GENERAL ANTI-ABUSE RULE
A NEW DEVELOPMENT FOR THE UK

In July 2013 the UK introduced a General Anti-Abuse Rule. Having regard to the widespread and international hostility against tax avoidance, this can hardly be considered a surprise. The legislation in the Finance Act 2013 is short but is supplemented by extensive Guidance Notes from HMRC. Unfortunately, although the idea is clear enough, some of the concepts are disconcertingly vague.

I yield to no-one in my support for all taxpayers to comply fully with their tax obligations – but it is very important to be able to determine what those obligations are. You cannot expect people to comply with rules if they cannot reasonably understand what they mean.

For a nation with such a proud history of the Rule of Law, the introduction of a GAAR is an interesting development and it remains to be seen how it plays out in the longer term. There are serious worries that although it sounds like it should apply only to major corporations sheltering their profits from tax in exotic ways, it may only be a matter of time before it is used against ordinary taxpayers undertaking ordinary transactions.

The Guidance Notes issued by HMRC are lengthy and contain extensive explanations and examples. However, they do not start well. HMRC explain that taxpayers are not free to reduce their tax bills by lawful means. They can only do so in a manner which is not regarded as abusive. What is meant by abusive in this context is obviously fundamental.

Where arrangements are entered into with a main purpose of obtaining a tax advantage, they will be regarded as abusive if they "cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions". Any transaction falling within this description will be subject to counteraction to remove the intended tax advantages.

It will immediately be seen that the term "abusive" is therefore being defined as "unreasonable" which many may feel is not the same thing at all and goes rather beyond the general mischief here.

In deciding whether arrangements can reasonably be regarded as a reasonable course of action we are obliged to consider whether they are intended to exploit any shortcomings in the legislation and whether they involve any contrived or abnormal steps. Furthermore, you have to consider what policy objectives should be implied by the legislation. I do not know how the ordinary taxpayer is supposed to do that – but in any event it is not enough for him simply to come to a sound and honest view on the matter. He has to second guess what HMRC will regard as reasonable (or doubly reasonable) and what HMRC say the policy objectives were. It is clearly impossible for the ordinary taxpayer (or anybody else) to make these judgments.

If HMRC consider there have been abusive tax arrangements which ought to be counteracted, they will write to the taxpayer and ask him to explain why the proposed counteraction should not take place. If HMRC are not persuaded, they cannot just take counteractive steps immediately; they must refer to the matter to the GAAR Advisory Panel who will express their view on whether or not the arrangements are abusive This is a panel of highly experienced and responsible tax professionals who are well equipped to determine the matter. This sounds like a good protection for the taxpayer – but unfortunately not. If the GAAR Advisory Panel say the transaction is not abusive, the legislation allows HMRC to ignore their view and proceed against the taxpayer anyway. I think autumn came early for this particular fig leaf. It is hard to imagine that if HMRC have already considered the matter and concluded that the arrangements are abusive, they will change their mind just because the Advisory Panel thinks otherwise. And just to make matters worse when the matter goes to court, the court are obliged to take into account the Guidance published by HMRC in the deciding what it all means.

The Guidance is beautifully written but you do need to stand back and think what some of the words really mean. For example, HMRC explain that there would be no challenge or allegation of abuse in situations where the law deliberately sets outs precise rules or boundaries. They say that: "*If the statutes specify a particular period or set of conditions quite precisely then tax payers are entitled to assume that they are on the right side of the line if they have satisfied the statutory condition and there is no contrivance about what they have done*".

On first reading that looks entirely reasonable, but actually what it means is that you are only protected if you satisfy the statutory conditions by accident. If you deliberately arrange things so that you satisfy the statutory conditions then you must have contrived to do so – and that is objectionable and can be counteracted as an abuse.

The Guidance Note is full of examples involving a wide range of planning arrangements which HMRC confirm will not be regarded as objectionable. That is obviously welcome. They say for example that salary sacrifice arrangements, disclaiming capital allowances, incorporating a business, selling shares rather than assets and choosing to borrow to invest in property rather than using surplus cash, are all straightforward legislative choices. Similarly, long established practices such as gift and loan trusts, the creation of euro bond instruments for avoiding withholding tax, the introduction of special provisions in a loan note to make sure that it is not a QCB are all quite unobjectionable. However, HMRC make it clear that this Guidance is not to be relied upon because each case has to be determined on its own facts, which regrettably deprives it of any real value.

When looking at the GAAR I started to imagine myself playing cricket. The opposition captain tells me that a batsman within my team will be out if he is caught. However, if he hits the ball where there is no fielder, the batsman will still be out because if they had put a fielder in the right place, he would have caught it. However, this rule does not apply to his batsman.

There is something instinctively wrong in the idea that there should be one rule for HMRC and another for the taxpayer. This is something which will immediately be recognised by taxpayers, and it will not encourage compliance – quite the reverse.

The main criticism from taxpayers is likely to be one of hypocrisy. If an argument supports the view of HMRC it will be regarded as sound and a proper application of law. However, if the same argument is used by the taxpayer, HMRC will claim that the interpretation is abusive.

An example would the cases of *Mayes* and *Lobler*. In the case of *Mayes* [2009] EWCA 2443 the taxpayers invested in (and later surrendered) some life policies in a manner which gave rise to (admittedly contrived) advantages under some exceptionally complex legislation. The High Court and the Court of Appeal found in favour of the taxpayer. HMRC say that this result was unacceptable. However, in the subsequent case of *Joost Lobler v HMRC* [2013] UKFTT 141 which concerned exactly the same legislation, Mr Lobler made a partial surrender of his life policy, making no profit at all. HMRC still insisted that it gave rise to huge amounts of tax which wiped out his life savings by reference to the specific tax legislation. The Court expressed the view that this was "outrageously unfair" but obviously HMRC regard this result as acceptable; after all it was in their favour.

It does not help that HMRC appear to have no hesitation (or indeed any compunction) in pursuing arguments which the courts describe as "outrageously unfair" or to act in an unfair and unconscionable manner (as in the case of *Hok v HMRC* [2012] UKUT 363 TCC). For HMRC to command respect and support – and therefore compliance – from the majority of taxpayers, it is essential that we have confidence that their conduct is above reproach.

It is important to recognise the key issue here is that the GAAR is designed for, and operates only in respect of, transactions which the courts say are entirely lawful and effective. If the court finds against the tax payer then there is no need for the GAAR.

There are many who feel that the Rule of Law is being seriously undermined by the GAAR as it will in reality give HMRC a wide discretion to levy taxes with very little interference. A real risk exists of the taxpayer being pressured in an unreasonable way with no real protection from the courts. What sensible taxpayer when faced with a demand from HMRC will go to the enormous trouble and expense (knowing that costs will not be recoverable) in challenging the might of HMRC before the Tribunal, which they know HMRC have the ability to require the court to consider the issues in accordance with their own published guidelines.

If used sensibly and responsibly to combat egregious tax avoidance (the whole basis upon which the idea was founded) the GAAR could be a valuable tool for HMRC – but if it comes to be used as a weapon against all taxpayers it will become an instrument of oppression. I fear there will be little confidence that HMRC will not abuse this new power. A tax authority which is deaf to criticism by the courts about their unconscionable conduct and the pursuit of what is outrageously unfair may find it too difficult to resist using the powers now bestowed upon them, to their maximum extent.

One way to protect the ordinary taxpayer (and to enhance compliance) would be to confine its application to large companies and to exempt SMEs. After all that is the position with Transfer Pricing and various related provisions, and this could strike an appropriate balance between the citizen and the State in this difficult area. However, I don't think I will hold my breath.

It will be some time before the first cases on the GAAR reach the Advisory Panel and even longer before they reach the public domain. This is an area that taxpayers in the UK (and maybe other jurisdictions) will no doubt be watching with interest.

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