FIELD COURT TAX CHAMBERS
3 Field Court - Gray's Inn - London - WC1R 4EP - 020 3693 3700

TAX BRIEF

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PATRICK WAY KC
pw@fieldtax.com

THE GAAR – HOW DO WE DEAL WITH IT?

WELCOME

After a two-year gap I have brought back the Tax Brief. In the meantime, Field Court Tax Chambers have been producing its FCTC Digest for some time and I have been contributing articles to it. If you would like to subscribe to the Digest please contact Stephanie Talbot on st@fieldtax.com

Please let me have any comments and feedback. I would very much welcome this.

SPEED READ: THE GAAR – HOW DO WE DEAL WITH IT?

More and more practitioners are concerned with the GAAR and this article seeks to explain why.

The GAAR has been with us since 2013.

At the outset practitioners focused on FA 2013 s.207 which applied the so-called double reasonableness test "in relation to the relevant tax provisions". This involved looking at whether the arrangements were intended to exploit any shortcomings in relation to the relevant tax provisions. That ought to be the key: look at the tax provisions: are they exploited?

The worry is, however, that s.211 states that account must be taken of HMRC's GAAR guidance. Paragraph C5.10.1 of that guidance states that the test is not to look and see whether there was a reasonable course of action *in relation to the relevant tax provisions* even though that is just what s.207 has told you to do. Indeed, paragraph C5.10.1 says:

> "Instead the test asks whether there can be a reasonably held view that entering into or carrying out the tax arrangements in question was a reasonable course of action."

So there is a tension between s.207 and the guidance and the wording of the guidance is, frankly, a worry.

STOP PRESS

The taxpayer has won its first GAAR case.

The case involved participator loans being recycled back and forth between related companies so that at the crucial time no s.455 loan was in existence.

The GAAR Panel held that this was not abusive.

This may be a game changer.

THE TAXPAYER HAS FINALLY WON A GAAR CASE!

What happened

In an opinion published on the 21st July 2022 the GAAR Panel has found that a series of events involving participator loans of significant amounts was not abusive.

The heading to the relevant link is "GAAR Advisory Panel Opinion of 26th April 2022: repayment of a participator loan through transactions involving group companies.

The relatively complicated facts (which repay reading) can be truncated as follows.

Company Z owed significant amounts to a director (Mr. M) through a director's loan account.

By 22nd February 2017 the outstanding loan was £10.8m.

Had the loan remained outstanding at 28th February 2017 then Company Z would have suffered corporation tax under CTA 2010 s.455 on that loan.

Cutting a long story short, a subsidiary company within the same group (Company Y) paid significant amounts to Mr. M by way of what was described as further loans and

an advance. With that money Mr. M was therefore in a position to repay the loans that he owed to Company Z before 28th February 2017.

Between 2017 and 2018 the reverse occurred.

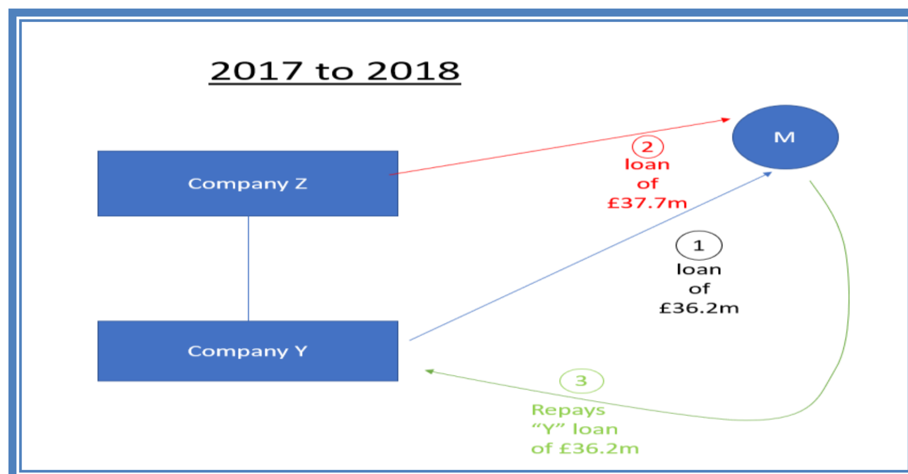
Company Y then made very significant loans to Mr. M totalling £36.2m.

The advice was given that the loan from Company Y should be recycled into a loan from Company Z and also that dividends should be paid from Company Z to Mr. M in order that he could use those amounts to repay the loan to Company Y. So the loan from Company Y was replaced with a loan from Company Z.

So, in a nutshell, there was a circularity.

Each time a s.455 charge was about to arise another company in the group put Mr. M in funds so that he could repay the outstanding loan. He was then left with a new loan and when the time came where another s.455 charge would arise in relation to the new loan the recycling was repeated.

So whereas as at 9th January 2018 Mr. M owed Company Y £36.2m. shortly afterwards he had received £37.7m. from Company Z and utilised the money to discharge the outstanding loan.



The GAAR hearing

HMRC argued that the steps were caught by the GAAR.

The taxpayer contended that:-

(a) the loans were to stop a charge under CTA 2010 s.455;

(b) the steps were not abusive;

(c) this was "a perfectly reasonable thing to do even if motivated by an intention to prevent a tax liability"; and

(d) they could have borrowed the money from a bank – so what's the difference?

Also:-

(a) the taxpayer paid a full rate of interest; and

(b) there was no intention to permanently transfer value out to Mr. M.

What did the GAAR Panel hold?

There were no contrived or abnormal steps.

They accepted that there was a possible shortcoming in the legislation but they thought that was not a GAAR issue but interestingly they thought that might be an issue that could be dealt with separately (presumably before the Tax Tribunal).

They asked themselves the following questions:-

does the planning result in:-

(a) an amount of income, profits or gains for tax purposes which is significantly less than the amount for economic purposes, or

(b) deductions or losses for tax purposes which are significantly greater than the amount for economic purposes, or

(c) a claim for repayment of crediting of tax which has not been and is unlikely to be paid and if so is it reasonable to assume that such a result was not the intended result when the relevant tax provisions were enacted (FA 2013 s.207(4)).

The GAAR Panel's conclusion

There was no problem because there had been no extraction of value tax free.

In particular they held:-

(a) the entering into the tax arrangement was a reasonable course of action in relation to the relevant tax provisions; and

(b) the carrying out of the tax arrangements was a reasonable course of action in relation to the relevant tax provisions.

GAME CHANGER

This really is a game changer. At long last we have the Panel applying the GAAR legislation in the way which I consider it should be. The issue is not whether there is tax avoidance, which is "unpleasant". The issue is whether there has been an *abuse of the legislation*. So maybe we are seeing a change at last.

THE GAAR GUIDANCE

Explanation

Having dealt with the most recent GAAR case I now look at the position relating to the GAAR guidance and its relevance.

Theory and reality

- In theory –

  are you exploiting the legislation?

- In reality (practice) –

  does the anonymous panel disapprove of what you are doing (regardless)?

So as explained in the speed read above, what you have to do is go to s.211(2)(a) which says that a court or tribunal must take into account HMRC's GAAR guidance providing that it was approved by the GAAR Advisory Panel at the time the tax arrangements were entered into as the next box shows.

211 Proceedings before a court or tribunal

(1) In proceedings before a court or tribunal in connection with the general anti-abuse rule, HMRC must show—

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

(b) that the adjustments made to counteract the tax advantages arising from the arrangements are just and reasonable.

(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, and

(b) any opinion of the GAAR Advisory Panel given—

(i) under paragraph 11 of Schedule 43 about the arrangements or any tax arrangements which are, as a result of a notice under paragraph 1 or 2 of Schedule 43A, the referred or (as the case may be) counteracted arrangements in relation to the arrangements, or

(ii) under paragraph 6 of Schedule 43B in respect of a generic referral of the arrangements.

(3) In determining any issue in connection with the general anti-abuse rule, a court or tribunal may take into account—

(a) guidance, statements or other material (whether of HMRC, a Minister of the Crown or anyone else) that was in the public domain at the time the arrangements were entered into, and

(b) evidence of established practice at that time.

You can see from s.211(2)(a) that any tribunal must take into account HMRC's guidance about the general anti-abuse rule and (looking at s.211(3)) even guidance, statements or other material that was in the public domain at the time the arrangements were entered into.

"Section 211(3)

(3) In determining any issue in connection with the general anti-abuse rule, a court or tribunal may take into account –

(a) guidance, statements or other material (whether or HMRC, a Minister of the Crown or anyone else) that was in the public domain at the time the arrangements were entered into, and

(b) evidence of established practice at that time."

So, we are not talking about anything particularly which you might say fell within "the rule of law". Rather we are looking at the views of whoever drafted the guidance on

the GAAR and we are looking at other statements none of which will have been necessarily approved by Parliament.

Key wording from the GAAR guidance

The following provisions are taken from the GAAR guidance and you can see why we have the position where the GAAR Panel, very largely, are entitled to apply the wording of the GAAR guidance without looking into the specifics (at least in my view) of s.207.

Put it another way, when the GAAR was being considered many of us practitioners thought that it would apply in relation to arrangements that were beyond "normal" tax avoidance arrangements and which were ones where the legislation itself was, in effect, being abused due to its own shortcomings. That does not appear absolutely to be the case anymore: the bar is greatly lowered by the wording of s.211 and the GAAR guidance.

I now set out the key provisions from the GAAR guidance and the paragraph numbers are taken from that guidance.

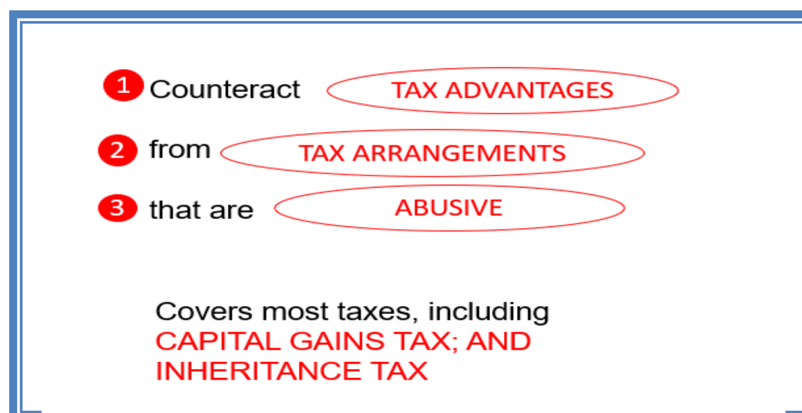
> "C5.10 The 'double reasonableness' test – whether the arrangements 'cannot reasonably be regarded as a reasonable course of action'
>
> C5.10.1 The double reasonableness test ('cannot reasonably be regarded') is the crux of the GAAR test. It does not ask whether entering into or carrying out the arrangements was a reasonable course of action in relation to the relevant tax provisions.
>
> Instead it asks whether there can be a reasonably held view that entering into or carrying out the tax arrangements in question was a reasonable course of action."

In other words, for some reason the GAAR guidance has watered down the stricter wording that was in the legislation and simply asks whether carrying out the tax arrangements was a reasonable course of action. That is quite different from asking whether there is a reasonable course of action "in relation to the relevant provisions" and "whether the arrangements are intended to exploit any shortcomings in those provisions". In my view, it is hard to see any justification for this leap away from the provisions of s.207. The guidance fundamentally changes the thrust of the GAAR even if the Panel do not always look at s.211. The point is that we practitioners must look at s.211 regardless.

THE LEGISLATION

Important terms

The GAAR legislation has three key expressions as per the box which follows.



So, putting on one side what s.211 says for the time being the starting point is to look at ss.206 and 207 to find out the meaning of "tax advantages", "tax arrangements" and "abusive".

Section 207

This section is set out in the boxes below.

207 Meaning of "tax arrangements" and "abusive"

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

(2) Tax arrangements are "abusive" if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action **in relation to the relevant tax provisions**, having regard to all the circumstances including—

(a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,

(b) whether the means of achieving those results involves one or more contrived or abnormal steps, and

(c) whether the arrangements are intended **to exploit any shortcomings in those provisions**.

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

I have highlighted "in relation to the relevant tax provisions" and "exploit any shortcomings in those provisions" because, as mentioned, the GAAR guidance seems to have moved away from the strict wording of s.207.

s.207 cont:

(4) Each of the following is an example of something which might indicate that tax arrangements are abusive—

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

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

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

but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.

(5) The fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive.

(6) The examples given in subsections (4) and (5) are not exhaustive.

As can be seen, s.207(4) sets out some examples of what might be abusive arrangements.

208 Meaning of "tax advantage"

A "tax advantage" includes—

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

As can be seen, s.208 sets out the meaning of tax advantage: nothing surprising.

PAUSING THERE AND CONCLUSION

We are therefore thrown on to s.211 which removes the obligation, where relevant, to see whether any of the arrangements exploit shortcomings in the tax legislation (s.207(2)(c)) and instead we just look at the GAAR Guidance which asks "whether there can be a reasonably held view that entering into or carrying out the tax arrangements in question was a reasonable course of action."

WHAT TO DO

So the concern is that the GAAR will always be an issue if a client is doing something which a judge might not think was reasonable whether or not the legislation itself is any way "abused". The potential therefore for considering what a judge might think was reasonable makes life for us practitioners difficult. It means that one is trying to second guess the subjective view of a judge rather than the objective view which might be said to be found pursuant to s.207. The recycling of participator loans case (published on 21st July 2022) may be has dramatically changed all of this. It does not make life easy for practitioners but it does give a glimmer of light that perhaps the GAAR Panel are beginning to apply the GAAR rules in the way which I consider they should be.

TWO RELEVANT OPINIONS

<u>Inheritance tax opinion</u>

Inheritance tax opinion of 2nd March 2020 – sidestepping a charge to IHT, reducing estate's value via subscription for shares in a new company and gifting shares to an employee succession trust

The first opinion I now consider is an inheritance tax one and it simply involved trying to avoid inheritance tax by using an EBT.

Shortly before her death Mrs A set up a company which she funded with £700,000. She then donated the shares in that company to a newly-formed EBT.

The hope was that the transfer of the shares to an EBT would escape inheritance tax by virtue of IHTA 1984 s.28 and in effect her shares would fall outside her estate.

The Panel's opinion

The Panel asked itself the following questions together with the following answers.

Does what was done involve contrived or abnormal steps? (FA 2013 s.207(2)(b))

Yes. There could be no incentive for employees as this was not a long standing company.

Is what was done inconsistent with the principles on which the relevant legislation is based and the policy objectives of that legislation? (FA 2013 s.207(2)(a))

Yes.

Is there a shortcoming in the relevant legislation that was being exploited (FA 2013 s.207(2)(c))

Yes – sort of. The legislation in question was intended to benefit a cadre of real staff and that was not the case here.

Was what was done consistent with established practice and had HMRC indicated its acceptance of that practice? (FA 2013 s.207(5))

There was no such practice.

Conclusion

The GAAR applied.

Capital gains tax opinion

Capital gains tax opinion 7th August 2019 – key legislation: Employee shareholder shares TCGA 1992 ss.236B-236G; ITTOIA 2005 s.385A

The second opinion which I am looking at is a capital gains tax opinion of the GAAR Panel.

The scheme involved employee shareholder shares in relation to which specific rules applied.

Missing out a great deal "ES" shares were issued but then they were not allowed to "grow" on their own. Instead, value from other shares was shifted into them to artificially grow the value of the tax-efficient shares at the expense of the other shares.

The aim therefore was that the valuable tax benefits that would flow with employee shareholder shares would apply even where the value which was attributed to those shares had effectively come from non-qualifying shares.

My view

This clearly seems to me to be an abuse of the legislation and it does seem to me that this is what the GAAR was all about. The tax legislation allows ES shares to grow for the benefit of employees and it is meant to be an incentive to employees. If, however, one takes existing shares and transfers the value into the ES shares that is clearly in my view abusive.

The Panel's opinion

The Panel held that the GAAR applied:-

(a) the results were not consistent with principles and policy objectives of employee shareholder scheme legislation;

(b) the relevant hurdle was abnormal and contrived;

(c) the scheme exploited a shortcoming in the legislation – they already had valuable shares – just moved value into ES shares.

Conclusion re the capital gains tax scheme

This case seems to me to be entirely what the GAAR is after. It focuses on s.207 itself.

CONCLUSION RE THE GAAR

The position is clearly unsatisfactory. If one focuses on s.207 one can see that the GAAR is all about schemes which exploit a loophole in the legislation. If one looks at s.211 however the position is much more difficult as one is simply asking oneself, in effect, whether the scheme itself is reasonable. This is why one must be careful when considering any kind of arrangement which might be said to be unpalatable.

As mentioned, however, the participator recycling scheme has maybe changed all of this. I hope so.

ONLY IN AMERICA

To lighten things up I am finishing off with a story which is doing the rounds again.

A lawyer in North Carolina USA (where else) purchased a box of very rare and expensive cigars and then insured them against many things including fire.

Within one month he had smoked all of the cigars. Without even having made his first premium payment on the insurance policy, the lawyer then filed a claim against the insurance company. In that claim the lawyer stated that the cigars had been lost in a series of small fires.

The insurance company refused to pay citing the obvious reason that the man had consumed the cigars in the normal fashion.

The lawyer sued and won.

Delivering the ruling the judge agreed with the insurance company that the claim was frivolous but the judge stated that the lawyer had obtained a policy from the insurance company in which the insurance company had warranted that the cigars were insurable and it had also guaranteed that it would insure the lawyer against fire without defining what was considered to be acceptable fire. As a result, the insurance company was obliged to pay the claim.

Rather than endure the lengthy and costly appeal process, the insurance company accepted the ruling and paid $15,000 to the lawyer for his loss of the 24 cigars lost in the fires.

The insurance company had the last laugh however.

After the lawyer had cashed the cheque in the insurance company arranged for the police to arrest him on 24 counts of arson.

Only in America.

PATRICK WAY KC
22nd September 2022

THANK YOU

Thank you for Stephanie Talbot for producing Tax Brief.

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