TAX JOURNAL

Published on *Tax Journal* (http://www.taxjournal.com/tj)

ConDoc on tax treaties anti-avoidance

Thu, 01/09/2011 - 15:20 -- Development

Many readers will have missed the publication of a *Technical Note* published for consultation on 1 August 2011 entitled *Tax treaties anti-avoidance*.

Perhaps the reason that it was missed is that it was published on the first Monday of the week when many people went on holiday. Even HM Treasury's list of consultation documents missed its appearance.

The process

The publication of this document is likely to cause a significant furore both as to the process of consultation (or lack of it) which it reflects, and as to the contents it proposes.

► An unnecessary own goal? Kevin Cummings writes

In brief, it proposes two broad, treaty-override provisions which would deny the benefit of any tax treaty provision where certain 'avoidance conditions' are met, and there is a 'scheme' in place.

Significantly, the definition of 'scheme' is not directed at a scheme to avoid tax, but simply a scheme to ensure that the benefits of the tax treaty provisions are enjoyed.

In effect, any arrangements to ensure that a tax treaty is enjoyed (whether by a UK resident or a non-resident) and which results in the reduction or elimination of UK tax, will fall foul of these provisions.

So far as the process of consultation is concerned, the document states that it is published at 'Stage 3' under the government's *Tax Consultation Framework*.

The draft legislation appears to have been rushed out in haste

Stages 1 and 2 – the setting out of objectives and determining the best options – have been skipped.

Even if this consultation document had not been slipped out on the first Monday in August, the failure to follow all stages of the *Framework* would have been unacceptable.

Avid watchers of the budget process will recall that neither the budget statement nor the press releases indicated that such a general provision was to be introduced: it was only mentioned in a few lines in the *Budget Red Book*.

The consultation process has now jumped to draft legislation without any discussion of the objectives, options or evidence that such a provision is required.

The substance

Turning to the substance of the draft legislation, it appears that it has been rushed out in haste without clear thinking.

The draft contains two sections to be inserted into TIOPA 2010: new ss 129A and 133A.

Section 129A deals with schemes for UK-residents, s 133A with non-residents.

Curiously, both provisions are headed 'interpreting provision' – this is a total misnomer: these are not interpretative provisions but are a general tax treaty override.

Given that the UK has generally opposed tax treaty overrides by other countries (for example the US) it is an extremely bad example that we are now proposing to introduce a general override.

Also, given that there is a committee discussing the possibility of a general anti-avoidance rule, one wonders why two general anti-treaty shopping provisions were thought necessary at this time.

The UK's tax treaties contain anti-avoidance provisions, including dominant purpose tests and beneficial ownership tests, which raises the question: why was this general anti-avoidance provision thought to be necessary?

UK-residents

So far as s 129A and UK-residents are concerned, the consultation document says that 'the proposed legislation is intended to reinforce the principle that, except in narrow and explicit circumstances ...

DTAs do not restrict the right of the UK to tax its residents'.

There is no such principle.

If there were such a principle cases such as *Padmore* ([1989] STC 493) would have been decided differently and the legislation which led to *Huitson* ([2011] EWCA Civ 893) would have been unnecessary.

Quite the contrary, tax treaties operate by providing that one or other state may tax particular income (or may only tax up to a certain limit): it is implicit in that approach that a treaty will benefit a UK-resident if the circumstances are appropriate.

If, as in the past, this is used to exploit treaties, then the remedy has been to enact specific anti-avoidance legislation, or to put anti-avoidance provisions into the treaty itself.

The writer of that paragraph in the ConDoc appears to have forgotten that the whole basis for foreign tax credits in the UK is provisions in tax treaties, which are designed to benefit UK-residents.

Section 129A applies if three conditions are present.

First, there must be a provision in a tax treaty which prevents or reduces the tax on a UK resident.

Secondly, there must be 'avoidance conditions' which are: that a scheme is put in place by one or more persons; that the provision in the tax treaty would not apply in the absence of that scheme; and that a main purpose test is satisfied.

The third element is that the main purpose is that the tax treaty provision applies to the income.

Thus, this simply requires that one or more persons have entered into any arrangement under which a tax treaty provision which reduces UK tax applies to income.

There are entirely commercial arrangements that would be impacted by this provision.

For example, in the absence of a *bona fide* commercial defence in the legislation, multinational groups have relied on treaties to override a charge under TCGA 1992 s 13 on a commercially driven disposal by a subsidiary.

Arrangements to use a treaty in those circumstances would appear to be caught by this provision.

Similarly, an individual establishing his residence in another treaty jurisdiction but having to return to the UK on a regular basis, possibly because his job requires visits back to the UK that are not merely incidental, would be unable to rely on the treaty protection against double taxation in the UK and in the country of residence, or even for credit for foreign tax.

The new section is to take effect regardless of when the tax treaty entered into force or when the scheme was put into place.

Thus, if arrangements were made years ago which took advantage of a treaty, the benefits would be denied going forward.

Non-residents

The second of the two proposed provisions is concerned with arrangements by non-residents.

It is targeted at arrangements to use a tax treaty to reduce or eliminate UK income tax on outbound dividends, interest, and royalties.

Again the conditions are that an arrangement is put in place by one or more persons such that the provisions of a tax treaty apply which would not otherwise apply, and the main purpose of the persons putting the arrangements in place is to ensure that the tax treaty provisions apply.

Again, it does not have to be a purpose of avoiding UK tax: thus any arrangement that is put in place to get the benefit of the reduced withholding taxes on passive income out of the UK would be caught.

Like s 129A, s 133A also applies whenever the treaty was concluded and whenever the arrangements were put in place.

Suppose, for example, a group of investors from a number of countries had decided to invest in the UK in previous years.

Let us assume that the investors all come from jurisdictions which do have a tax treaty with the UK which would eliminate any withholding tax.

Nevertheless, for commercial reasons they established a vehicle in a jurisdiction which has a treaty with the UK which eliminates withholding tax on outbound interest.

That arrangement would be caught by the provisions since the treaty between the UK and that country would not otherwise have applied, there is an elimination of UK withholding tax, and the purpose of the persons behind the arrangement is to ensure that the treaty applies.

Where does this leave us?

This consultant document demonstrates the importance of ensuring that HMRC and HM Treasury abide by all stages of the *Tax Consultation Framework*.

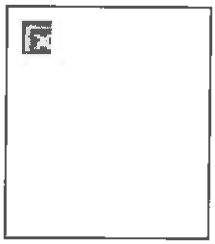
If not, there will be fiascos like this where proposals are put forward as draft legislation which have an impact on existing commercial arrangements without any proper prior discussion.

The author is gathering examples of entirely *bona fide* commercial arrangements which will be impacted by these proposals, and would like to hear from readers with any such examples.

Philip Baker QC, Barrister, Gray's Inn Tax Chambers

The ConDoc is available on the HMRC website [1]. The consultation closes on 22 September.

An unnecessary own goal?



Kevin Cummings, Partner, Berwin Leighton Paisner

The ConDoc – a peculiar move, causing much consternation in the City and further afield.

It comes at a time when the government has done much to clean up the UK's act on domestic and overseas taxation.

The revamp of the CFC regime is heading in the right direction, and the recent overhaul of the offshore funds rules, the new foreign branch exemption and reform of