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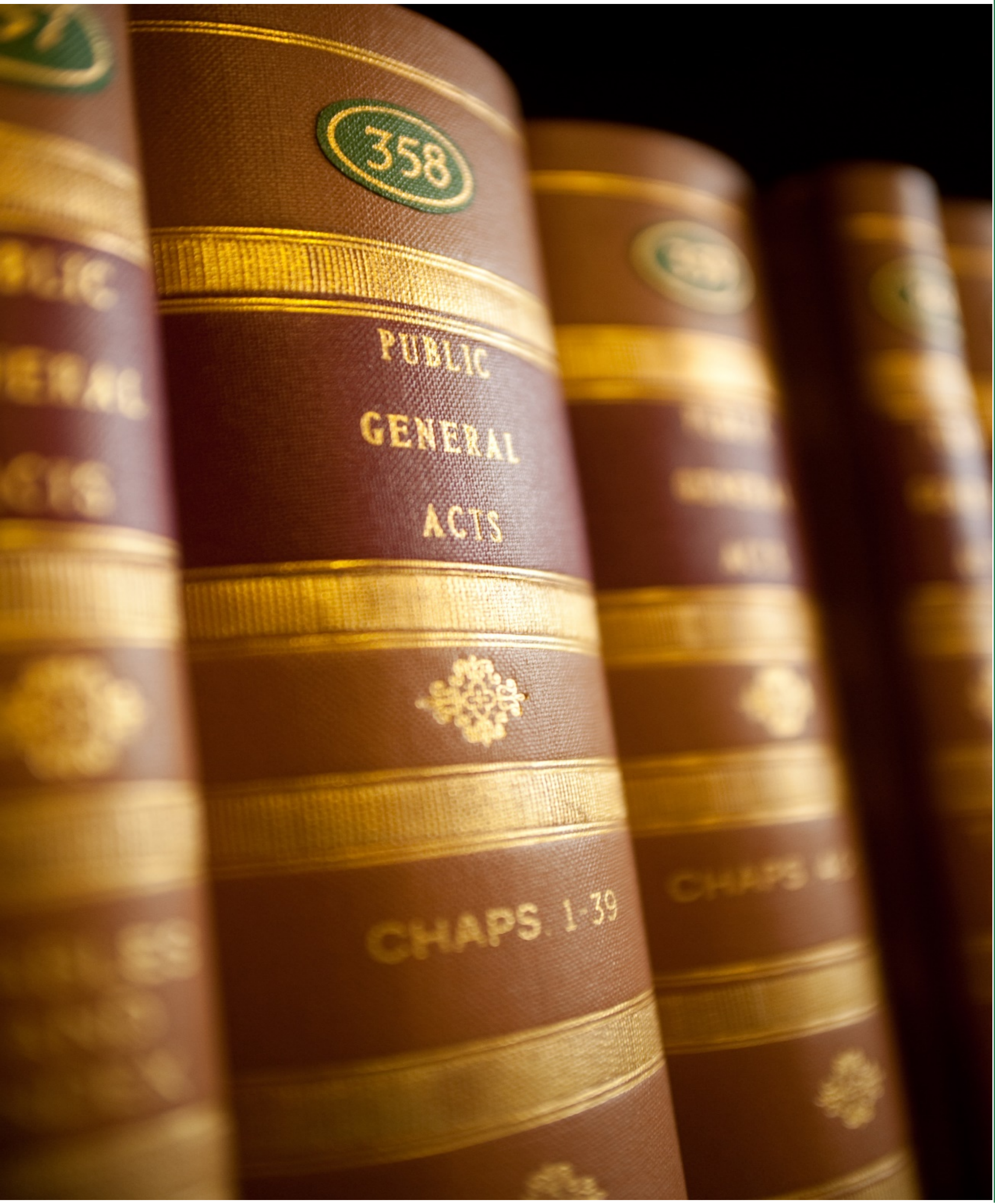
Tax avoidance: a General Anti-Avoidance Rule - background history (1997-2010)

By Antony Seely



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UK tax law is specifically targeted rather than purposive: in tackling the exploitation of loopholes in the law, governments have legislated against individual avoidance schemes as and when these have come to light. Often the response has been the creation of new schemes to circumvent the law, which in turn has seen further legislative action – an 'arms race' between the revenue authorities and Parliamentary counsel on one side, and on the other, taxpayers aided and abetted by the legal profession.

Over the past twenty years many commentators have suggested having legislation to counter tax avoidance in general: by providing certainty as to the tax consequences of any transaction, a 'General Anti-Avoidance Rule' (GAAR for short) might dissuade the most egregious efforts to avoid tax, encourage taxpayers and legal counsel to redirect their energies to more productive activities and allow the authorities to simplify the law without fear of it being systematically undermined.

In the late 1990s the Labour Government consulted on a GAAR before deciding against the idea. By 2003, evidence of the scale of tax avoidance – particularly schemes targeted at individuals working in the financial sector – rekindled interest in a GAAR, though in its 2004 Budget the Labour Government announced a new 'disclosure regime' as an alternative, whereby tax avoidance schemes would be required to be disclosed to the revenue departments.[1] This note looks the debate on the case for a GAAR over these years, and the introduction of the regime for the Disclosure of Tax Avoidance Schemes – or 'DOTAS' as it is known.

In its first Budget in June 2010 the Coalition Government stated it would explore the case for a GAAR, and in November 2011 published the report of a study group, led by Graham Aaronson QC, commissioned to report on this question.[2] Mr Aaronson argued in favour of a 'moderate' rule 'targeted at abusive arrangements'. The Government confirmed its plans at the time of the *Autumn Statement* in December 2012.[3] Provisions in the *Finance Bill 2013* for the new General Anti-Abuse Rule were agreed, without changes, and the new rule came into force on 17 July 2013. A second Library paper discusses these developments.[4]

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1 HC Deb 17 March 2004 c329

2 *Budget 2010*, HC 61 June 2010 para 2.114; HC Deb 21 November 2011 cc2-3WS

3 *Autumn Statement*, Cm 8480 December 2012 para 1.178; see also, *Budget 2013*, HC 1033, March 2013 para 1.211

4 *Tax avoidance: a General Anti-Abuse Rule*, Commons Briefing paper CBP6265, 16 January 2020

1. Assessing the case for a GAAR (1997-2003)

1.1 Tackling avoidance – 'squeezing the balloon'

In the UK the traditional approach to countering tax avoidance has been to introduce legislation to prevent individual tax-planning schemes exploiting loopholes in the law, once their operation has come to light.[5] A common response from the tax avoidance industry to new legislation has been to introduce new schemes to circumvent its effect – so that the history of tax avoidance has been characterised as "one of squeezing the balloon in one area only to see a new bulge emerge in another."[6]

In his first Budget following the 1997 General Election, the new Labour Chancellor, Gordon Brown, announced that alongside a number of individual measures to counter avoidance, the case for a 'General Anti-Avoidance Rule' (GAAR) would be considered:

> The tax burden avoided by the few falls on the many … A Government committed to the proper funding of public services will not tolerate the avoidance of taxation, and we will be relentless in our war against tax avoidance. I have instructed the Inland Revenue to carry out a wide-ranging review of areas of tax avoidance, with a view to further legislation in future Finance Bills. I have specifically asked the Revenue to consider a general anti-avoidance rule.[7]

The basic arguments for and against a general avoidance rule were summarised at the time by the *Financial Times*:

> So-called 'catch-all' rules mean transactions must be looked at in terms of substance - not legal form. If it is designed to avoid tax - rather than for a proper commercial reason - then it should be ruled out. The UK's system, in contrast, is based on a large body of specific laws often aimed at narrowly defined abuses - although they are increasingly broadly interpreted by the courts. "Catch-all laws do have a deterrent and compliance effect but they introduce uncertainty - which is not good," said Mrs Joy Svasti-Salee, of accountants KPMG. Switzerland, like most countries with such a provision, relies on the 'substance over form' principle which is part of its constitution of 1847 … Canada has a general anti-avoidance rule which was enacted in 1988. Mrs Svasti-Salee said that like many such laws it had led to little actual litigation. "I think that is the theme around the world," she said. "Courts have been very reluctant to apply it in Australia and New

5 As noted by the then Paymaster General, Dawn Primarolo, in answer to a PQ on tax avoidance in 1999 (HC Deb 30 November 1999 c174W).

6 Dave Hartnett, then Director General at HM Revenue & Customs in a speech in 2005 (*Address to CIOT as part of 75th anniversary celebrations*, 19 July 2005). See also, Oxford University Centre for Business Taxation, *Tax Avoidance*, December 2012 (in particular, pp17-20).

7 HC Deb 2 July 1997 cc311-312. See also, Inland Revenue Budget press notice IR7, 2 July 1999. At this time the UK had two revenue authorities responsible for direct and indirect taxes respectively: the Inland Revenue and HM Customs & Excise. In 2005 the two bodies merged to form HM Revenue & Customs.

> Zealand as the laws are so widely drawn," agreed Mr Peter Wyman, head of tax at Coopers & Lybrand.
>
> In contrast, federal US legislation designed to block so-called 'step transaction', where the commercial reality of a deal is obscured by intermediate stages, had been successful. "That's relatively effective - but it does not apply to a huge number of artificial avoidance schemes." Mr Wyman added that in countries such as the Netherlands, which also has a general provision, a comprehensive system of pre-transaction rulings was in place. These rulings, provided by the tax authorities, tell taxpayers in advance how they will be taxed. "If you do have a general provision you need pre-transaction rulings," Mr Wyman said. The Inland Revenue turned down such a system. Some tax experts argue the UK does not need a catch-all rule because the courts are more inclined - as in the recent *McGuckian* case[8] - to see through taxpayers' schemes. But the government may think it needs all the help it can get to protect 'people's money' from schemes devised by the tax planning industry.[9]

In November 1997 the Tax Law Review Committee published a substantive report on tax avoidance in which it argued in favour of a "sensible targeted statutory general anti-avoidance provision" in preference to "the continued development of judicial anti-avoidance doctrines."[10] In the United States of America, a substantive body of general anti-avoidance law has been established over sixty years from the decisions of the courts, relying on their inherent powers as courts, rather than statutory authority. The Committee's report examined similar developments in the UK – the so-called "new realism"[11] – that has a much shorter history, starting with a judgement made by the House of Lords in the early 1980s: the case of *W. T. Ramsay Ltd. v. Inland Revenue Commissioners*, or '*Ramsay*' for short.

Put in lay terms, the 'new realism' sought to regard taxes operating in the real world – addressed to profits or losses made from the pursuit of business, rather than arithmetic sums conjured up from a series of legal transactions, designed to disguise or rebadge those profits and losses when considered from the perspective of tax law. Similarly the new realism refused to be restricted to looking at a series of transactions one by one, but found that there were cases when transactions could be construed as a whole. This was critical when the legality of any individual transaction was not at doubt, but the substantive purpose of linking them together into a single continuous operation was simply and exclusively to avoid tax. An extended extract from the Committee's report on the impact of *Ramsay* is given below:

> **The 'new realism'**
>
> In the 1970s a new form of tax avoidance appeared. Tax avoidance became big business and schemes were commercially

8 *Inland Revenue Commissioners v McGuckian*, 12 June 1997
9 "Catch-all law offers power but uncertainty", *Financial Times*, 4 July 1999
10 The Committee was established in 1994 under the aegis of the Institute for Fiscal Studies, to assess whether the tax system was working as intended, efficiently and without imposing unnecessary burdens.
11 The Committee noted that the term was used by Lord Oliver of Aylmerton, "Judicial Approaches to Revenue Law", Gammie & Shipwright (eds), *Striking the Balance: Tax Administration, Enforcement and Compliance in the 1990s*, IFS 1996

marketed. A characteristic scheme was directed at transactions that had already taken place. It was therefore too late for conventional tax planning but the scheme aimed to manufacture a loss, which could be used to offset the tax liability. It was important that the loss should not be a real loss; otherwise there would be no advantage to the taxpayer. The "new realism" describes the approach adopted by the Courts to curb these complex and artificial tax avoidance schemes. … There is still no judicial doctrine that allows the Revenue departments to tax on the basis of the economic substance of transactions. The Courts have, however, emphasised the legal substance and nature of transactions over their form.

The new realism first gained acceptance in *W T Ramsay v IRC*,[12] when the Law Lords struck down a scheme as a fiscal nullity. The case demonstrated an example of a circular scheme in which transactions were entered into, money changed hands and documents were executed with legal effect. At the end of the day, however, everyone was back where he or she started apart from payment of a fee to the promoter of the scheme. Lord Templeman vividly described the artificiality of it all [at page 128]: "The facts ... demonstrate yet another circular game in which the taxpayer and a few hired performers act out a play; nothing happens save that the Houdini taxpayer appears to escape from the manacles of tax ... the play is devised and scripted prior to performance ... The object of the performance is to create the illusion that something did happen, that Hamlet has been killed and that Bottom did don an ass' head so that tax advantages can be claimed as if something had happened."

In the House of Lords the Inland Revenue argued successfully that the taxpayer had made no real financial loss and could not claim a loss for tax purposes. In a series or combination of transactions, intended to operate as such, it was the legal nature of the series that mattered. There was no requirement that each step had to be considered separately. The intermediate steps could be struck out.

The effect of this was underlined by Lord Diplock in *IRC v Burmah Oil*.[13] He said that the approach taken in Ramsay marked [at page 214] "a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable."

The development of the doctrine continued in *Furniss v Dawson*.[14] The taxpayer wished to sell shares to an independent third party. Here the scheme, which involved making the sale of shares via an offshore intermediate company, was not circular but linear. By routing the transaction in this way, the taxpayer hoped to defer indefinitely the liability to capital gains tax that would have accrued on a direct sale of the shares. The House of Lords extended the Ramsay fiscal nullity doctrine to redefine what the taxpayer had done. There was a single composite transaction consisting of a pre-ordained series of transactions, into which steps had been inserted with no commercial purpose beyond the avoidance of tax. Where these conditions were present the Court

[12] (1979) 54 TC 101
[13] (1981) 54 TC 200
[14] [1984] 55 TC 324

> would ignore the inserted steps and look to the end result to determine the tax consequences. Effectively, the exchange was not of a type that the courts would recognise as falling within the provisions allowing tax to be deferred.[15]
>
> The new realism also embraces a new willingness to examine very carefully the actual legal effect of transactions, or a series of transactions, to decide precisely what are the true legal rights and obligations to which they give rise. The Courts are not bound by the labels which the parties themselves give to their transactions or by their form if the legal effect is something different.[16]

The future for this developing judicial doctrine was thrown into doubt by further case law. While in *IRC v McGuckian*[17] the Lords took the opportunity to "restate vigorously" the Ramsay doctrine,[18] a major challenge to the Ramsay approach was posed by *Westmoreland v MacNiven.*[19] In this case Lord Hoffmann took issue with the Ramsay doctrine, arguing that it resembled an overriding legal principle superimposed upon the whole of revenue law without regard to the language or the purpose of any particular provision – something that was beyond the courts' constitutional authority. The Committee argued this uncertainty was undesirable for taxpayers and the Government, and a GAAR could be a solution:

> The judicial doctrine exemplified by the *Ramsay* and *McGuckian* decisions has played an important role in counteracting some of the most uncommercial tax avoidance operations. The refinement of this doctrine in future cases may work to keep in check the ingenuity of those intent on adopting any legal means to limit their tax liabilities. Nevertheless, we have concluded that innovative judicial anti-avoidance techniques are unsatisfactory, for two main reasons:
>
> i. A judicial doctrine fashioned on a case by case basis through the hierarchy of the Courts produces considerable uncertainty. Uncertainty is a matter of degree. The tax effect of an arrangement may be certain if it need only satisfy an excessively literalist interpretation. The tax effect may be less certain if it must be demonstrated to the court that arrangement is consistent with the intentions of Parliament in passing the legislation in question. The language of a statutory general anti-avoidance provision will not be certain and remains subject to interpretation by the courts. However, we think that undue uncertainty as to the direction a judicial anti-avoidance doctrine. may follow is undesirable in taxpayers' private and commercial affairs and unsatisfactory also for the Government, which must respond to avoidance activity long before the Courts are able to express their view of particular arrangements.

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[15] The House of Lords was adopting a similar approach to the one that used by Learned Hand J nearly 50 years earlier in the US tax case of *Helvering v Gregory* (1934) 69 F 2d 809, affirmed [1935] 293 US 465; see Millett, "Artificial Tax Avoidance: The English and American Approach" [1986] BTR 327.

[16] Institute for Fiscal Studies, *Tax avoidance: a report by the TLRC*, November 1997 pp12-13

[17] [1997] STC 908

[18] Interested readers are referred to the Committee's report (pp 8-16).

[19] *Westmoreland Investments Limited v MacNiven* HL [2001] STC 237. For commentary on the case see, "Tax avoidance: where are we now?", *Tax Journal*, 26 February 2001 & "A welcome decision", *Taxation*, 15 March 2001

> ii. A developing judicial doctrine—however radical—operates retrospectively and offers no clear framework within which it shall operate or not, which we consider unsatisfactory especially with the adoption of self-assessment for direct taxes.
>
> We prefer a solution that avoids these problems. We consider that tax avoidance should be countered principally by legislation rather than by the further development of the current judicial anti-avoidance doctrine. A statutory rule can attempt to make good some of the limitations inherent in a judicial rule and provide a proper framework for the application of a general anti-avoidance rule.[20]

Although the authors felt that a GAAR could "offer a number of advantages over judicial anti-avoidance doctrines" they were also concerned that proper procedures should be established for its efficient operation, so that it did not deter "legitimate tax planning or mitigation in taxpayers' ordinary commercial or personal affairs":

> A general anti-avoidance rule inevitably requires the Revenue authorities to form their opinion in the first instance whether transactions that have the effect of reducing tax liabilities fall within the Parliamentary intent or not. The critical balance, therefore, between the public interest in seeing taxes are not unduly avoided and the legitimate interests of taxpayers in their commercial and legal affairs, lies in ensuring that (a) the rule is sensibly targeted, (b) there are sensible procedures for invoking the rule and (c) there is proper oversight of its exercise.[21]

To elucidate the problems in drafting a GAAR, the authors set out a number of features that it should incorporate:

> i. Its scope of operation should be limited to transactions which, judged as a whole, have tax avoidance as a main purpose or, in the case of multi-step transactions, when a particular step in the transaction has tax avoidance as its sole purpose.
>
> ii. It should exclude transactions that are consistent with the intention of Parliament, as appears from the legislation taken as a whole.
>
> iii. The provision should at its introduction be invoked centrally by the Head Office of the Revenue authority concerned (i.e. local or regional officers should not be able to invoke the rule or offer clearances in respect of the rule).
>
> iv. An administrative clearance system should be established so that taxpayers can ascertain whether the Revenue authorities would regard a proposed transaction as falling within the scope of the new provision. A clearance application necessarily implies some delay but this should be kept to the minimum.
>
> v. There should be a single stage appeal to an independent tribunal against a refusal of a clearance, based on the papers submitted to the Revenue authority.
>
> vi. When invoking the rule against a completed transaction, the onus in the first instance should be on the Revenue authority to show why the transaction is of a nature that the general anti-avoidance rule ought to apply.

20 *Tax avoidance*, November 1997 pp xi-xii
21 *op.cit.* p xv

> vii. As part of the procedure for invoking the rule, the Revenue authority would be required to state the alternative transaction that it considers should be substituted for the actual transaction as the basis for assessing tax. If there were more than one permitted alternative transaction, that which attracts the least tax should be adopted.[22]

A contrary view to the value of a GAAR was put by Edward Troup in a long piece in the *Financial Times* in 1999. At the time Mr Troup was in private practice and was a regular witness on tax issues to the Treasury Select Committee, though he later joined HMRC and was the Department's Executive Chair and Permanent Secretary up to 2017. In his article Mr Troup argued that in its interest in a GAAR the Government had misunderstood the root causes of tax avoidance. Avoidance was "a normal market reaction" and "the aim of government should [be to] … do its best to ensure that the 'return' from tax planning is as low as possible … a simpler tax system, with fewer reliefs, exemptions and discontinuities would, in the long term, frustrate most of the tax avoiders' ploys." While agreeing that the issue was "real and important", Mr Troup was concerned that the study risked looking at avoidance "in isolation from the wider questions of the structure and direction of the tax system as a whole." His comments are worth reproducing at length:

> Successive chancellors have consistently failed to understand the inevitable nature of avoidance as a reaction to complexity and have ended up addressing its symptoms and not its causes. Tax avoidance is a normal market reaction. Faced with the opportunity to devote resources to increasing sales or minimising tax bills, business will make a risk/return evaluation ... This judgment is not immoral, it is inevitable in a market economy. The aim of government should not be to adopt a high moral tone but to do its best to ensure that the 'return' from tax planning is as low as possible. The pitfall that recent governments have fallen into is to challenge the tax planners on their home turf. Successively more complex sets of rules have been created, which in turn provide opportunities for exploitation. A simpler tax system, with fewer reliefs, exemptions and discontinuities would, in the long term, frustrate most of the tax avoiders' ploys …
>
> Faith in a general anti-avoidance provision is based on a lack of understanding of the real nature of tax avoidance. The popular idea is too often confused with the claim that 'tax avoiders are paying less tax than they should', even though is no objective way of determining how much they 'should' be paying.
>
> Tax law does not codify some Platonic set of tax-raising principles. Taxation is legalised extortion and is valid only to the extent of the law. Tax avoidance is not paying less tax than you 'should'. Tax avoidance is paying less tax than Parliament would have wanted. Avoidance is where Parliament got it wrong, or didn't foresee all possible combinations of circumstance. The problem of tax avoidance is reduced to the problem of finding an answer to the question of what parliament intended and making sure that this is complied with. I would not pretend this is a simple task. But recognising this as the issue and dealing with it equitably and constitutionally would be a significant step on the way to tackling avoidance effectively.

22 *op.cit.* pp xv-xvi

> Too often at this point in the analysis the dangerous chimera of the general anti-avoidance provision hoves into view. This will, supposedly, answer the question of what is avoidance or not by determining that actions which frustrate the intention of parliament should be ineffective. A general anti avoidance provision does no such thing. Merely saying that steps taken for tax avoidance motives can be ignored or rewritten takes the analysis no further. It is merely a pious statement that that parliamentary intention should not be frustrated.
>
> But such a general anti-avoidance provision would not be ineffective. It would, of necessity, have to give the revenue authorities the discretion to invoke, or not to invoke, its operation. The taxpayer would be laid at the mercy of the bureaucrat … The determination of what parliament might have intended would be shifted further from the hands of the courts, and from parliament itself, and further into the hands of the executive. Hardly the outcome a good constitutionalist would wish … The issue of avoidance is real and important, but it cannot be considered in isolation from the wider questions of the structure and direction of the tax system as a whole.[23]

Some years later, in June 2016, Mr Troup gave evidence to the Treasury Select Committee when he was HMRC Executive Chair, and was asked by the Chair, Andrew Tyrie, about his argument, and his comments are worth noting given the way the GAAR was introduced:

> **Edward Troup:** I am glad something I wrote for the FT still retains such an interest 17 years on. … The language is probably more colourful than I would use in my more staid days as a civil servant now, but, if you read the article … it made the point, which I completely stand by, that the challenge of tax collection is to recognise that it is effectively using legal means to raise money for the state that is necessary to fund public services.
>
> As such, it has to be supported by the word and force of the law, and not left to the discretion of the bureaucrats or designed in a way that creates uncertainty for the taxpayers. The article was criticising not the concept of a general anti-avoidance rule but the proposal put forward in 1998 by a previous Government.
>
> **Chair:** Which is now in better shape.
>
> **Edward Troup:** It is now in much better shape and, sitting on this side of the table, the criticisms I made of the formulation there have been dealt with, because it is not in our discretion as HMRC, as to whether we like something or not, to determine the application of a rule. It is set out, as clearly as is possible with a general rule, by the word of statute, with protection through an independent panel who will, effectively, give a view before the rule can be applied. The point made in the article about the importance of taxation being rooted in law and the administration being delivered with certainty by professional administrators remains good.[24]

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23 "Why the chancellor is missing the point", 15 July 1999

24 Treasury Committee, *Oral evidence: HMRC Executive Chair and Chief Executive*, HC 232, 8 June 2016 Q8

1.2 Consultation on the case for a GAAR

In October 1998 the Inland Revenue published a consultative document on the case for introducing a GAAR, inviting views by the end of the year.[25] The department noted that a serious drawback with the traditional method of combating avoidance was that it had little deterrent effect since "short of retrospective legislation, the Government cannot recoup the tax lost to early users of the schemes." The Revenue noted that its 'sister' organisation, HM Customs & Excise, was looking at the possibility of having a number of 'mini-GAARs', but that in the direct tax field it was likely that a "single all-embracing GAAR" would be more effective, and might reduce the uncertainty created by the development of case law:

> In the last 20 years or so, much legislation has been enacted to counter tax avoidance. At the same time, the courts have developed a doctrine, following the *Ramsay* case[26], which has put some limits on the scope for avoidance. However, new devices for avoiding tax continue to be developed …
>
> The United Kingdom is unusual among developed countries in having neither a statute nor an established legal principle to counter tax avoidance in general. Many other countries in the developed world have found such a rule or principle to be a very useful remedy for countering tax avoidance, although not a universal cure. The aim of a GAAR would be to reduce tax avoidance. It should not unduly harm the level of certainty of tax treatment enjoyed by businesses that are not engaged in avoidance. A GAAR, applying at first only to the corporate sector, would aim to put a stop to many of the complex avoidance schemes which currently cost the Exchequer large sums. In addition, it would be expected to discourage people from devising contrived avoidance schemes in the future.
>
> Taxpayers using avoidance schemes stand to gain a lot while risking little. The sole or main purpose of the arrangements, or of one or more of the steps in them, is to gain a tax advantage. The traditional way in the UK of countering such schemes has been to litigate or to introduce specific anti-avoidance legislation to stop them. Litigation has its benefits and with or without a GAAR there will always be cases at the borders of statute or case law where the courts will have to decide on the correct interpretation. But litigation in complex avoidance cases can take a long time to resolve and the uncertainty of the outcome can be prolonged considerably. Legislation targeted at specific avoidance schemes or arrangements stops them for the future. But, short of retrospective legislation, the Government cannot recoup the tax lost to early users of the schemes. Consequently it has little or no deterrent effect. This type of legislation is vulnerable to yet further avoidance schemes, constructed to find a way around the letter of the law.
>
> One possible approach would be to introduce "mini-GAARs" general rules to stop avoidance in a particular area of the tax system. That is the option that Customs and Excise are exploring in the area of VAT. But it seems unlikely that this would be as effective as a single, all-embracing GAAR for countering avoidance of corporate direct taxes. This is because of the

25 Inland Revenue press notice 127/98, 5 October 1998
26 *W. T. Ramsay Ltd v IRC.,* 54 TC 101

> complexity of the direct tax system and the scope for interaction within its provisions.
>
> An important criterion of the success of a GAAR would be that it should not unduly harm the levels of certainty which companies currently have about the tax treatment of a transaction. The Tax Law Review Committee (TLRC) report on Tax Avoidance expressed concern about the uncertainty created by what it saw as "innovative judicial anti-avoidance techniques" operating retrospectively. To that extent, the introduction of a statutory GAAR would be a positive step in this area.
>
> Although a GAAR should reduce avoidance and maintain certainty, it must be accepted that neither aim can be absolute. The need for targeted anti-avoidance legislation will remain, for instance where avoidance centres on the interaction between the tax systems of the UK and other countries, and there will always be some areas where the application of the law has to be resolved through the courts.[27]

For its part the Tax Law Committee was very critical of the department's proposals – in particular, the idea that a burden of proof should lie with the taxpayer (to show that the specific transaction they wished to complete was provided for in law), and the importance the Revenue placed on the administrative arrangements for clearing transactions. On the matter of the burden of proof the Revenue had argued the following:

> The test for identifying a transaction which has a tax avoidance purpose is an objective one so that, in seeking to apply a GAAR to any given transaction, the Revenue ought to be able to show that it had a tax avoidance purpose. Once this has been done, however, the taxpayer ought to be able to show why tax should be avoided, in other words why the transaction meets the criteria for "acceptable tax planning". If the taxpayer cannot do this then it is logical either that the transaction should be ignored or that the taxpayer should be taxed according to the normal transaction.[28]

An extract from the Committee's response is reproduced below:

> The questions that we have addressed [in this response document], and our answers, are these:
>
> - Does the framework for a GAAR discussed in the Consultative Document represent a sensibly targeted statutory provision? - No.
> - Do the proposals offer appropriate safeguards for taxpayers? - No.
>
> We therefore oppose the adoption of a statutory GAAR in the form proposed.
>
> There are three main reasons for our conclusion-
>
> - The proposed GAAR places no adequate burden on the Inland Revenue to justify its use of the Rule to impose tax where it cannot otherwise bring the taxpayer's arrangements within the clear taxing words of the Act. We believe that the Inland Revenue should be required to

[27] Inland Revenue, *A General Anti-Avoidance Rule for Direct Taxes*, October 1998 pp8-9

[28] *A General Anti-Avoidance Rule for Direct Taxes*, October 1998 p 24

show, as a gateway to its imposition of tax under the GAAR, that the taxpayer's arrangements fall within the scheme of the Act so as prima facie to give rise to a charge to tax. The proposed GAAR places on the taxpayer the obligation of proving Parliament's intentions and not, as we contend it should, on the Revenue.

- The scope of the proposed GAAR and the reservations expressed in the Consultative Document on the administrative arrangements proposed in the TLRC Report make us doubt the adequacy of the proposed clearance procedure and of the resources that would be devoted to it. The breadth of the proposed GAAR is likely to place undue emphasis on the use of non-statutory guidance by the Inland Revenue as the practical method of administering the Rule. We consider that the proposed GAAR fails to strike a proper balance between a reasonable statutory rule and reliance on extra-statutory guidance.
- The proposed GAAR also offers no limitation on the parallel development of judicial anti-avoidance doctrines and no satisfactory opportunities for legislative simplification. The TLRC Report considered these to be major objectives of any proposed GAAR.[29]

Similar criticisms were made by, among others, the Chartered Institute of Taxation; the Institute argued that "the onus of proving the GAAR applies must be firmly with the tax authorities, rather than the taxpayer having to prove innocence" and that "a clearance mechanism is vital for the GAAR to operate properly. It must be able to respond quickly with a 'fast track' available."[30]

In a separate, related development in January 1999 HM Customs & Excise published a consultation document on the possible use of a 'mini-GAAR', to tackle tax avoidance in the construction industry.[31] In the introductory section of this paper the department examined why a GAAR might be preferable to specific anti-avoidance legislation:

> **Why a more strategic approach is needed in VAT**
>
> There is currently no equivalent in VAT of the doctrine developed by the Courts in the Ramsay[32] line of cases, which has put some limits, on the scope for the avoidance of direct taxes. Widespread avoidance of VAT affects receipts. The Customs/ Treasury report *The VAT Shortfall*[33] estimated that the annual loss from "packaged" avoidance schemes since the late 1980s has been about £1 billion, compared with total VAT receipts in 1997-8 of £50 billion. In recent years more and more anti-avoidance legislation has been enacted, but new devices continue to be developed. Taxpayers who use such schemes endanger valuable facilitation measures to secure a short term, and unintended, tax advantage.

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29 Institute for Fiscal Studies, *A General Anti-Avoidance Rule for Direct Taxes*, February 1999 pp vii-viii
30 *Financial Regulatory Briefing*, February 1999 p21
31 HM Customs & Excise press notice 3/99, 20 January 1999; *A VAT mini General Anti-Avoidance Rule in construction services: a consultative document*, January 1999.
32 *W.T.Ramsay Ltd v. IRC* 54 TC 101
33 HM Treasury, *The VAT shortfall: report of the Working Group on VAT Receipts and Forecasts*, Treasury Occasional Paper No:9, September 1997

> Avoidance can also lead to significant distortion of competition between broadly similar businesses. Avoidance schemes have been countered by litigation and by anti-avoidance legislation aimed at specific mischiefs. But litigation can take years to resolve, and specific measures have their disadvantages. They complicate the tax; can open up further avoidance opportunities if they are narrowly framed; or may — if they are drafted very widely — have an adverse impact on 'innocent' non-avoiders. Also, in the absence of retrospective legislation the tax lost to early users of a scheme cannot be recovered.
>
> The United Kingdom is unusual among developed nations in that it has no GAAR to counter tax avoidance in general. Such a rule could make a positive contribution to the tax system through discouraging the future development of contrived avoidance schemes, reducing their existing use and promoting a level playing field between taxpayers. The Inland Revenue is currently consulting on the principle and form of a GAAR in the context of company taxation.
>
> The VAT option currently being considered is a series of mini-GAARs, sectoral general measures intended to combat avoidance of any type in a specified area of the tax, such as 'construction services'. Mini-GAARs have certain advantages over specific measures: as a type of general rule, they should deter and be effective against various kinds of avoidance. At the same time, they can be more precisely targeted on would-be avoiders and avoidance transactions. As with a single, all-embracing GAAR, one important issue would be maintaining certainty for taxpayers. A mini-GAAR ought not to affect adversely the degree of certainty that businesses have about the VAT treatment of their transactions. A need for a system of rulings as a feature of any mini-GAAR is considered [elsewhere in this paper.][34]

This consultation produced quite a lot of commentary from the profession.[35] The Chancellor's 1997 Budget speech also sparked off a general debate on the avoidance issue, seen in a series of articles published in *The Tax Journal*, with contributions from the then Paymaster General Dawn Primarolo, officials from the department and tax practitioners, on the nature of tax avoidance.[36]

However in its 1999 Budget the Labour Government confirmed that it would not proceed with a GAAR, nor with a mini-GAAR in construction: "the Chancellor today … said that the general anti-avoidance rules (GAAR) for corporate direct taxes remained an option for the future if more targeted legislation proved ineffective in dealing with the problem of avoidance, but that the Government would not be proceeding with a GAAR in this Budget or with a mini-GAAR for VAT on construction services."[37] A little more detail for this decision was given in a written answer after the Budget:

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34 *A VAT mini 'GAAR' in construction services*, January 1999 pp 1-2

35 For example, "GAAR today gone tomorrow", *The Tax Journal*, 11 January 1999; CIOT press notice, February 1999; "Catch all avoidance law 'flawed'", *Financial Times*, 25 February 1999

36 "Playing with fire", "A sterile activity" 22 September; "Age of anxiety", "Opening up the debate", "All measures available", 29 September; "Upholding the law", 22 November; "Customs take stock", 22 December; "Advancing the debate", 19 January 1998.

37 HM Customs & Excise/Inland Revenue Budget press notice CW3, 9 March 1999

> **Mr. Gibb:** To ask the Chancellor of the Exchequer if he will publish the results of the General Anti-avoidance Rule and Mini-GAAR consultation process.
>
> **Dawn Primarolo:** The Chancellor said in a Budget Day Press Release that the General Anti-avoidance Rule (GAAR) for corporate direct tax remains an option for the future if more targeted legislation proves ineffective in dealing with the problem of avoidance, but that the Government would not be proceeding with a GAAR in this Budget or with a mini-GAAR for VAT on construction services. The Chancellor has asked Customs to consider a mini-GAAR in the area of the VAT grouping facility. The responses to the consultative documents (other than those made confidentially) may be inspected at the head offices of the Inland Revenue or Customs and Excise.[38]

1.3 Further debate on the use of a GAAR

Following the 1999 Budget the debate on a GAAR receded, though 'catch all' rules of this type were introduced in both Ireland and Australia.[39] However the wider debate on tax avoidance remained very contentious,[40] usually with tax professionals on one side of the divide and the revenue authorities on the other.[41] In the run-up to the 2004 Budget the *Financial Times* reported that the Government were considering the case for a GAAR anew:

> [The Chancellor] is being told that tax avoidance is getting worse, not least because the Inland Revenue's powers to close schemes are too limited ... The Inland Revenue has to challenge schemes on a case by case basis in the courts. Mr Brown is therefore being urged to consider far more sweeping tax avoidance legislation amid signs that Britain could move to the tougher legal framework that operates in Australia and the US. Australia operates a General Anti-Avoidance Rule (GAAR) which empowers authorities to block the operation of avoidance schemes once identified.[42]

The paper also reported that the Government were also looking at the experience in the United States, where companies were encouraged to give early disclosure of their tax planning the revenue authorities. The advantage with this approach is that it would avoid the operation of a GAAR being tied up in legal challenges – as in Canada – or allowing the authorities to impose tax outcomes on taxpayers at their discretion – as in Australia:

> [Dave Hartnett, then deputy chairman of the Revenue] said last September: "The really big question around tax avoidance and tax planning is disclosure . . . So that the Exchequer and the Revenue

38 HC Deb 27 April 1999 cc124-5W

39 The Tax Law Review Committee comment on other countries experience in their report (*Tax avoidance*, November 1997 pp17-29). See also, "The Irish GAAR", *Tax Journal*, 25 June 2001 & "If it seems too good to be true, it probably is", *Tax Journal*, 16 July 2001.

40 "The causes and responses to tax avoidance", *Tax Journal*, 28 January 2002. See also, "Walking the tightrope: avoidance, morals and the law", 9 February 2004 & "What is the 'right amount of tax'", 18 July 2005.

41 One exception to this rule was a piece in the *Financial Times* in summer 2003 when a practitioner argued for a change of attitude by both the authorities and the profession: "United we stand a chance", 21 August 2003.

42 "UK looks at tougher regime on tax avoidance", *Financial Times*, 10 March 2004

> departments can look at planning much earlier than we do now. "A nifty tax scheme for a big corporate might get sold no more than 30 times. They are sold in conditions of secrecy quite often and we might see it two or three years after it gets sold." Mr Hartnett raised doubts that a voluntary disclosure system would work "given how aggressive some parts of the tax planning industry can be". The Treasury and the Revenue have been looking for inspiration from the US ... "Tax shelter legislation in the US requires very prompt disclosure by both the corporate and the promoter," said Mr Hartnett.[43]

At this time it was reported that the Inland Revenue had had meetings with the big four accounting firms to complain about their role in selling a particular tax avoidance scheme, creating artificial losses on government bonds to set against other taxable income.[44] Legislation was announced to tackle this[45] but – as the *Financial Times* suggested – this was unlikely to provide a long-term solution: "Commentators say accounting firms have become adept at devising clever schemes that they market very quietly and keep from scrutiny for as long as possible by advising clients to send in their tax returns at the last minute. The Revenue is then hit with a barrage of claims for tax relief before it can close a scheme."[46]

Turning back to the speculation over a GAAR prior to the 2004 Budget, the *Financial Times* reported on the views of the profession and the wider business community to these rumours:

> [The GAAR] would create a system in which if companies, and possibly individuals, do anything for tax-avoidance purposes, then it will be disregarded in determining their tax liabilities. It is an approach that has received some support but would outrage many businesses. Sebastian Hordern, a senior policy adviser at the CBI, the employers' body, says its members fear it would create more red tape and increase uncertainty. "Any transaction potentially caught by the rule would have to go for professional advice, and there would have to be some sort of clearance procedure so businesses can get approval for what they're doing," he says. "That imposes extra burdens on business and the Revenue."
>
> Loughlin Hickey, UK head of tax at KPMG, suggests a general anti-avoidance rule would send out a very negative signal to business. "If the Treasury wants to create a compact between business and government, then a GAAR is the wrong way to go about it," he says. "If Gordon Brown announced that his Budget is about enterprise and then announces a GAAR, I don't see how it stands up." He adds that a general anti-avoidance rule would "totally undermine" the point of the expected merger of the Inland Revenue and Customs & Excise, intended to improve tax policy-making and administration for business."[47]

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43 "Revenue sets its sights on adding powerful weapon to armoury", *Financial Times*, 11 March 2004

44 "Big four warned about their role in 'unacceptable' tax avoidance", *Financial Times*, 17 March 2004

45 [HC Deb 15 January 2004 c48WS](); Inland Revenue press notice 02/04, 15 January 2004. See also, Inland Revenue Budget Note REVBN30, *Tackling avoidance: strips of government bonds*, 17 March 2004.

46 "Avoidance stars face beefed-up scrutiny", *Financial Times*, 20 March 2004

47 "Bogeyman lurks as Brown starts to lose patience", *Financial Times*, 11 March 2004

2. The Labour Government's alternative approach

2.1 The Disclosure Regime

Introduction of 'DOTAS'

In the 2004 Budget the then Chancellor Gordon Brown announced that he did not intend to "introduce a general anti-avoidance rule … at this stage" but alongside legislation to tackle a number of individual avoidance schemes, the Government would introduce disclosure requirements on those marketing avoidance schemes and taxpayers using them.[48] Details were given in the Budget report:

> **Tackling tax avoidance**
>
> 5.84 Schemes designed to avoid tax represent a significant threat to the integrity of the tax system. These sophisticated and aggressive avoidance schemes thrive on concealment and secrecy. Therefore, Budget 2004 introduces new measures to improve transparency in the tax system. The rules, aimed at those marketing and using certain tax avoidance schemes and arrangements, will allow early detection of such schemes and enable more effective targeting of avoiders. As a result of these measures:
>
> - promoters who market schemes and arrangements that meet certain criteria for direct taxes will be required to disclose details of these schemes to the Inland Revenue; and
> - businesses with an annual turnover of £600,000 or more using VAT avoidance schemes that appear on a statutory list, and businesses with an annual turnover of £10 million or more using VAT arrangements that meet certain criteria, will be required to notify HM Customs and Excise.
>
> 5.85 In addition, the Government is taking action to close a number of loopholes currently being exploited to avoid tax, including:
>
> - preventing company profits being wrapped up in a partnership structure and extracted as untaxed or low-taxed capital receipts;
> - stopping two avoidance schemes where users obtain a double relief for the cost of capital assets used in their business;
> - countering avoidance by life companies using financial reinsurance; and
> - further measures to prevent exploitation of loopholes in the VAT system.[49]

A summary of the rules regarding direct taxes was given in a Revenue Budget notice:

48 HC Deb 17 March 2004 c329
49 *Budget 2004*, HC 301, March 2004 pp118-9

> The new rules will require tax scheme promoters to provide details of certain defined schemes and arrangements to Inland Revenue shortly after the scheme is sold. They will be required to provide a description of the scheme, including details of the types of transactions planned which form part of the scheme and the tax consequences of the arrangements and the statutory provisions they rely upon. Inland Revenue will register these schemes and allocate each a reference number.
>
> In most cases, taxpayers using schemes and arrangements within the new rules will be required only to include on their tax return the registration number of the scheme, which promoters will be required to provide to them. But where they have used a scheme purchased from an offshore promoter which affects their UK tax liability, or where the scheme has been devised in-house rather than purchased from a promoter, taxpayers themselves will be required to provide details of the scheme to Inland Revenue. Taxpayers will be required to disclose details of schemes shortly after the scheme was purchased or first implemented.
>
> The new rules will require disclosure of schemes and arrangements where a main benefit is the obtaining of a tax advantage and where they meet further conditions. These conditions are designed to target schemes and arrangements based on financial products, and employment based products. Full details of these conditions will be published in the Finance Bill.[50]

Details of the new rules regarding VAT arrangements were given in a second Budget notice:

> The measure introduces a requirement for businesses with supplies of £600,000 or more to disclose the use of specific avoidance schemes that HM Customs and Excise will publish in a statutory list. A business using a listed scheme must disclose its use to Customs. This must be done within 30 days of the date when the first return affected by the scheme becomes due after 'listing'. Failure to disclose will incur a penalty of 15% of the tax avoided.
>
> The measure also introduces a requirement for businesses with supplies exceeding £10 million a year to disclose the use of schemes that have certain of the hallmarks of avoidance. This must be done within 30 days of the date when the first return affected by the scheme becomes due. The measure also includes provisions that provide a voluntary facility for those who devise and market VAT avoidance schemes (promoters) to register schemes that have the hallmarks of avoidance with Customs. A business using a scheme registered by a promoter will not have to make a separate disclosure of its use. Failure to disclose will incur a flat rate penalty of £5,000.[51]

Provision to implement these two disclosure regimes was made in the Finance Bill following the Budget.[52] Alongside this the revenue departments published regulatory impact assessments on the new arrangements. The Revenue's assessment gave some background on the reasons for choosing this option to tackle 'illegitimate' tax avoidance:

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50 Inland Revenue Budget Notice REV BN28, 17 March 2004

51 HM Customs & Excise Budget Notice CE1, 17 March 2004

52 ie, clause 19 & Schedule 2 (VAT) and clauses 290-302 (direct tax) of *Finance Bill 2004*. They were debated in Committee: Standing Committee A, 6 May 2004 cc69-91 (VAT) & 22 June 2004 cc703-740 (direct tax).

> In deciding upon the current structure of these rules we examined similar arrangements in the United States and Australia. In the US disclosure rules on scheme promoters have been credited with reducing the levels of tax avoidance particularly those schemes that the Internal Revenue Service would consider most aggressive. In contrast until now the traditional UK "plug and fix" approach to managing the risk of avoidance was no longer considered capable of, on its own, increasing the rates of compliance and deterring aggressive avoidance schemes.
>
> The "plug and fix" approach will remain a feature of UK law. However without some radical shift in approach the problems associated with tax avoidance would continue to grow. So the UK proposal seeks to adopt the best practice evident from the US and Australian rules along with those of Canada and introduces for the first time measures that will allow the Revenue to better understand the supply side of the avoidance market and so better protect revenue flows from avoidance. A pre transaction rulings system is not considered a viable option. Any such system would require a very much greater amount of information about the scheme or arrangement to be provided by the promoter or taxpayer thereby increasing the compliance burden. Equally the Inland Revenue would be unlikely to give a favourable ruling to the kind of schemes that the disclosure rules are aimed at here.
>
> This proposal therefore introduces a new disclosure rule requiring production of details of the scheme at an early stage. To ensure the intended effect of this proposal it is necessary to identify and define who are the promoters, what schemes and arrangements should be disclosed and what information is required. It will be crucial that these areas are clearly defined and understood. It is considered preferable to focus on areas of high risk and to construct the disclosure requirements narrowly by targeting particular types of avoidance thereby reducing the overall compliance costs to both promoters and taxpayers.[53]

HM Customs & Excise's assessment on the disclosure regime for VAT was less detailed, although it did set out the Government's rationale for the scheme:

> Tax avoidance thrives on secrecy and concealment. It can be very difficult for revenue authorities to identify tax avoidance schemes, and all those using them, in time to assess the potential threat to tax revenues and take appropriate counteraction. VAT returns do not include information about schemes being used or how they work. Even when an avoidance scheme is identified there often has to be a lengthy enquiry process to establish the facts. A successful anti-avoidance strategy therefore needs to be supported by appropriate tools to allow the revenue authorities to find, and then challenge or close down, avoidance schemes as quickly as possible. The new measure is designed to provide greater information about the take-up of schemes Customs already know about, and early notice of some new, potentially damaging, schemes.[54]

Following the Budget the then Permanent Secretary at the Treasury Gus O'Donnell met with business representatives, and the accountancy and legal professions involved in work on tax, to set out further details of

53 Inland Revenue, *Regulatory impact assessment: tackling tax avoidance- disclosure requirements*, April 2004 p 2

54 HM Customs & Excise, *Tax avoidance impact assessment*, 8 April 2004 para 3

the proposals,[55] as well as to discuss the proposed merger of the Inland Revenue and HM Customs & Excise. (A review of the two revenue departments lead by Mr O'Donnell recommended this move, which the Chancellor announced in Budget 2004.[56] The new department - HM Revenue & Customs – began life in April 2005.) At the time there was concern that a disclosure scheme might result in the revenue departments becoming "swamped with information at a time when the government is embarking on the difficult task of merging Customs and the Revenue."[57]

As part of its report on the 2004 Budget the Treasury Select Committee considered the Inland Revenue disclosure scheme.[58] Although many concerns were raised by the profession following the Budget,[59] in evidence to the Committee both John Whiting (then at PWC) and Edward Troup (then at Simmons & Simmons), argued that a disclosure regime had distinct advantages over a GAAR. The Committee's main report quoted Mr Troup's evidence:

> Mr Edward Troup of Simmons & Simmons told us that "one of the problems that the Revenue and the Government face is the asymmetry of information between what businesses are doing and what they find out about them. At the moment the Revenue does not generally find out about tax-avoidance schemes until months or even years after they have taken place and very often, because they are constructed as complex, financial transactions, it may not even detect them … so getting hold of the information earlier is one of the planks of dealing with avoidance. It is a very different approach from …a general anti-avoidance rule [which] effectively seeks to change the law … The problem with a [GAAR] is that it is incredibly uncertain and international experience has shown that the courts are likely to react to [one] in very different ways so you can never be confident actually that it would work. Also, because of its uncertainty, it necessitates the introduction of a clearance procedure whereby businesses undertaking legitimate tax planning can go to the Revenue [to seek confirmation that the general anti-avoidance rule will not apply] in order to plan their affairs with certainty."[60]

At the same session Mr Whiting also made some interesting remarks:

> I would echo Edward's comments about the GAAR. It is clumsy and it does not fit very well with the UK's way of doing tax law which is that the citizen is taxed by the plain words and it is too subjective. The pre-registration … seems a sensible way forward, as Edward says, to balance the information flow. The natural concern is that it has to be made workable for all sides because, speaking as an adviser, we want to know what we have to register and when we have to do it and we do not want our clients to have to wait too long before proceeding with a commercial transaction just because of uncertainties over what has to be registered. At the same time, I suspect the tax

55 HM Treasury press notice 29/04, 18 March 2004
56 HC Deb 17 March 2004 c331. The O'Donnell's review was published at this time: HMT, *Review of the Revenue Departments*, Cm 6163, March 2004.
57 "Downing St talks seek dialogue on 'abusive' schemes", *Financial Times*, 18 March 2004
58 Treasury Committee, *The 2004 Budget*, HC 479, 6 April 2004 pp22-24
59 for example, "Big brother forces a confidence – I & II", *Taxation*, 13 & 20 May 2004
60 *The 2004 Budget*, HC 479, 6 April 2004 pp22-3.

> authorities do not want to be swamped with unnecessary disclosure, so we are certainly looking forward to extensive discussions over the coming weeks and months as we seek to work with the tax authorities to try and get a workable rule.[61]

The Committee, while supportive of this initiative, was concerned about its possible costs, for both taxpayers and the authorities:

> We agree with the statement made by one of our expert witnesses working in the tax field that there can be no issue with the concept of full disclosure of tax planning to the tax authorities, and we fully support this proposal in principle. We believe what is required in practice is a scheme that tackles tax avoidance effectively without creating undue compliance burdens for taxpayers and their advisers, or undue administrative burdens for the tax authorities. The details of the scheme will merit close examination once they are available during the passage of the Finance Bill through the House.[62]

The disclosure rules came into effect on 1 August 2004 and in the *Pre-Budget Report* later that year, the Government stated that they were "already achieving their purpose of allowing earlier and more targeted action against avoidance schemes."[63] In a speech in July 2005 to the CIOT, Dave Hartnett, then Director General at HMRC, gave some examples of the types of scheme the new rules had revealed:

> By way of illustration of the sort of thing the disclosure rules are bringing to light include:
>
> - The Silver Box scheme – which exploited legislation designed to encourage employee share participation to get round the charge on the award of shares and take dividends to avoid NI and reduce the income tax due
> - The Blue Box scheme was similar to Silver Box but involved options over gilts gifted to charitable trusts, and exploitation of the Gift Aid rules that members of the CIOT have so roundly condemned.
> - The imaginatively named Kevin which relies on the individual repaying borrowed gilts, and claiming a deduction for the manufactured interest payment that has to be made and an allowance under the accrued income scheme – generating repayment claims. Quite unlike, of course, the other well known scheme called Kevin which involved remuneration awarded in the form of restricted securities.
> - Using limited liability partnerships to generate 100% first year capital allowances on information technology assets which are then licensed. The individuals get a share of the loss to set against other income. This was an example of where we were able to take rapid corrective action in the Finance Bill.
>
> We have scheme disclosures ranging from £250m tax at stake for a single user of the scheme to a scheme designed to avoid a maximum charge of £1,900 a year. So we are seeing all sorts –

61 *The 2004 Budget*, HC 479-II, 6 April 2004 Ev Q73
62 *The 2004 Budget*, HC 479, 6 April 2004 pp23-4
63 *Pre-Budget Report*, Cm 6408 December 2004 para 5.88

> but the key point is that we get the tip-off early and Government can act quickly where appropriate to close schemes down.[64]

Impact, development, assessment

In December 2004 the Treasury Select Committee took evidence on the new rules, concluding that the new system was working well:

> We note and welcome the evidence that the new tax avoidance disclosure regime put in place at the time of the 2004 Budget is working well and is having an effect both in terms of allowing the revenue departments to close off avoidance schemes earlier than was the case previously and in having a measure of disincentive effect on the tax avoidance industry. Without wishing to challenge the legitimate right of individuals and businesses to manage their tax affairs in the most effective way for their purposes, we regard it as an equally legitimate objective for the government to seek to protect the tax revenue against inappropriate avoidance schemes.[65]

In December 2005 the Government announced the scope of the regime would be widened to include all of income tax, corporation tax and capital gains tax.[66] Initially the rules had only covered schemes relating to the taxation of employment and certain financial products, as these areas represented the highest risk of avoidance. The rationale for this step was set out in HMRC's impact assessment:

> [When first introduced] disclosure was an entirely new concept and there were inevitable uncertainties as to how it would operate in practice. Many commentators expressed concerns that it would generate a flood of disclosures of ordinary tax planning that the then Inland Revenue would be unable to cope with. Consequently, it was decided to limit the scope of the regime to the highest risk areas.
>
> However significant avoidance exists outside these areas. For example, measures were announced in PBR 2005 to combat significant avoidance of corporation tax involving the use of intangible assets. There has also been a series of measures combating avoidance within the leasing regime. Both of these areas are outside the current scope of the disclosure regime. Moreover, the success of the disclosure regime presents the risk that avoidance will migrate to areas that are outside the regime. The success of the disclosure regime also increases the risk that promoters and users of avoidance schemes will try to find ways of not disclosing schemes that the regime is intended to capture.
>
> It is inherently difficult for HMRC to assess, in real time, whether there are schemes that the regime was intended to capture that are not being disclosed, and if so why they are not being disclosed. HMRC has no powers to enquire into schemes that have not been disclosed. However, in order to understand how the law is being interpreted, promoters have been asked to provide examples of schemes, which they had decided fell just short of disclosure. Promoters have not provided such

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64 *Address to CIOT as part of 75th anniversary celebrations*, 19 July 2005
65 *First report: the 2004 Pre-Budget Report*, HC 138, 27 January 2005 p41
66 *Pre-Budget Report*, Cm 6701 December 2005 para 5.114

information, but HMRC accepts that there are legitimate reasons (particularly client confidentiality) why this is so.[67]

The disclosure regime continued to evolve over the next few years:[68]

- In May 2007 its scope was extended to cover National Insurance contributions, and a number of further changes were announced the March 2010 Budget – including increased penalties for failure to comply with the rules, and a requirement for promoters to provide periodic information about clients who implement a notifiable scheme.[69]
- In April 2011 the scheme was extended to cover inheritance tax on trusts.[70]
- In the 2013 Budget the Coalition Government introduced provisions to allow HMRC to get information on scheme users from a promoter "where the client named on a client list is an intermediary (who may or may not be the end user of the scheme," and to require clients to provide promoters with their Unique Taxpayer Reference (UTR) and/or National Insurance Number (NINO).[71]

Guidance on the operation of the current regime is published online.[72]

HMRC has published statistics on DOTAS, which showed a large number of schemes being notified in its first two years, followed by a gradual, steady decline. For direct tax, the total number of disclosures peaked at 607 in 2005/06 and declined significantly in later years to less than 10 by 2014.[73] Clearly there will be many factors behind these figures – the state of the economy, the tax burden and perceptions of the financial gain from avoidance – though the main driver appears to be the initial success of DOTAS in persuading many to stop investing in avoidance activity, even though the attractions remained for a stubborn minority of advisers and taxpayers.

The Lords Economic Affairs Committee has looked at the operation of DOTAS several times, as part of its annual report on the Finance Bill.

In its report in 2006 it noted a perception "shared by witnesses, both tax professionals and official alike, that its operation has served to create something of a behavioural shift against wide-scale adoption of the more aggressive and sophisticated artificial schemes". That said, the inclusion of further avoidance legislation in the 2006 Bill showed the "need for HMRC to keep its guard up":

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67 HMRC, *Tackling Tax Avoidance: extension of the disclosure regime to the whole of IT, CT and CGT*, June 2006 paras 17-21. Changes to the regime were made by Order (SI 2006/1543), and took effect from 1 August 2006

68 see, National Audit Office, *Tax avoidance : tackling marketed schemes*, HC 730, 21 November 2012 p21 (Figure 6 : Changes to DOTAS since 2004).

69 HM Revenue & Customs Budget Note BN64, 24 March 2010. Legislation was introduced in the *Finance Act 2010*, which was agreed prior to the General Election – to take effect from 1 January 2011.

70 This measure was announced in the Coalition Government's first Budget in June 2010 (*Budget 2010*, HC 61 June 2010 para 2.115).

71 *Lifting the lid on tax avoidance schemes – summary of responses*, December 2012 paras 6.4, 6.10-11. Provision was made by s223 of the *Finance Act 2013*.

72 HMRC, *Disclosure of tax avoidance schemes: guidance*, April 2018

73 HMRC, *Disclosure Statistics (for 1.8.2004 to 30.9.2014)*, October 2014

> [A regulatory impact assessment produced by HMRC on the regime in April 2006 gives its] present overall assessment of the disclosure regime's effects, from the point of view particularly, but not exclusively, of employment-related products: "There is a risk that the disclosure regime could simply ratchet up the tendency for promoters to create ever more complex schemes intended to avoid anti-avoidance measures themselves. But HMRC does not believe that this has been the outcome.
>
> Rather, various strands of intelligence and information strongly suggest that there has been a sharp decline in marketed tax avoidance schemes and in particular of schemes aimed at avoiding tax and National Insurance contributions on employment income. HMRC's assessment is that disclosure has been an important contributory factor to that decline, although clearly there are others at play (e.g. corporate governance issues).
>
> The decline of employment schemes is attributable to disclosure combined with the Paymaster General's statement of 2 December 2004 announcing the Government's intention to take action, if necessary back to that date, against schemes falling within the scope of that statement" … [the so-called Primarolo statement, which is discussed below]
>
> Dave Hartnett … [later Permanent Secretary for Tax at HMRC] (Q 272) gave us one anecdotal illustration of the effect of the rules in practice, which served to illuminate the impression of a behavioural change towards aggressive tax planning taking place about which we had heard from private sector witnesses. He told us of a conversation he had had with a leading banker, following legislative action to block one particular dividend strip scheme that had been disclosed under the rules. The banker had told Mr Hartnett "You have wrong-footed my bank. We were preparing to use this scheme to wipe out our tax liability for the present year. This is the third time you have wrong-footed my bank through the disclosure rules. Our board are now considering a reappraisal of our tax strategy and are likely to decide not to get involved in aggressive tax avoidance any more".[74]

In its enquiry into the *Finance Bill 2011*, the Committee reviewed anti-avoidance strategy, in the context of provisions in the Bill to tackle "disguised remuneration"; in evidence to the Committee Mr Hartnett confirmed this trend had very much continued:

> Over five years, there have been 62 anti-avoidance measures informed by the disclosure rules, blocking £12.5 billion of tax avoidance and bringing in some money as well. That is our key and crucial tool for dealing with avoidance … I think the disclosure rules have had, going back to 2004 lots of schemes were being marketed at business by accountants, lawyers, bankers and others. It was a big business. Marketed schemes in that area are now relatively rare. We have not killed them off altogether, but they are relatively rare and we are still pushing very hard.[75]

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[74] *The Finance Bill 2006*, HL Paper 204, 23 June 2006 para 26, paras 21,23

[75] *The Finance Bill 2011*, HL Paper 158, 17 June 2011 Ev Q262. In a paper on DOTAS published by the Oxford Centre for Business Taxation in 2012, the authors argued that it "is not entirely evidence what the £12.5bn [figure given by HMRC] actually represents or how the broader success of the regime is measured" (OUCBT, *The disclosure of tax avoidance schemes regime*, December 2012 pp22-23).

Sue Walton, Head of the department's Anti-Avoidance Group, said a little more on this occasion about the future prospects for DOTAS:

> We introduced a package of improvements in January this year, one of which was to increase the maximum penalties for failing to disclose, because we were finding that there were certain people who would just bear the cost of the penalty and take the advantage of disclosing too late. It is key to us to get early information. The earlier we get information, the better chance we have of taking action to disrupt avoidance activity, preferably before it has got going. We also are working to improve the descriptions of schemes that people have to tell us about. Shortly we will be starting an informal consultation on some new descriptions of things that people have to tell us about. We will be using that as a means of monitoring what happens around disguised remuneration moving forward, so we can use the disclosure regime to monitor what is happening in the avoidance market.
>
> Other parts of the improvements were to introduce a requirement for promoters of avoidance schemes to tell us the people to whom they provided the scheme. If somebody makes a disclosure to us, we allocate a scheme reference number to it. The promoter then has to give that number to the people who use the scheme, who then put it on their tax returns and we can follow it through. We are introducing, or are just starting to see, lists of information about the people to whom a scheme has been given a reference number. We get that earlier information, which will give us a better opportunity to assess the scale of the scheme and it gives us earlier information to be able to move even in advance of seeing returns coming in.
>
> We see the disclosure regime as something that needs to be dynamic. We keep revisiting it to make sure that it is working effectively. We also see people applying their ingenuity to getting round the disclosure requirement just as much as they to do inventing tax avoidance schemes.[76]

In November 2012 the National Audit Office published an assessment on the disclosure regime, noting that it had enabled HMRC to make "some important headway by closing legal loopholes and reducing the opportunities for avoidance."[77] However, the NAO found that the regime had not prevented the existence of an active market of avoidance schemes:

> Over 100 new avoidance schemes have been disclosed under DOTAS in each of the last four years, many of them involving variations on themes as promoters respond to changes in tax law. There is no evidence that the use of such schemes is reducing. However, most tax practitioners and experts we consulted said that changes to tax law had reduced the opportunities for avoidance and that the larger accountancy firms, for example, were now less active in this area. They told us that most schemes were now promoted by small specialist tax advisers, some of whom had a business model that relied on helping their clients avoid paying tax.

76 *op.cit.* Q265

77 *Tax avoidance: tackling marketed avoidance schemes*, HC 730, 21 November 2012 p8, para 21

> Our analysis of DOTAS disclosures since 2004 supports the view that the market has changed in this way. HMRC believes that most of the marketed schemes now promoted won't work – that is, they would be defeated if tested in the courts, and any tax advantage accrued by the schemes' users would have to be repaid – but it can take HMRC many years to prove this[78]

Furthermore, there was evidence that HMRC had been unable to enforce compliance "on those promoters determined to avoid disclosure":

> Most promoters comply with DOTAS, but a minority will go to some lengths to avoid disclosing a scheme if they perceive an advantage in doing so. There are penalties for promoters who fail to disclose a scheme under DOTAS. However, where a promoter has obtained a legal opinion that a scheme does not require disclosure, it can claim this represents 'reasonable excuse' and no penalty is applicable. Since September 2007, HMRC has opened 365 enquiries where it suspected a promoter had not complied with the disclosure rules, in most cases concluding that there had been no failure to comply. It has applied 11 penalties over that time, each of £5,000.[79]

Further developments

In July 2012 the then Exchequer Secretary David Gauke gave a major speech on tax avoidance in which announced consultation on further reforms to DOTAS, arguing that "as the avoidance landscape changes, so must [the disclosure regime]."[80] In brief, with fewer schemes being sold, often of a lower 'quality', many schemes can be overturned without a change in the law, "because it is clear that they do not work and simply do not deliver the tax advantages advertised by those who promote them." Consequently, "it is increasingly important for DOTAS to identity avoidance schemes, regardless of whether or not they are new and innovative, to enable communication with users and inform counteraction by operational challenge."[81]

The proposed reforms indicate how DOTAS appears to have changed the economics of tax avoidance. When a promoter discloses a scheme, HMRC gives it a scheme reference number (SRN), which in turn, the promoter's clients must use. Promoters must also provide 'client lists' – quarterly returns to HMRC giving name and address information on clients given SRNs, but the level of this information can be insufficient to warn or dissuade individual taxpayers who have been tempted to invest in a scheme that, in all likelihood, has no chance of withstanding a legal challenge:

> Client lists have fulfilled their original, and limited, objective which was to provide information about the number and type of persons using a scheme so that HMRC could risk assess the scheme and choose the appropriate response. Where the response is operational challenge, early knowledge of the numbers of users

78 *op.cit.* p6, para 7
79 *op.cit.* p6, para 8
80 HM Treasury press notice, *Speech by Exchequer Secretary to the Treasury, David Gauke MP; Where next for tackling tax avoidance?*, 23 July 2012
81 HMRC, *Lifting the Lid on Tax Avoidance Schemes*, 23 July 2012 para 2.4, 2.8

> enables HMRC to ensure that resources are in the right place at the right time.
>
> The information that promoters are required to provide on client lists is not sufficient, where the scheme is mass-marketed to individuals, for HMRC to readily match the data to specific customers.
>
> Moreover, the client may be merely an intermediary, not the end user who is intended to obtain the expected tax advantage. There is no onward reporting obligation on intermediaries, so in such cases client lists will not inform HMRC who the end user is. For example, HMRC has had disclosures of employment income schemes where the client is an offshore umbrella company. Further, since it is offshore, it cannot be compelled to pass on the scheme reference number to those parties (UK companies and individuals) who intend to obtain income tax and NICs advantages. So, at present it is inherently difficult for HMRC to identify the end users of such schemes.
>
> The Government wants to ensure that HMRC obtains sufficient information to be able to cut through the chain of introducers and intermediaries in such cases and identify who the end users are. One option is to impose additional 'client list' reporting obligations on promoters and intermediaries. Another option is to provide HMRC with additional powers to require persons involved in marketing a scheme to identify the other parties in the scheme and what their role is. A third option is a mix of the two.[82]

In December 2012 HMRC published the responses it had had to this consultation. On this question respondents had generally taken the view that "the solution should be enhanced powers for HMRC to call for further information from the promoters concerned." In turn the Government introduced provisions to allow HMRC to get information on scheme users from a promoter "where the client named on a client list is an intermediary (who may or may not be the end user of the scheme," and to require clients to provide promoters with their Unique Taxpayer Reference (UTR) and/or National Insurance Number (NINO).[83]

In the 2014 the Coalition Government introduced new rules to undercut the market for tax avoidance: 'Accelerated Payment Notices' (APNs).[84] In brief, HMRC have powers to demand that where taxpayers have used an avoidance scheme similar to one that they are challenging in the courts – 'follower cases' – any disputed sums owed would be held by HMRC, until the courts had definitely ruled on whether the scheme was successful or not. Delays created by the legal process have given individuals a considerable cash flow advantage, even where, some time later, the scheme was judged to be legally deficient.[85]

After first proposing this new regime, in Budget 2014 the Government announced that HMRC would *also* be empowered to issue notices for

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82 *Lifting the Lid on Tax Avoidance Schemes*, 23 July 2012 para 4.5-8

83 *Lifting the lid on tax avoidance schemes – summary of responses*, December 2012 paras 6.4, 6.10-11. Provision was made by s223 of *FA 2013*. At the Committee stage of the Bill the Minister gave a short explanation of these changes: Public Bill Committee, *Twentieth sitting*, 20 June 2013 c669.

84 HMRC, *Follower notices and accelerated payments : guidance*, July 2015

85 This issue is discussed in detail in, *Tax avoidance and tax evasion*, Commons Briefing paper CP7948, 23 December 2019 (see, section 4).

disputed tax for any scheme that fell under DOTAS. The future for tax avoidance was explored by the barrister Jolyon Maugham when he gave the annual ICAEW Hardman Lecture in November 2014. In this he noted that extending APNs this way created incentives for accountants and lawyers to find schemes that evaded the disclosure rules:

> Accelerated Payment Notices fundamentally alter the dynamics of tax avoidance. In the salad days of tax avoidance, you would, on the 5th of April, dip into your overdraft for 20, borrow 80 in a funding loop, put 100 into the scheme du jour, claim 100 of loss relief, set that against your income of 100, enjoy a reduction in your tax liability of 40, spend 21 of that 40 repaying your overdraft and have 19 left over to spend on Bordeaux futures.
>
> That's a gross oversimplification, of course, but the attractiveness of the arrangements really did depend on them being no worse than cash-flow neutral. In other words, you had at least to be able to repay your 20 overdraft. Accelerated Payment Notices (for DOTASed schemes) remove that cash-flow advantage. So promoters have responded by searching high and low for schemes that don't need to be disclosed under DOTAS.[86]

In December 2014 the Government confirmed another series of changes to DOTAS, following a second consultation exercise: in brief, this consisted of updating the rules determining what had to be disclosed; changing the information that had to be provided to HMRC; enabling HMRC to publish information about promoters and disclosed schemes; and establishing a taskforce to enforce the DOTAS regime.[87]

At the time the Chartered Institute of Taxation raised some concerns that these changes might undermine the co-operation between advisers and HMRC that helped DOTAS work, but, strikingly, noted the same trend in promoters' behaviour as Mr Maugham:

> The CIOT has cautiously welcomed the announcement today that legislation will be introduced to strengthen the Disclosure of Tax Avoidance Scheme (DOTAS) regime, and that a new DOTAS taskforce will be created to improve the administration and enforcement of the system.
>
> Jon Preshaw, Chairman of the CIOT's Management of Taxes sub-committee, explained: "We accept that there is a need to look at how DOTAS operates going forward, given the link now in place between accelerated payment notices (APNs) and DOTAS. There is clearly now a risk that advisers will try to avoid the APN regime by circumventing the DOTAS rules and thereby mislead potential scheme users. We therefore support changes to DOTAS that will make it harder for so-called 'high risk' promoters to use non-disclosure to create an advantage for themselves."[88]

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86 Jolyon Maugham, *"Tax avoidance – game over?", ICAEW Hardman Lecture*, 12 November 2014

87 HMRC, *DOTAS regime changes – tax information & impact note* & *Strengthening the Tax Avoidance Disclosure Regimes: summary of responses*, December 2014. Provision for these changes was made by s117 of *FA2015*.

88 CIOT press notice, *Changes to DOTAS are necessary but would be more effective if targeted better, says Tax Institute*, 3 December 2014. See also, "DOTAS: where are we now?", *Tax Journal*, 3 February 2017

2.2 The 'Primarolo Statement'

A second strand to the Labour Government's approach to tackling avoidance came in the Pre-Budget Report in December 2004. At this time the Government announced a number of anti-avoidance measures to counter a number of individual schemes,[89] but *alongside* this the Paymaster General made a written statement on the Government's approach "to dealing with any future attempts to frustrate its intention that employers and employees should pay the proper amount of tax and National Insurance Contributions on rewards from employment." Part of this is reproduced below:

> We will be including legislation in FB 05, effective from today, to close down the avoidance schemes we know about. A technical note explaining what we intend to do in FB 05 will be published today. We will also ensure that NICs is charged on these schemes with effect from today.
>
> However, experience has taught us that we are not always able to anticipate the ingenuity and inventiveness of the avoidance industry. Nor should we have to. Our objective is clear and the time has come to close this activity down permanently.
>
> I am therefore giving notice of our intention to deal with any arrangements that emerge in future designed to frustrate our intention that employers and employees should pay the proper amount of tax and NICs on the rewards of employment. Where we become aware of arrangements which attempt to frustrate this intention we will introduce legislation to close them down, where necessary from today.[90]

There was a general consensus that the 'Primarolo Statement' was a major development in the field of tax avoidance – and that, as the Treasury Select Committee noted at the time, the Statement came very close to a GAAR:

> The indication in this statement that the Government will continue to announce proposed legislation, effective from the day of the announcement, to stop schemes which come to their attention is nothing new. What is new is the declaration that future schemes, not yet devised or which have not yet come to the Inland Revenue's attention, may be stopped as from 2 December 2004. This amounts to a general anti-avoidance rule in this area of taxation of income and rewards, although no new powers are being taken by government.[91]

In 2009 HMRC reviewed the impact of the Statement in its early years of operation, which estimated that over £300m in additional tax revenues had been collected as a result of its use. In their conclusions the authors comment on difficulties of assessing Statement's success,

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89 HM Treasury Pre-Budget Report press notice PN3, 2 December 2004. The wider issue of retrospective provisions in tax law is examined in, *Retrospective Taxation*, Commons Briefing paper CBP4369, 10 January 2020.

90 HC Deb 2 December 2004 cc44-46WS. Provisions to allow for retrospective NICs legislation, as well as extending the scope of DOTAS, were introduced the next year under the *National Insurance Contributions Act 2006*. A Library paper prepared for the second reading debate of this legislation gives more details (Library Research paper 05/67, 26 October 2005).

91 *First report: the 2004 Pre-Budget Report*, HC 138, 27 January 2005 para 90

but go on to suggest how it may have marked a sea change in taxpayers' attitudes:

> There are inevitably many difficulties with evaluating the impact of a single policy in a changing policy environment when taxpayers have been subject to a number of previous and subsequent policy measures in the area of the evaluation. This is further complicated in the area of tax-avoidance where it is difficult to identify the group targeted by the policy – as individuals engaging in avoidance, they do not want to be readily identified.
>
> Additionally, there is the question of the credibility of the announcement. If individuals viewed the announcement as credible, then avoidance behaviour should have changed in the 2004/05 tax year as the bonus period followed directly after the announcement. However, if individuals did not believe the announcement was credible without legislation such that their response was delayed, then this could further complicate the evaluation.
>
> It is important to note that whilst the anti-avoidance announcement was one in long-line of anti-avoidance measures it was qualitatively different. Whilst previous anti-avoidance measures were targeted at specific schemes, the announcement that legislation to close down schemes would have retrospective effect was designed to engineer a permanent change in behaviour. So although this evaluation has found evidence of behaviour changing prior to the announcement as a result of targeted anti-avoidance measures, it is possible that without the prospect of future legislation being retrospectively implemented, these changes would not be sustained and individuals would seek out new avoidance opportunities. As such, the anti-avoidance announcement had an impact on avoidance behaviour that was different to previous, more specific, measures.[92]

As noted above, in their report on the 2011 Finance Bill, the Lords Economic Affairs Committee looked at provisions in the Bill to tackle "disguised remuneration". Many private sector witnesses raised serious concerns about the complexity of the legislation – and some, such as the Chartered Institute of Taxation, suggested that developing or adapting the Primarolo Statement could have been an alternative. The Committee raised this point with Mr Hartnett at HMRC, and he gave some comment on how the statement had been received initially, before alluding to the new Government's attitude to its operation:

> "The first reaction is a wry smile, if I may. When the Primarolo statement was issued, I do not think it would be an overstatement to say that in some areas of the tax industry there was complete uproar. They did not like it. It was not legislation; it was a promise of what was going to happen. A huge amount was written in criticism. So I am surprised that there is some thinking that it could be useful … What about the present Government? It has made it very clear that it sees retrospective legislation of the sort promised in the Primarolo statement as wholly exceptional … If ever HMRC was to make a case to Treasury Ministers that something was exceptional ... then a hunch ... is that this might be [such] an area … We are going to be monitoring it carefully,

92 HMRC, *Evaluation of the December 2004 Anti-Avoidance Announcement – HMRC Working Paper 6*, April 2009 p36

> because it is really important that we advise our Ministers on how this legislation works." [93]

For its part the Committee suggested that "the willingness of our private sector witnesses to consider the Primarolo Statement is an indication of how unhappy they are with the disguised remuneration legislation." It went on to recommend that, "the status of the Primarolo Statement should be clarified and, as necessary, further consideration be given to a revised statement to help deter future avoidance in this general area of the tax system." [94]

The Coalition Government did not take up the Committee's suggestion for a revised 'Primarolo Statement', but in 2012 there was one further development in this area. In the 2012 Budget the then Chancellor, George Osborne, announced the Government's forthcoming consultation on a tailored anti-avoidance rule, as well as specific measures to crack down on specific schemes to avoid stamp duty on expensive, residential property. Further to this the Chancellor went on to state his intention to bring in retrospective legislation, if further schemes came to light – just as Ms Primarolo had done in 2004: "Let me make this absolutely clear to people. If you buy a property in Britain that is used for residential purposes, we will expect stamp duty to be paid. This is the clear intention of Parliament, and I will not hesitate to move swiftly, without notice and retrospectively if inappropriate ways around these new rules are found." [95]

In the 2013 Budget the Government announced that it would introduce legislation "to put beyond doubt that certain SDLT avoidance schemes that abuse the transfer of rights rules do not work. These changes will have retrospective effect to 21 March 2012." [96] During the proceedings of the Finance Bill the Government announced that a further 'transfer of rights' scheme had been identified,[97] and tabled amendments to the Bill to ensure this scheme was also closed with effect from the date of the Chancellor's initial warning in his 2012 Budget.[98]

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93 *The Finance Bill 2011*, HL Paper 158, 14 June 2011 para 181
94 *op.cit.* para 183
95 HC Deb 21 March 2012 c804
96 *Budget 2013*, HC 1033, March 2013 para 2.188. see also, HMRC, *Stamp duty land tax avoidance – tax information & impact note*, March 2013
97 HC Deb 4 June 2013 c85WS
98 Provision was made by s194 of *FA 2013*. At the Committee stage of the Bill the Minister gave an explanation of these changes: Public Bill Committee (Finance Bill), *18th Sitting*, 18 June 2013 cc584-7.

3. Further discussion of a GAAR (up to 2010)

Although the Labour Government's approach to avoidance shifted attention away from a general anti-avoidance rule, some commentators continued to make the case for this approach.[99] In July 2005 the Institute of Chartered Accountants of Scotland (ICAS) published a report arguing that the Government should consult on the idea again.[100] The paper argued that the existing anti-avoidance rules were too complex, and the resulting uncertainty – as to whether a particular activity was or was not legal – was too costly for business. The solution, as the authors saw it, might be a new anti-avoidance rule combined with a pre-transaction ruling system, so businesses would know in advance whether any possible scheme breached this rule; taken together these measures would allow the Government to "repeal much of the existing anti-avoidance system":

> There has been an unwelcome and unhealthy blurring by politicians and senior fiscal officials of the distinction between evasion and avoidance. Recent legislation has included disclosure and notification requirements. There is greater uncertainty now that there is a policy of trying to use retrospective legislation. The evidence is that attempts to close loopholes can involve poorly targeted legislation than can have unintended and unwelcome consequences for legitimate business. We believe that it is unsatisfactory to enact law which is impractical or unduly harsh …
>
> Essentially, with the disclosure regime now in place, the addition of a GAAR would enable the Revenue to pick out 'offenders' as they would see it (who can then defend their position through the courts) rather than tightening the legislative noose for the rest of the population which sometimes has unintended consequences, and generally makes the UK an increasingly complex place to do business. With a GAAR in place we hope that the Treasury might be persuaded to repeal some of the existing anti-avoidance legislation.[101]

In contrast to this view, Judith Freedman, Professor of Taxation Law at Oxford University, argued that certainty should not be the critical test in assessing the value of an overarching anti-avoidance provision.[102] An extract from an article of hers published in the *British Tax Review* in late 2004 is given below:

> Morality can play only a limited role in defining taxpayer responsibilities and must be backed up by law. The principle derived from the *Duke of Westminster's* case ([I936] AC I) that taxpayers may organise their affairs so as to pay the least tax possible under the law, is firmly established in the UK taxpayer's psyche and will need legislation to qualify it definitively. The

[99] see, for example, "1936: a good year for tax?", *Taxation*, 25 August 2005; "Taken at the flood", *Taxation*, 7 December 2006

[100] ICAS press notice, *Tax simplification campaign turns towards general anti-avoidance rule*, 15 July 2005

[101] ICAS, *Simplification: is it time for a GAAR?*, 1 July 2005 p 4, p 8

[102] "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle", *British Tax Review* [2004] No 4 331-356. The article was discussed in, "Burden of clampdown is just too taxing for all", *Financial Times*, 23 June 2005

> developing pressures on corporate taxpayers as part of the movement for greater corporate social responsibility will have a part to play, since tax-related behaviour may have an impact on reputation. Corporate governance mechanisms will only operate effectively to control taxpayer behaviour, however, within a framework giving clear legal direction. Likewise, although individual tax payers and their advisers may not relish criticism in the press for entering into tax avoidance schemes, the media should not be relied upon to set the boundaries of behaviour: these boundaries should be supplied by the legislature.
>
> The proposal put forward here is that direction should be given by means of a legislative general anti-avoidance principle. It is important to note that it is not claimed that such a provision would provide certainty. Certainty has great significance in commercial law, and, even more so, in criminal law, but there are circumstances in which it should not be the overriding aim and where, in any event, it may be elusive or even undesirable.[103]
>
> Previous rejection of a general anti-avoidance provision on the grounds that it would fail to provide certainty might therefore be misplaced: it depends entirely on the role envisaged for such a provision. It is argued here that a legislative provision is needed to provide an overlay to the substantive tax rules; the very overlay that Lord Hoffmann in *MacNiven v Westmoreland*[104] rejected as being beyond the constitutional authority of the courts to impose themselves. This overlay could then be developed by the judges with full constitutional legitimacy. It is not the content of that provision which matters so much as the signposting that will be provided by it: hence it is referred to as a principle and not a rule…
>
> With such a legislative provision in place there would be a clear indication from the legislature that the courts were entitled to go further than the ordinary rules of statutory construction permitted in negating artificial tax avoidance schemes which abused the wording of the legislation. Once that overlay had been created, there would be better scope than at present for the judiciary, the revenue authorities and the taxpaying community to manage any uncertainty within a sensible regulatory framework.[105]

The possibility was raised occasionally by Members, though the Labour Government's position remained unchanged.[106] In a discussion of tax avoidance at the report stage of the Finance Bill in July 2009, the then Financial Secretary Stephen Timms noted that earlier consultations had raised "a lot of objections", in particular concerns that it would require "a fairly comprehensive clearance system, which would potentially be costly to provide" and that even with this, a GAAR could well produce considerable uncertainty for taxpayers.[107] The Minister reiterated these concerns in 2010:

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103 See T. Endicott, *Vagueness in Law* (OUP, Oxford, 2000) [The article goes on to discuss this further.]

104 [2001] STC 237 at 248. [As noted in the first section of the paper, the case had major ramifications for the role of the courts in striking down tax avoidance schemes. The author goes on to discuss *MacNiven* in detail: *op.cit.* pp350-3.]

105 *British Tax Review* [2004] No 4 pp333-4

106 For example, HC Deb 18 May 2009 c1184W

107 HC Deb 7 July 2009 c857

> **Jim Cousins:** To ask the Chancellor of the Exchequer what factors he took into account in reaching his decision not to incorporate a general anti-avoidance principle in taxation law.
>
> **Mr. Timms:** The Government keep all taxes under review, including the possibility of introducing a general anti-avoidance rule (GAAR). Following an extensive consultation on the possibility of a GAAR in 1998, the Government made the decision not to introduce a GAAR at that time in the light of responses received. The factors considered include how a GAAR would work in conjunction with existing extensive anti-avoidance provisions; how it would affect new avoidance legislation going forward; and, whether, as in some countries with a GAAR, a special clearance system would be required.[108]

At this time a major survey of the UK tax system - the Mirrlees Review – was being completed by the Institute for Fiscal Studies; in its final report which was published in September 2011, the authors touched on the case for a GAAR, but went on to argue that a more effective solution to avoidance lay in tackling its root cause – the wider inconsistencies in the tax system itself:

> [The current UK tax system] involves complexity, unfairness, and significant economic costs. One consequence of it, on which we have already commented, is the amount of taxpayers' energy that goes into avoiding tax and governments' energy that goes into combating avoidance. The more complex and inconsistent the tax base, the more avoidance will be possible and the more legislation will be required, so the more effort is put into shoring up tax revenues rather than into following a coherent strategy.
>
> Certainly, one of the central problems of dealing with tax avoidance in the UK has been the propensity of governments to tackle the symptom—by enacting ever more anti-avoidance provisions aimed at the particular avoidance scheme—rather than addressing its underlying cause—often the lack of clarity or consistency in the tax base. Following our agenda should tackle some of the underlying inconsistencies and unnecessary dividing lines within the UK's tax system and hence should produce a system that is more robust against avoidance. If activities were taxed similarly, there would be no (or, at least, much less) incentive for taxpayers to dress up one form of activity as another—and there would correspondingly be little or no revenue loss to the Exchequer if they did so.
>
> We are not so naive as to believe that our proposals will banish avoidance to the outer limits of the tax system, and, given the exponential growth in anti-avoidance legislation in recent years, there may be a case for reconsidering the enactment of a statutory general anti-avoidance rule or principle (a 'statutory GAAR') as is found in Australia, Canada, and New Zealand, all of which share a common legal heritage with the UK.
>
> But the primary response should be to address the fundamental causes of avoidance rather than blindly resorting to anti-avoidance provisions, whether of a general or a specific nature. Simply demonizing tax avoiders and exhorting them to behave better is also a feeble stratagem. Lord Kaldor's dictum[109] that 'the existence of widespread tax avoidance is evidence that the system,

[108] HC Deb 1 February 2010 c106W
[109] Kaldor, N. (1980), Reports on Taxation, I, London: Duckworth

> not the taxpayer, is in need of reform' is surely the right starting point.[110]

This last point brings one back to the first discussions of a GAAR in the early 1990s – and the difficulties faced by the revenue authorities in 'squeezing the balloon' of tax avoidance. In its 1997 report on tax avoidance the Tax Law Review Committee noted that "some structures for levying taxation are more prone to avoidance than others":

> Complex legislation, imposing special tax penalties or conferring special tax privileges, on selected kinds of economic activity, may prove a standing invitation to avoidance. The proper and satisfactory response to avoidance may therefore be to change the structure of the system or elements within it.[111]

In evidence to the Lords Economic Affairs Committee, as part of their enquiry on the *Finance Bill 2013*, Malcolm Gammie QC, argued that "tax avoidance is a function of the tax base":

> The issues of avoidance might be less significant if avoidance opportunities were evenly spread across taxpayers generally. Avoidance opportunities, however, are likely to be disproportionately available to the better off and to the better advised, with the result that the effective tax outcomes produced by the tax system after those opportunities have been taken into account will be inequitable and inappropriate.
>
> It is not possible, however, to discuss sensibly the issues of tax avoidance in terms of morality, 'fair shares', what is reasonable or, even, the definition of what is or is not avoidance. However important perceptions of tax avoidance may be, those perceptions can only effectively be tackled and the issues of avoidance properly addressed by adopting a more analytical and thoughtful approach to the problem.
>
> It is important to remember that tax avoidance is a function of the tax base. As the minority report of the 1955 Royal Commission observed, *"the existence of widespread tax avoidance is evidence that the system, not the taxpayer, stands in need of reform."*[112]

As Mr Gammie noted, this point was made over fifty years ago, in the report of the Royal Commission established to consider reforms to the taxation of income and profits.[113] In its discussion of tax avoidance the authors noted that avoidance would pose much less of a problem "if it were possible to assert as a matter of general principle that a man owes a duty not to alter the disposition of his affairs so as to reduce his existing liability to tax." They went on to discount such a principle being either desirable or feasible:

> Taken at any one moment of time the affairs of different taxpayers are arranged in the most various forms and the extent to which they respectively incur a burden of tax may vary correspondingly. There is no reason to assume that the situation of any one taxpayer at that moment is the fairest possible as between himself and others differently situated: and if there is

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110 The Mirrlees Review, *Tax By Design: Chapter 20 - Conclusions and Recommendations for Reform*, Institute for Fiscal Studies 2011 p501
111 Tax Law Review Committee, *Tax avoidance*, November 1997 px, para 11
112 *The Draft Finance Bill 2013 : Oral & Written Evidence*, 13 March 2013 p114
113 *Royal Commission on the Taxation of Profits and Income Final report*, Cmd 9474 June 1955

> not, it seems wrong to propound any principle that would have the effect of fixing each taxpayer in his situation, without allowing him any chance of so altering his arrangements as to reduce his liability to assessment.[114]

Three members of the Commission submitted a minority report, in which they endorsed this view, adding this observation:

> We feel impelled, in the light of the discussion of Tax Avoidance in [Chapter 32 of] the Report, to record unequivocally our view that the existence of widespread tax avoidance is evidence that the system, not the taxpayer, stands in need of radical reform. We agree with the basic view expressed in that Chapter that it would be wrong to assert that a man owes a duty to the community not to alter the disposition of his affairs so as to reduce his liability to taxation. It is up to the community, acting through Parliament, so to frame the tax laws that they do not leave wide loopholes or open broad avenues for tax avoidance.[115]

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114 *op.cit.* p305, para 1017
115 *op.cit.* p365, para 33

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