even stranger when one considers that under the procedure set out in Schedule 43, FA 2013, the Advisory Panel will be supplied with HMRC's and the taxpayer's written submissions concerning whether or not the arrangements are abusive and not just whether or not they meet the single reasonableness test.[36] Moreover, the Advisory Panel is not empowered to opine on "the proposed counteraction" but merely on whether the tax arrangements are or are not reasonable. This seems to involve a surprising lack of precision in the drafting. Read literally, both the taxpayer and HMRC are empowered to make representations on something that the Advisory Panel is not empowered to opine on. Given that HMRC and the taxpayer will make written representations about the applicability of the GAAR itself, this may give rise to the temptation for the Advisory Panel to exceed its statutory remit and to opine not only on whether the tax arrangements are reasonable or not but also on whether they are "abusive".[37]

---

34 Para 11(3), Schedule 43, FA 2013.

35 Section 207(2) , FA 2013.

36 Paras 4 and 9, Schedule 43, FA 2013.

37 See E3.5.1 of the GAAR Guidance which strangely refers to the taxpayer making representations to the Advisory Panel about the proposed counteraction, even though the panel has no role in relation to the counteraction.

Given the tactical advantage for the taxpayer if the Advisory Panel remains within its statutory remit, the taxpayer's adviser will wish to draft the written representations to the Advisory Panel very carefully in order to ensure that the panel's opinion does not pre-empt the answer to the "abusive" test, the proper forum for which is the tax tribunal and not the advisory panel. Specialist assistance in drafting the taxpayer's written representations may well be sensibly sought from members of the Tax Bar.

6 Role and status of the GAAR Guidance

6.1 This section considers (1) the role of the GAAR Guidance relating to the burden of proof in establishing that the GAAR applies and (2) from an evidential perspective, what is the legal status of the Guidance in court and tribunal proceedings?

Looking at the first topic under this heading – the role of the Guidance relating to the burden of proving that the GAAR applies - in deciding any issue concerning the GAAR, a court of tribunal *must* take into account:

(a) the GAAR Guidance; and

(b) any opinion of the Advisory Panel about the arrangements.[38]

In relation to (a), it is noteworthy that in addition to considering the GAAR Guidance, the court or tribunal is also directed to have regard to the principles and policy objectives of the legislation, whether there are any contrived or abnormal steps and whether the arrangements are intended to exploit any shortcomings in the legislation.[39]

With regard to (b) the court or tribunal will wish to keep in mind that the Advisory Panel are employees of, and not independent of HMRC and that the sub-panel which produced the opinion was chosen by the chairman who himself holds office at the pleasure of HMRC. In evidential terms, the opinion should therefore be treated in the same way as a submission made by counsel acting for HMRC during his argument and given no

---

38 Section 211(2)(a) and (b), FA 2013. It is thought that the reference to "arrangements" in (b) above is to the taxpayer's tax arrangements in question and not to any similar arrangements on which the Advisory Panel may also have opined, given the words "(see paragraph 11 of Schedule 43)" immediately following the reference to "arrangements" in section 211(2)(b), FA 2013 indicate that it is the taxpayer's arrangements on which the Panel has opined.

39 Section 207(2)(a)-(c), FA 2013.

more weight than this. It is certainly not to be treated as equivalent to an expert's evidence because it lacks the requisite independence and objectivity. Unlike an expert's evidence it is not addressed to the court or tribunal nor will it contain the standard statement required under rule 35.10(2) of the Civil Procedure Rules 1998 that the expert understands and has complied with their duty to the court nor will it comply with the requirements of Practice Direction 35. Any attempt by counsel acting for HMRC to treat the opinion as quasi- expert evidence should therefore be firmly resisted.

6.2 What significance, if any, should be attributed to the word *must* in this context? In my view the use of the word must in this context has little, if any, effect on the approach that a court or tribunal should adopt. In any case concerning the GAAR, a court or tribunal was always very likely to give consideration to the GAAR Guidance even in the absence of the requirement that they *must* take it into account and so this requirement seems to be otiose and could even be regarded as the executive attempting to patronise or, even worse, influence the judges. If the authors of the GAAR were really intending by the use of the word *must* that the judges be in some way bound by the GAAR Guidance, then they could have put such an express requirement into the statutory provisions but in the absence of such a requirement the word *must* in this context seems to add little, if anything. The requirement to take the GAAR Guidance into account is just that and it does not follow that the judges are bound to follow the guidance. The GAAR Guidance itself says at A3 that it is "…an aid to the interpretation and application of the GAAR, by discussing its purpose, considering particular features of the GAAR and, where appropriate, illustrating that discussion by means of examples."[40] The GAAR Guidance does not have the status of statutory rules or regulations and is not subject to formal Parliamentary scrutiny.[41] The contrast between the use of the words *must* and *may* in this context is not significant and in my view merely reflects the reality that the GAAR Guidance is of direct relevance to proceedings involving the GAAR and so should be taken into account whereas other

---

40 It is not helpful in this context that some of the examples appear to be incorrect and parts of the guidance to be at odds with the statutory provisions – see below.

41 The GAAR Consultation document published by the HM Treasury on 12th June 2012 stated at 7.3 that the GAAR Guidance was not intended to have the same status as legislation and at 7.5: "Ultimately, it is for the tribunal and the court to apply the GAAR legislation as enacted by Parliament and while the guidance must be taken into account, it is up to the tribunal or court to weigh this evidence as with any other evidence and apply the law in the normal way."

forms of guidance and materials may not be of such direct relevance and so need not necessarily be taken into account.[42] We now turn to the question of what evidential weight a court or tribunal should attribute to the GAAR Guidance.

6.3 It should be kept in mind at all times that the GAAR Guidance is HMRC's guidance. It is written and published by HMRC and is approved by, a non-independent Advisory Panel who are appointed by and are employees of, HMRC. With this in mind, a good starting point from which to consider the status of the GAAR Guidance is the statement by Lord Clarke in *R (on the application of Alvi) v Secretary of State for the Home Department* where he said:

> "*It seems to me that, as a matter of ordinary language, there is a clear distinction between guidance and a rule. Guidance is advisory in character; it assists the decision maker but does not compel a particular outcome. By contrast a rule is mandatory in nature; it compels the decision maker to reach a particular result*."[43]

And, according to Bennion on Statutory Interpretation at section 232:

> "*Official statements by the government department administering an Act, or by any other authority concerned with the Act, may be taken into account as persuasive authority on the legal meaning of its provisions*."[44]

This passage has been accepted as authoritative by the House of Lords.[45]

However, as Bennion also notes, "the judiciary, not the executive, decide on the meaning and effect of legislation". An official statement "*may be of assistance for some purposes, for example if it throws light on the background to the legislation and thereby enables the court to understand better its general purposes". Further, "insofar as the views expressed in such a document are inherently persuasive, they may be taken into account". However, "that is as far as it goes*".[46]

---

42 The GAAR Consultation document published on 12th June, 2012 took the same view at 4.8.

43 [2012] UKSC 33 at [120].

44 5th Edition.

45 *R v Montila* [2005] 1 All ER 113.

46 Bennion on Statutory Interpretation, 5th Edition, second supplement (1st October, 2012) quoting extracts from *R (Risk Management Partners Limited) v Brent LBC* [2010] PTSR 349 at 227]. See also the Supreme Court decision in *Grays Timber Products Limited v. Revenue & Customs Commissioners* [2010] UKSC 4 at [54, 55].

A succinct statement of the correct approach to official guidance was made by Lloyd Jones J. in *Chief Constable of Cumbria Constabulary v Wright and Another*[47] where the Home Office Guidance being considered stated at para 1.1.2 :

"*This guidance is designed principally for:*

- *the courts;*
- *the police;*
- *teams involved in tackling anti-social behaviour*".

The relevant passage from the judgment is worth quoting in full as follows:

"*15. The appellant submits that although the Guidance has no statutory authority, it should be taken into account when interpreting the 2003 Act and should not be disregarded without good reason. The appellant draws an analogy with Explanatory Notes.*

16. The second respondent submits that the Guidance should not be taken into account by the court when interpreting the 2003 Act. She submits that there is a clear danger in adducing guidance provided by and or behalf of the executive when determining the intention of Parliament. She also points to the fact that in R (Errington) v Metropolitan Police Authority [2006] EWHC 1155 Collins J identified a significant error in the Guidance (at paragraph 29) and considered another passage to be potentially misleading (at paragraph 36).

17. It is, of course, for the courts and not the executive to interpret legislation. However, in general, official statements by government departments administering an Act, or by any other authority concerned with an Act, may be taken into account as persuasive authority on the legal meaning of its provisions. That is the principle stated by Bennion on Statutory Interpretation, 4th Ed, section 232. In the present case we are concerned with Guidance published by the Home Office, which is the government department which had responsibility for the enactment and operation of the legislation in question. In any given case, it may be helpful for a court to refer to the Guidance in the interpretation of the legislation. It may be of some persuasive authority. However, to my mind that is the limit of its influence. It does not

47 [2006] EWHC 3574 (Admin).

differ in that regard from a statement by an academic author in a text book or an article. It does not enjoy any particular legal status. There seems to me to be no satisfactory basis for the submission that it gives rise to a presumption that the views it contains are correct and should be rejected only for good reason.

18. The appellant seeks to draw comparisons with Explanatory Notes under the new practice followed since 1999 whereby such notes are published alongside the majority of public Bills introduced by the Government into Parliament. The text of such notes is prepared by the Government department with responsibility for the Bill. The practice is described by Lord Steyn in his speech in R (Westminster City Council) v National Asylum Support Service [2002] 1 WLR 2956; [2002] UKHL 38 at paragraph 3. I am not persuaded that this is a true analogy. In any event it is apparent from the speech of Lord Steyn in the Westminster case that there are important limitations on the extent to which recourse may be had to such Explanatory Notes. In particular it is impermissible to treat the wishes and desires of the Government about the scope of the statutory language as reflecting the will of Parliament. The aims of the Government in respect of the meaning of clauses as revealed in Explanatory Notes cannot be attributed to Parliament.

19. In the present case, the mischief against which the legislation is directed is not in dispute. Moreover, the Guidance with which we are concerned cannot be taken as any indication of the intention of Parliament. The Guidance provides one view as to meaning of the legislation. It is of some persuasive authority, but no more than that.

20. Accordingly, I would answer the second question as follows:

The Guidance may be taken into account by a court considering the legal meaning of the statutory provisions to which it refers. It is capable of being persuasive authority."

In my view, the position set out in the extract from the judgment of Lloyd Jones J above will be the same in relation to the GAAR Guidance. In other words the GAAR Guidance may be taken into account as persuasive authority on the meaning of the statutory provisions of the GAAR but that will be the limit of its influence. The fact that it was written by HMRC and approved by a non-independent body composed of persons appointed by, and who are employees of, HMRC who will be a party to the legal proceedings will be borne in mind in deciding what weight to

ascribe to its evidential value. It does not enjoy any particular legal status and there is no room for a presumption that the views expressed in the guidance are correct and should be rejected only for good reason. Indeed there are parts of the GAAR Guidance which appear to be incorrect and in one case in conflict with House of Lords case-law authority.[48] It is to these matters that we now turn.

7 Reliability of the GAAR Guidance

7.1 In this section, I am going to consider two areas where, in my view, the GAAR Guidance seems to be at odds with either superior court authority or the GAAR legislation itself, or is simply plain wrong. This is not an exhaustive list and it is likely that further issues with the validity of the Guidance will emerge in time.

7.2 The first area of contention relates to whether the test for "tax arrangements" is exclusively an objective one (as the GAAR Guidance states) or whether the taxpayer's subjective intention is also relevant. In order for the arrangements to be caught as "tax arrangements" it must be reasonable to conclude that the main purpose, or a main purpose, of the arrangements was the obtaining of a tax advantage[49]. Although the requirement for reasonableness imposes an objective test, strictly speaking, however, the statutory definition of "tax arrangements" requires a two stage process. The first stage is an enquiry as to whether the obtaining of a tax advantage could have been a main purpose of the arrangements. This is a subjective test involving an enquiry into what was intended by the taxpayer and his adviser. As Lord Upjohn said in *Brebner*:

> "*I agree the question whether one of the main objects is to obtain a tax advantage is subjective and, as Lord Greene M.A. pointed out in Crown Bedding Co. Ltd v. Commissioners of Inland Revenue (1946) 34 TC 107, at pages 115 and 117, is essentially a task for the Special Commissioners unless the relevant Act has made it objective (and that is not suggested here).*"[50]

---

48 See for example C3.3 of the GAAR Guidance which is at odds with *CIR v Brebner* 43 TC 705 at 718E. Part E of the GAAR Guidance in suggesting that the Advisory Panel is independent of HMRC is simply incorrect. The examples provided at Part D38 on the commencement provisions are incorrect for the reasons given below.

49 Section 207(1), FA 2013

50 *CIR v. Brebner* 43 TC 705 at 718E. There are however Privy Council authorities that

Although that case involved a statutory provision which used the words "main object" rather than the words "main purpose" there is in practice no difference in the meaning of "object" and "purpose" in this context. The GAAR Guidance at C3.3 states however that this is an objective test because of the presence of the expression "reasonable to conclude". C3.3 of the GAAR Guidance states:

> "*C3.3 The expression "reasonable to conclude" shows that this is an objective test, which is to be applied by taking into account all the relevant circumstances and asking whether, in the light of those circumstances, a reasonable conclusion would be that obtaining a tax advantage was the main purpose, or one of the main purposes, of the arrangements. It is neither necessary nor appropriate to enquire whether any particular person (e.g. the taxpayer himself, or a promoter of the arrangements, if there was one) actually had that intention. In practice, though, it would be very rare to find a situation where objectively the obtaining of a tax advantage appeared to be one of the main purposes of an arrangement although, subjectively, the participators did not in fact have any such aim.*"

In my view the guidance on this point in seeking to suggest that the test is only objective unrealistically ignores the subjective element that is necessarily present in the test and is therefore also contrary to the authority of the House of Lords in *Brebner*. At its core the test is essentially a subjective one with the "reasonable to conclude" test imposing an additional objective check to safeguard the taxpayer against HMRC seeking to impute a main tax avoidance object to the taxpayer when in reality that was not the case. Further, the indication at C3.8 of the GAAR Guidance that the definition of "tax arrangements" sets "a low threshold" and that many transactions that achieve some tax advantage will fall within the definition seems to be contrary to *Brebner* which actually sets quite a high threshold.[51] This difference between the GAAR Guidance and clear House of Lords authority creates something of a quandary given that a court or tribunal *must* have regard to the guidance but where that guidance is contrary to binding precedent it may, or should, not be followed. The status of official guidance as to the meaning of statutory wording which is at variance with the actual

---

suggest that the test is objective: see footnote 30 at Chapter 2.

51 In that case the transaction would not have proceeded without the anticipated tax saving and yet the tax saving was held not to have been a main purpose. See further 2.8 – 2.10 below for a detailed analysis of *Brebner* in this context.

meaning of the statutory wording concerned was considered in detail above.

Clearly whatever the status of the GAAR Guidance it is nevertheless insufficient to overturn superior court authority on the point in issue in the absence of clear statutory language to that effect.

In my view, while the GAAR Guidance may be of some persuasive authority, where it conflicts with clear superior court authority it cannot however overrule that authority or release a lower court or tribunal from the obligation to follow that authority.

It can also be noted at this point that where a particular statutory tax exemption or a relief is protected by a "TAAR" or targeted anti-avoidance rule, the GAAR is unlikely to be relevant. This is because a typical TAAR such as section 16A, TCGA 1992 uses the same sort of main purpose test as the GAAR. Hence, if the taxpayer were to be caught by the TAAR then the GAAR would not need to be deployed. However, if the taxpayer passes the TAAR unscathed then the same should also be true of the main purpose test in the GAAR with the consequence that the GAAR could not then apply. The GAAR should not therefore be seen by HMRC as a second line of defence after a TAAR has failed where the TAAR is framed in terms of a main purpose test. The GAAR Guidance however overlooks this point and states at B7.2:

> "*In principle the GAAR operates independently of these other anti-avoidance rules, and it might well be used to counteract an abusive arrangement which was itself contrived to exploit a defect in the other anti-avoidance provisions, whether a TAAR or otherwise*."

For the reason given above this guidance should be regarded as merely aspirational rather than as accurate in the case of a main purpose test type of TAAR. HMRC say at B6.2 that there may be some cases where it would be appropriate to invoke the GAAR without first deploying more specific anti-avoidance legislation and that in such cases the taxpayer cannot object to the use of the GAAR. It is open to HMRC to deploy the GAAR straightaway but the main purpose test in the GAAR itself will of course still need to be satisfied if the GAAR is to apply.

If the first stage i.e. the subjective test discussed above gives a positive answer, one is then required to ask whether that is a reasonable conclusion in all the circumstances. In terms of the ordinary human thought process, however, these stages are likely to be combined together.

Indeed, HMRC's GAAR Guidance elides these two stages.[52] It may be, however, that if the question arises in a particular hearing before a tribunal or a court and there is little or no evidence available to prove the purpose of the particular arrangements, then the taxpayer's counsel may request that HMRC demonstrate the reasonableness of the conclusion that the obtaining of a tax advantage was a main purpose of the arrangements.[53]

This situation might arise for example if at the planning stage the taxpayer has included his legal advisers in the discussion of the purpose of the arrangements so that this remains legally privileged and not available as evidence: see *R (on the application of Prudential plc and another) (Appellants) v. Special Commissioner of Income Tax and another (Respondents)* [2013] UKSC 1. Such a tactic may however not impress the tribunal or court as in *Project Blue Limited v Comm for HM Rev & Customs* [2013] UKFTT 378 (TC) at paras 156 and 231 where the Clifford Chance tax structure paper was not disclosed even though the taxpayer was required to show that SDLT avoidance was not a factor in how it had structured the transactions in question.

7.3 Another area of contention concerns what the GAAR Guidance says about the statutory commencement provisions in section 215, FA 2013. The GAAR Guidance[54] acknowledges at D37.2 that:

> "*It [i.e. the GAAR] does not apply to tax arrangements entered into before this date [i.e. royal assent to FA 2013]*".

So far, so good. This simply reflects the statutory position. The guidance then creates the twin terms "Post-Commencement Tax Arrangement" (as short-hand for a tax arrangement entered into on after the operative date) and "Broader Arrangement" (a broader arrangement entered into before the operative date) and goes on at D37.7 to state that:

> "*However, where a Post-Commencement Tax Arrangement is by itself abusive, regardless of any earlier steps taken as part of the Broader Arrangement, HMRC can still apply the GAAR*."

It is important that taxpayers and their advisers do not read the above passage as carrying the implication that those parts of a tax arrangement first entered into before the operative date but which occur on or after the operative date are within the scope of the GAAR. Such post-operative date steps are not within the GAAR's scope as long as they

---

52 GAAR Guidance, C3.3 quoted above.

53 Particularly as section 211(1), FA 2013 places the burden of proof on HMRC.

54 See D37 of the GAAR Guidance

form part of the same tax arrangement that was begun prior to the operative date.[55] It is also worth noting that the Broader Arrangement concept is defined only in terms of an arrangement entered into before the operative date and not "tax arrangements". The same distinction also occurs within section 215 (2) and (3) FA 2013. Hence a Broader Arrangement may not necessarily be a "tax arrangement".

Example 1 at D38 of the GAAR Guidance is also an example of how the guidance appears to be at odds with the statutory provisions of the GAAR. It relates to a scenario which has already been stated at D8 of the guidance to illustrate a shares for debt transaction with a commercial driver but which has been structured in a contrived or abnormal way so as to give rise to a result that is said to be abusive. D38.1 postulates a situation where the first part of the arrangements, namely the acquisition of shares in a connected company which have been created for the purpose of the scheme, occurs before the operative date. Following the operative date, the remaining steps in the contrived scheme occur, namely a distribution in the form of a bonus issue of debentures. According to D38.2, the first question is whether on a standalone basis the distribution can be regarded as a "tax arrangement" which is "abusive", without taking account of the pre-operative date steps and the distribution together. The second question according to D38.2 is if the distribution can be regarded as an "abusive tax arrangement", can those pre- and post-operative date steps be taken into account together so that the distribution is non-abusive?[56] D38.4 then states that the distribution constitutes an arrangement whose main purpose was to crystallise a tax advantage so that:

> "*That arrangement is in itself a tax arrangement that is contrived and inconsistent with the policy principles of the shares as debt rules. The post-commencement tax arrangement is therefore by itself an abusive arrangement to which the GAAR would apply.*

---

55 See Section 215 (1) FA 2013. All that is necessary is that the tax arrangements were entered into i.e. commenced, before the operative date. "Enter into" is a phrasal verb (transitive) and connotes the act of commencing or starting to take part in something, to embark on or to begin. There is no requirement that the tax arrangements should have been completed before the operative date nor any wording which subjects the post-operative date steps of such arrangements to the GAAR. It is also worth remembering that in *IRC v Brebner* 43 TC 705 the relevant arrangements lasted for nearly two years and in *Escoigne Properties Ltd v CIR* [1958] AC 549 the House of Lords held that an arrangement had existed between an original uncompleted sale in 1950 and its completion by way of conveyance in 1954 to a company that was not even in contemplation in 1950.

56 This appears to the author to be a pointless question given that the tax arrangements clearly began pre-operative date.

> *Taking into account the pre-commencement steps and payment of the distribution together does not prevent the payment of the distribution from being abusive*".

The error in the extract quoted above is quite apparent. The author of the extract has lost sight of the basic principle in section 215 (1) FA 2013 that only tax arrangements entered into on or after the operative date are within the GAAR. The tax arrangement postulated was actually stated at D38.1 to have been entered into when the shares necessary for the scheme were acquired prior to the operative date. That was when the scheme was entered into. Given that the distribution which took place after the operative date was part of the same tax arrangement that was first entered into before the operative date then the scheme is clearly outside the scope of the GAAR. The author of the example appears to have become confused and somehow thought that the references in section 215 (2) FA 2013 to the tax arrangements forming part of other broader arrangements which in this case are not relevant, but which do not come to the taxpayer's aid meaning the post-operative date steps must be caught by the GAAR. This is a simple non-sequitor.[57]

8 The real purpose of the GAAR Guidance?

8.1 Although the statutory double-reasonableness test is intended to provide some protection for the taxpayer, in reality it may add little, if anything, and appears to be merely a kind of formal step in the process of applying the GAAR which gives the appearance of protecting the taxpayer whilst adding little of substance. In other words, once arrangements are classified as "tax arrangements" the criteria that they have met will usually mean that they cannot pass the double-reasonableness test assuming that it is not a reasonable course of action to try to defeat the evident intention of Parliament. But leaving this consideration aside, the apparent protection afforded by the double reasonableness test is undermined by the facility afforded to HMRC of inserting examples of what tax planning is and is not to be regarded as reasonable in part D of the GAAR Guidance, subject only to the approval of the Advisory Panel a body which it has already been shown is not independent of HMRC. What effective role does the test play when the outcome has already arguably been decided by HMRC via an example inserted in the next annual edition of the GAAR Guidance? There seems to be nothing to

---

57 This guidance was approved by the Interim Advisory Panel so it is surprising that those examples made it into the final GAAR Guidance.

prevent HMRC from inserting an example into Part D of the next annual edition which was on all fours with a particular transaction that it did not like and which was working its way slowly under an enquiry towards an appeal with HMRC then subsequently invoking the GAAR against the transaction. Such a situation if it happens could be likened to an opening batsman strolling out to the crease to face his first ball only to be informed by the umpire that he had already been given out leg-before-wicket even before the first ball had been bowled. Here perhaps we can see the true practical effect of the GAAR Guidance and its undermining effect on the rule of law.