

Analysis

GAAR: challenging assumptions

SPEED READ The current 'informal engagement' to explore whether there is a case for the GAAR may very well result in no action and this would be a relief for many in the tax community. But before dismissing the idea, it is worth considering what the alternatives might be and whether a carefully crafted GAAR resulting from thorough consultation and with appropriate safeguards might not be preferable. The tax world has changed since 1997. The tax community should engage fully in the GAAR debate which might give it an opportunity for considerable input – an improvement on sitting back and waiting for case law and piecemeal legislation.



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Changing times

The *Times* reported on 13 September 2010 that although policymakers are consulting on a general anti-avoidance rule (GAAR) 'there is speculation that this plan has been frozen.' There are certainly many tax practitioners and directors who would breathe a sigh of relief if that were the case, and it is well known that there are those in HMRC who are not keen on the idea. Andrew Goodall's well balanced report in *Tax Journal* on 12 July 2010 suggested, however, that the debate is not a repeat of that which occupied the tax community in 1997. Since then, case law has moved on in the UK and in other jurisdictions. The economy and politics have changed.

For once the UK could learn from other jurisdictions and come up with an improved version of the GAAR

A scheme for disclosure of tax avoidance schemes (DOTAS) has been introduced and developed – in response there has been much specific anti-avoidance legislation and the tax system has become even more complex than it was in 1997. Increasingly we rely on HMRC guidance to assist us through the maze and yet there is lack of clarity about the extent to which that reliance is safe. These changing circumstances call for a re-examination of the GAAR question.

'Informal engagement'

The current discussion arises from an

undertaking in the *Red Book* to 'engage informally with interested parties to explore whether there is a case for developing a general anti-avoidance rule (GAAR)'. This is clearly the result of a political compromise between different parts of the Coalition government. It will be unfortunate if this issue becomes a political football. The idea that a GAAR could bring in vast sums of revenue in the coming year or so to meet the deficit is clearly misconceived.

If too much is claimed for this device it will undoubtedly fail to meet expectations, but that does not mean that the tax community should not examine it seriously as a possible tool, to be used in conjunction with other techniques, to improve the workings of the system. Being an 'engagement' and not a 'consultation', this exercise does not seem to be covered by the formal rules of consultation and it is not clear who decides who are the 'interested parties'. Nevertheless, the HMRC/HMT team tasked with the engagement has, by all accounts, talked to a large number of people in a short time. They have also held meetings and workshops, the results of which will no doubt be reported in due course.

What follows is based on a short talk I gave at one such workshop (representing my personal views and not those of HMRC). I aimed to move the debate beyond instant dismissal based on outdated arguments.

Reasons why we do not need a GAAR

Commentators give a number of reasons for not having a GAAR. These need fresh examination rather than uncritical repetition.

The courts can deal with avoidance already

The argument here runs: we do not need a statutory rule, since we have the judicial approach in the *Ramsay* line of cases. But the case law has not developed in a linear direction. While the House of Lords rejected the existence of a judicial doctrine and stated that the 'new approach' is no more than a purposive interpretation applied to the facts viewed realistically (*Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1), their Lordships comments on the same day in *IRC v Scottish Provident* [2005] STC 15 suggest that something remains of the old case law. Subsequent decisions of lower courts use language which derives from this earlier case law. Cases and HMRC guidelines, such as the anti-avoidance signposts, continue to refer to pre-ordained transactions, commercially unnecessary steps and artificiality. Yet other cases indicate that the only thing that has to be looked at is the statute. Whilst practitioners may think they have a good feel for what is and what is not going to work, to suggest that currently we have a clear and predictable judicial approach that can be explained to clients and business people is unduly complacent.

GAARs have not worked in other jurisdictions and our judiciary would be reluctant to apply a GAAR

No jurisdiction has yet developed a perfect solution to tax avoidance and none ever will. That does not mean that a GAAR is worthless, although much depends on how one judges success. The initial failure of the Australian GAAR has now been addressed. Predictions that the revised legislation would suffer 'judicial castration' in the same way as its predecessor have not come to pass and the revenue authorities have had successes in the cases of *Spotless* (1996) 186 CLR 404 and *Hart* [2004] HCA 26. Criticism continues, of course, but it is a powerful tool which is used only rarely but it is a control on activity. Similarly in Canada, New Zealand and Hong Kong the revenue authorities have had recent victories in GAAR cases (*Lipson* in Canada (2009 SCC 1); *Ben Nevis* and *Glenharrow* in New Zealand ([2008] NZSC 115 and 116) and *HIT Finance* and *Tai Hing Cotton Mill* in Hong Kong (FACV 8/2007, 16/2007 and FCV 2/2007). Again, these have been subject to extensive criticism by the commentators, but it cannot be said that the GAAR has made no difference or has been destroyed by the judiciary and even the critics agree that in each jurisdiction it is a powerful weapon.

In South Africa, after an extensive study of systems in other jurisdictions, a new provision was introduced based on some of the better elements found in other countries, such as the use of objective and explicit indicia of avoidance. According to the 2010 Large Business Customer Survey conducted on behalf of HMRC most large corporate taxpayers say that they have a clear idea of what HMRC considers avoidance to look like, so why not set out the indicators in the legislation rather than only in guidance?

India is close to introducing its own provision modeled on that of South Africa. In the USA, the judicial economic substance test has been codified in legislation. There are many critics of all this legislation, but for once the UK could learn from other jurisdictions and come up with an improved version of the GAAR, bypassing the worst pitfalls. This requires detailed study of those other systems rather than outright dismissal of their attempts as failures.

One problem that concerned people in 1997 (that a statutory rule could conflict with the judicial rule) should no longer be present if we now have no judicial doctrine. A GAAR would simply be another piece of legislation to apply purposively. A GAAR should be drafted in such a way as to show that it is a principle, in accordance with which other legislation should be interpreted. Our judges are adept at handling jurisprudence from the European Court and under the Human Rights Act, both of which involve the application of principles in this way. It is not suggested that the judiciary can be, or should be, removed from the process of interpretation and the attitude of

the judiciary to GAAR will be a critical factor. If experience elsewhere were properly applied, however, and clear enough signals were given, the GAAR could be a tool that the judiciary would welcome, and a more constitutionally legitimate way forward than a judicial doctrine.

We have DOTAS and specific anti-avoidance legislation

There are reportedly around 300 anti-avoidance clauses with unallowable purpose tests in our legislation. It is hard to believe that this is simpler to manage than a single GAAR would have been. Moreover, these were introduced often with no framework of clearances or other safeguards. Increasingly practitioners are finding these tests unmanageable and require guidance on their application. The prospect of slightly different jurisprudence growing up around each of them

The longer we leave giving the GAAR a chance, the more specific provisions we shall have

is unpalatable. It would be naive to suppose that these tests and other anti-avoidance legislation would disappear overnight as a result of the introduction of a GAAR. It would take time and a number of successes before HMRC would rely on the GAAR to that extent. But the longer we leave giving the GAAR a chance, the more specific provisions we shall have. Would it not be sensible to put the GAAR in place in the hope that eventually this would reduce the need for new specific legislation? Disclosure has had some success, but this is a process that increases the number of provisions, some of which may then be used as a basis for schemes in the process of creative compliance. The relentless build-up of specific anti-avoidance provisions is a significant cause of complexity in our system.

A GAAR would increase uncertainty and be anti-competitive

In view of all the other current concerns of business in the international tax sphere and indeed the impact of the higher rate of income tax and the proposed bank levy, it seems unlikely that a GAAR would figure high on the list of anti-competitive provisions for most businesses. Most taxpayers are very familiar with GAARs in other countries and with anti-abuse laws in domestic law as well as in treaties and many would probably be surprised to hear that the UK had no statutory rule.

In fact it probably would not loom large at all unless it was highlighted as major problem by their advisers, which seems unnecessary. We lived with a supposed judicial rule for many years after 1981. If anything, a well drafted GAAR

Far from being an excuse for poor drafting, a GAAR should be a stimulus for better legislation

could increase certainty in this area, although anti-avoidance is an area of law that will never be absolutely precise, since if bright lines are drawn they will be manipulated by those devising schemes.

What is important is to have a framework which allows taxpayers who are engaging in normal commercial activity to ascertain their position with certainty. Some argue that a clearance system would be an essential accompaniment to a GAAR; others are concerned that a clearance system might degenerate into a de facto requirement to apply for clearance for every transaction and so increase costs. If the tax profession can put aside its antipathy to a GAAR sufficiently to engage in the design of a clearance system and ensure it does not just become an added burden, it could become a useful (and possibly at least partially self-funding) feature of the tax system.

It would be better to improve the underlying legislation

A very real objection to a GAAR is that a sweeping anti-avoidance provision is no substitute for good legislation and a coherent underlying tax system. Were a GAAR to be seen as an excuse for sloppy drafting elsewhere that would be a serious problem.


A GAAR will only work well if the purpose of the underlying legislation is coherent and discernible. Thus a GAAR needs to be backed up by improved legislation and possibly further moves towards principles-based legislation, in the proper meaning of that term, which goes beyond anti-avoidance provisions. Far from being an excuse for poor drafting, a GAAR should be a stimulus for better legislation.

A GAAR would give too much power to HMRC and undermine the rule of law

A widely drafted GAAR would be likely to be backed up with HMRC guidance and there might also be a clearance system. This could be seen as transferring power to the administration. While this is a valid concern, we are not free from administrative guidance under the current system, and this has emerged piecemeal and is not given within a framework of binding statutory clearances. One of the areas in which the tax community could engage if a GAAR were to be formally consulted upon would be the framework for delivery, policing and value of guidance. It might be considered desirable to set up some kind of panel involving the wider tax and business community to assist with these tasks and the decision of when to use the GAAR, as is done in Australia. This might be an opportunity to exert some measure of control over HMRC's discretion rather than a necessary extension of HMRC power.

Conclusion

The standard objections to a GAAR need to be questioned. Changing conditions mean that now is a good time for a formal consultation on a GAAR and not just an informal engagement. It would not solve every tax avoidance problem and changes emerging from its introduction would be seen gradually, not immediately. Its introduction should not be rushed and we need to learn from the mistakes of other jurisdictions. If, however, the tax community could get past the old arguments and see this discussion as an opportunity rather than dismissing it out of hand, the GAAR could be a vehicle for obtaining a clearer framework for anti-avoidance legislation, explicit statutory indicia of ineffective avoidance, a clearances system and a stimulus for better drafting of tax legislation more generally. The alternative is to continue with the current mish mash of unpredictable case law and piecemeal legislation with yet more unallowable purpose tests being introduced and, no doubt, further ad hoc guidance. It is hard to believe that that is a recipe for the competitiveness and certainty about which the critics of the GAAR seem so concerned. ■

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