HM Revenue & Customs

HMRC'S GAAR GUIDANCE

(Approved by the Advisory Panel with effect from 15 April 2013)

PART D – Examples

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Part I – Background to the examples

D1 Introduction

D1.1 The purpose of the examples is to illustrate when an arrangement might or might not, applying the double reasonableness test, be treated as abusive in the context of the GAAR. As an overarching comment it is important to remember a key policy objective of the GAAR – that it is targeted at abusive tax avoidance schemes, but does not delineate in any way what may or may not be regarded as tax avoidance in a broader sense and which HMRC might want to challenge outside the context of the GAAR in any event.

D1.2 Anything which constitutes a tax arrangement will by definition have a main purpose of obtaining a tax advantage – so the examples will all show evidence of tax planning.

D1.3 As the examples below illustrate, however, tax motivated transactions will not necessarily fall to be treated as part of an abusive arrangement.

D1.4 At each end of the range of tax arrangements it is likely to be clear when something is or is not abusive. The key difficulty is applying the GAAR to cases where it is not clear if they are or are not abusive. It is hoped that the examples will assist those facing that task and illustrate the principles to be applied.

D1.5 A number of preliminary points need to be made before moving on to the themes that the examples illustrate and then the examples themselves.

D1.6 The examples include not only arrangements whose analysis in GAAR terms should be clear but also arrangements that might, depending on the broader context and the particular facts of the case, fall on either side of the ‘abusive’ line.

D1.7 This introduction and the examples themselves are not, however, to be taken as indicating HMRC's blanket acceptance or approval of all transactions or arrangements of a similar type – or as in any way limiting HMRC's ability to counteract using other means. Each case depends on its own facts and context. Again it is important to emphasise that whilst an arrangement may not be abusive in GAAR terms, it could be subject to challenge under other anti-avoidance rules or specific 'technical' tax rules.

D1.8 The GAAR covers a wide range of taxes and a wide variety of taxpayers. What is normal behaviour or a common transaction or action in one context may be exceptional in another context. The GAAR needs to be considered in each case by reference to not only the facts and circumstances of that case but also of the underlying tax and related law. The examples should accordingly be looked at in that light.

D1.9 The themes or categories listed below are illustrative and not necessarily exhaustive or exclusive.

D1.10 Some of the examples could easily fall into more than one of the categories listed below - and a slight amendment, the addition of further features or its use in a different context may cause an example not only to move categories but also perhaps to cross the line. One of the benefits of using examples is that it illustrates how something that may not be regarded as abusive in certain circumstances can become abusive by being pushed too far (by the addition of contrived or abnormal features for example) or by being used in an inappropriate context.

D1.11 What this introduction and the examples illustrate is that facts and circumstances and overall context will play a major role in deciding on which side of the 'abusive' line an arrangement falls. Whilst the purpose of the law will often be clear, there may be occasions where it is more difficult to discern what Parliament actually (or might, if it had been aware of the arrangements, have) intended.

D1.12 Please refer to Part VIII for further information on commencement and illustrative examples.

D2 Categories of examples

D2.1 Recognising all this and in order to guide thinking as to what may or may not be considered to be abusive, arrangements have been divided into a number of themes or categories.

D2.2 ***Straightforward legislative choice***

D2.2.1 This covers, for example, giving assets to children to reduce future IHT liabilities, sacrificing salary in return for enhanced pension rights, disclaiming capital allowances to preserve reliefs for a later period, deciding to incorporate a business or to sell shares rather than assets (in both cases so as to pay less tax or SDLT) and choosing to borrow to invest in buy to let rather than using surplus cash or having a bigger mortgage on your main residence.

D2.2.2 These are all clearly things that are envisaged by statute and Parliament has thus given taxpayers a choice as to the course of action to pursue. This category might also include reorganising a trust or corporate structure in a straightforward way in order to fit within a new tax regime.

D2.3 ***Long established practice***

D2.3.1 This category covers situations where arrangements have become embedded into tax or business practice in such a way that it would be wrong now to treat them as abusive. They are normal conduct by taxpayers and have effectively become accepted as standard practice by HMRC (even though they may not have been recognised as such in HMRC published material or accepted HMRC practice as described in s204(5) FB 2013). The acceptance of the arrangement as normal conduct will, if recognised as such by the Advisory Panel, be taken into account in its decision as to what is reasonable in all the circumstances.

D2.3.2 Into this category fall such simple transactions as gift and loan trusts in the inheritance tax context; creating something which qualifies as a quoted Eurobond for withholding tax exemption purposes but is not widely held; putting special provisions into a consideration loan note to make sure that it qualifies as a non-QCB; and giving choice when a listed company is returning funds to shareholders as to whether those funds come out in capital or in income form (so that certain so-called B share schemes would come into this category).

D2.3.3 This does not of course mean that a new scheme incorporating elements of such practice could not be treated as abusive under the GAAR – such a new arrangement would not constitute part of normal taxpayer behaviour and would not have effectively been accepted by HMRC. Nor does it mean that such practice might not change, whether as result of a change in law, a court decision or an announcement of a change of interpretation.

D2.4 ***Situations where the law deliberately sets precise rules or boundaries***

D2.4.1 If the statute specifies a particular period or set of conditions quite precisely, then taxpayers are entitled to assume that they are on the right side of the line if they have satisfied the statutory condition and there is no contrivance about what they have done. This would, for example, cover:

- the rules for employee share options;
- granting an option rather than making an immediate sale to defer CGT (though artificiality could be further built into such an arrangement and make it abusive);
- complying with bed and breakfast time limits when effecting market transactions in listed shares in order to trigger a capital loss;
- a gift of any share in a house where the donor and donee both occupy it, thus taking advantage of the IHT exemption by technically avoiding a reservation of benefit;
- satisfying the long funding lease rules to ensure that capital allowances are obtained by one party rather than the other;
- making an election for a dwelling to be treated as a principal private residence; or
- deciding to take a 10 year lease with an option to renew rather than a 20 year lease with a break clause and a higher SDLT charge.

D2.4.2 Pushing the statutory boundaries with artificial shares or trust structures or some other contrivance could of course take an arrangement of this type across the ‘abusive’ boundary but that should not be the general case under this heading.

D2.5 ***Standard tax planning combined with some element of artificiality***

D2.5.1 At this point, we are starting to move more obviously into potential GAAR territory although arrangements could still, depending on the facts and circumstances, fall on either side of the 'abusive' line.

D2.5.2 This category thus includes cases where what may otherwise have been regarded as standard tax planning is carried out with steps that are more abnormal or contrived than those often seen but where the resulting arrangement is still not regarded as abusive because the form of planning might satisfy the double reasonableness test (albeit the arrangements may be challenged under other anti-avoidance rules or specific 'technical' tax rules). It will also, however, include cases where the circumstances require an arrangement to be treated as abusive in its own context.

D2.5.3 In the corporation tax area, arrangements that might fall on the right side of the 'abusive' line are illustrated by the late paid interest and *Mawson* examples. Examples of the converse case would be transactions or arrangements where someone who did not naturally qualify for a particular relief or status enters into a contrived transaction in order to fit technically within the rules while, in spirit, remaining outside their natural scope. The example at D21 shows how an arrangement can move from being acceptable to unacceptable by the addition of abnormal features.

D2.5.4 In the context of inheritance tax and trusts generally the position can be particularly difficult to determine given that gifts and distributions from trusts do not usually generate real income or profits but are often non-commercial transactions where the primary motivation may well be the saving of tax. For example, some carve out arrangements are not specifically prohibited by the inheritance tax legislation (for example, the creation and gift of reversionary leases). Although artificial, such transactions have genuine economic consequences in that the donor no longer has the valuable asset to sell; the donee acquires the asset at a low cost and it is the donee's asset to do with as he please. Moreover the donor will have to pay pre-owned assets income tax instead of inheritance tax and therefore has accepted the penalty for carrying out such tax planning. Such transactions may therefore fall on the right side of the 'abusive' line despite their apparent artificiality.

D2.6 ***Transactions that are demonstrably contrary to the spirit (or policy and wider principles) of the law***

D2.6.1 These fall into two sub-categories. There are arrangements where something very contrived or uncommercial has been done in order to fit the particular arrangements within a legislative framework. The GAAR is then certain to be in point (as in the *Mayes v RCC* example). There are also arrangements where a simple or conventional transaction may have been implemented but consideration of the context shows that such a transaction was out of the ordinary for the taxpayer concerned and/or has been combined in some way with other features so that, viewed as a whole, it is right for it to be seen as contrary to the policy and principles of the law and hence potentially abusive. In the corporation tax area, the unit trust example would be one such**.** So, in another area of the tax law, might be a novel way of remunerating employees.

D2.7 ***Exploiting a shortcoming in legislation whose purpose is to close down a form of activity (including for example, therefore, a recent TAAR)***

D2.7.1 The GAAR is intended to bring to an end, so far as possible, the game of legislative catch-up and to make sure that "keep off the grass" warnings are heeded. If, therefore, a TAAR has been introduced with a clear purpose of preventing a particular type of behaviour but a taxpayer enters into arrangements that are intended to exploit a loophole or shortcoming in the TAAR and obtain a benefit that is clearly unintended, the GAAR will apply.

D2.7.2 One example of this would be the transactions giving rise to the recent change of law in relation to debt buy-back through partnerships. Other examples include the corporation tax shares as debt example below, devising ways of UK domiciliaries buying interests in excluded property trusts for inheritance tax purposes, devising contrived ways of circumventing the disguised remuneration rules or enabling employees to obtain pension rights above the statutory limits.

D2.7.3 Shortcomings in legislation can obviously be found in various other contexts, as they were in the *Mayes* example. This category (D2.7) is included as indicated in the heading above simply because “keep of the grass” is an important practical point to bring out as an indicator of when arrangements may be in GAAR territory.

D2.8 ***Arrangements that are contrived or abnormal and produce a tax position which is in no way consistent with the legal effect and economic substance of the underlying transaction***

D2.8.1 These will fall squarely in GAAR territory – and the fact that examples could fall under more than one heading is illustrated by the fact that a good case could be made for putting *Mayes* into this category too.

D3 How are the examples structured?

D3.1 In all of the examples below (except for D18) it is assumed that the schemes are tax arrangements for the purposes of the GAAR. Normal challenges against the schemes under other anti-avoidance legislation or under specific 'technical' tax rules are not considered, or if they are mentioned this is done in passing and without any detailed analysis of the likely challenge. The question for consideration in the examples is whether the tax arrangements are abusive tax arrangements within the meaning of the GAAR.

D3.2 Many of the examples are based on real transactions or schemes. The relevant tax provisions mentioned in the examples are those which were in force at the time of the arrangements. The examples are used to illustrate the principles and broader considerations that will be relevant to the application of the GAAR.

D3.3 In some cases, the conclusion is that whether the GAAR will or will not apply depends on subtle nuances of fact that are described in the context of the example.

D3.4 Each example follows a similar structure:

- Some relevant **background** to the arrangements and relevant tax rules is first given to set the scene;
- the **arrangements** in question are then summarised;
- the **relevant tax provisions** are listed;
- the **tax analysis** provided by the taxpayer in support of the claimed treatment is then provided; and
- finally, the **GAAR analysis** is given.

D4 Reasonable ...having regard to all the circumstances?

D4.1 The GAAR analysis in each case takes into account a wide range of relevant circumstantial evidence. This is required by the terms of the double reasonableness test which provides that whether arrangements can reasonably be regarded as a reasonable course of action must have regard to all the circumstances. This includes what may have become long established taxpayer practice, as referred to above. The legislation also prescribes that a court or tribunal may take into account any guidance, statements or other material that was in the public domain at the time the arrangements were entered into. Examples of matters that may be taken into account include: Hansard, Explanatory Notes, Written Ministerial Statements, academic literature, external practice, HMRC guidance and evidence as to how particular arrangements were at the relevant time normally structured in the market place (so as to compare or contrast such practice with the arrangement under consideration).

D4.2 The context given for each of the GAAR examples is inevitably incomplete. In none of the examples is any single factor or consideration conclusive as to the application of the GAAR. Rather it is the cumulative weight of all of the facts and circumstances given that leads to the conclusion that the GAAR does or does not apply.

D4.3 It is possible that the same arrangement carried out in different circumstances might lead to a different GAAR analysis. For example: if a particular, apparently egregious arrangement were forced on the taxpayer by a regulatory requirement this might lead to the conclusion that the GAAR did not then apply. Similarly, if an arrangement were carried out following a change of law and a clear Written Ministerial Statement about the intent of that change had been made, attempts to work around the new rules might lead to the conclusion that the GAAR did apply.

Part II – Corporation tax

D5 Accessing trapped non-trade deficits carried forward

This example is intended to illustrate a taxpayer making a legitimate choice.

D5.1 ***Background***

D5.1.1 Loan relationship debits can be surrendered as group relief in the year that they arise but it is not uncommon for there to be excess debits that can only be carried forward in accordance with s457 Corporation Tax Act ("CTA") 2009. In such cases the carried forward deficit can only be used to offset non-trading profits of the same company arising in subsequent accounting periods.

D5.1.2 These include profits arising where another group company realises a chargeable gain which is reallocated by election under s171A Taxation of Chargeable Gains Act ("TCGA") 1992.

D5.1.3 A group may make arrangements to generate non-trading income in the company so as to obtain effective tax relief for the expenses that have given rise to the carried forward deficit. A simple way of achieving this is to inject equity into the company, which then lends the funds to another member of the group that has sufficient taxable income to obtain relief for the interest that it pays to the company. The company itself utilises some or all of the loan relationship debits brought forward to shelter some or all of its corporation tax liability.

D5.2 ***The arrangements***

D5.2.1 Company A has substantial amounts of non-trading loan relationship deficits at the end of Year 1. Another company in the group, Company B, typically makes large taxable profits. The two companies enter into an arrangement that involves the following steps:

- Company A issues preference share to Company B for consideration that derives from Company B's trading operations.
- Company A lends the cash back to Company B at a commercial rate of interest.

The terms of the preference shares are that they entitle Company B to dividends equal to the interest that Company B pays on the loan from Company A.

D5.3 ***The relevant tax provisions***

- Section 457 CTA 2009; and
- Part 5 CTA 2010.

D5.4 ***The taxpayer's tax analysis***

D5.4.1 *Company A*

This company receives interest from Company B and pays equivalent dividends to Company B. The interest is taxable under the loan relationship rules, and no deduction is sought for the dividends payable. The taxable interest is covered by Company A's non-trading loan relationship debits brought forward.

D5.4.2 *Company B*

Company B expects to obtain a tax deduction for the interest it pays to Company A, and not to be taxable on the dividends it receives in respect of the preference shares. The disguised ·interest rules in Chapter 2A of Part 6 CTA 2009 do not apply to those shares because of the excepted share rule in s486E CTA 2009.

D5.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D5.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The loan relationship rules are aimed at securing that a company is chargeable to tax on the amounts that fairly represent the GAAP-measured profits on its loan relationships. The interest that Company A derives is a non- trading loan relationship profit and the interest is chargeable under those rules. As a separate matter s457 CTA 2009 then requires any of Company A's unrelieved prior year non-trading loan relationship deficits to be carried forward and set against any subsequent non-trading profits. Company A's claimed tax treatment is consistent with these tax rules.

As for Company B, the disguised interest rules are disapplied by the excepted share provision. The consultation document on the disguised interest rules notes that the exclusion for intra-group shareholdings is intended to put beyond doubt that straightforward share investments in group companies cannot give rise to a disguised interest charge at any tier. The rationale is that where a lower tier company earns interest then a higher tier company might receive a corresponding uplift in the value of the shares that it holds, but taxing that under the disguised interest rules would amount to double taxation. Company B's claimed tax treatment is therefore consistent with the principles of the disguised interest rules.

D5.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The arrangement involves circular cash flows. HMRC would regard this as involving contrived or abnormal steps.

D5.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The arrangements are not exploiting shortcomings in the loan relationship rules; this is the way that the rules are intended to work.

D5.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

None of the indicators of abusiveness is present.

D5.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

These arrangements were discussed in detail during the consultation on the disguised interest rules and the excepted share rule was introduced following representations that they should be allowed to continue. Subject to a loan not having an unallowable purpose within s441 CTA 2009, HMRC has indicated its acceptance of such arrangements. Acceptance of such arrangements is indicated, for example, in CFM 92210 (part of the HMRC manuals that indicate how carried forward deficits can be used in the context of the debt cap).

D5.6 ***Conclusion***

D5.6.1 There is a possible view that the arrangements are abusive based on two features. First, the group relief rules only allow a surrender of current year losses and reliefs (Part 5 CTA 2010). The arrangements might be seen as a way of effectively transferring carried forward reliefs from Company A to Company B, which the group relief rules do not allow. Secondly, the loan arrangements are circular and lack other commercial purpose. As indicated, they involve contrived or abnormal steps within s204(2)(b) FB 2013.

D5.6.2 However, the loan relationships regime allows the use of carried forward non-trading deficits against any non-trading profits arising in Company A. This rule has co-existed with the group relief rules for many years and it is well established corporate housekeeping to seek to locate profits arising within a group in a company that has available carried forward reliefs. (So for example if a chargeable gain were realised by Company B the gain could be elected into Company A under s171A TCGA 1992 and sheltered by the non-trading deficits). Arrangements involving intra-group loans which move income into one group member create deductions in another and avoid stranded interest relief have been implemented by corporates, and have been seen by HMRC, on many occasions over the years. Their use is consistent with what is allowed by s457 CTA 2009, and therefore can be seen overall to be consistent with the policy objectives of that provision, without exploiting any shortcoming in it.

D5.6.3 The analysis might be different if the group relief rules contained provisions that sought to counteract measures taken to shift profits from one member of a group into another, which has available reliefs. Attempts to exploit any shortcomings in those rules would then be an indicator that the arrangements might be abusive.

D5.6.4 In the circumstances a reasonable view can be taken that the loan is a reasonable course of action approaching things from the viewpoint of what the loan relationships regime permits and what the group relief rules do not seek to preclude.

D6 Late paid interest rules

This example is intended to illustrate how some arrangements despite having contrived or abnormal steps will not be within the scope of the GAAR because:

- *the substantive result of the arrangement is consistent with the principles on which the relevant tax provisions are based; and*
- *they accord with established practice.*

D6.1 ***Introduction***

D6.1.1 The arrangements described involve a company engineering itself into the late paid interest rules to secure that the interest is tax deductible on a paid rather than on an accruals basis. The benefit in its doing so is that the company is able to time exactly when the deduction for interest is given to maximise the use of the deduction and any resulting loss arising with respect to the interest.

D6.2 ***Background***

D6.2.1 The corporation tax rules on interest normally allow a company to deduct interest payable in accordance with accounts drawn up under generally accepted accounting practice (an “accruals basis”). However, where the interest is payable to a connected party that is not chargeable to corporation tax, and that party is resident in a non-qualifying territory (i.e. one with which the UK does not have a double taxation agreement with a non-discrimination article) it is deductible only when it is actually paid (a “paid basis”).

D6.2.2 The purpose of this provision (the "late paid interest rule") is to address the asymmetry which may arise where a debtor is allowed a tax deduction for interest accrued, but the creditor is taxable only on receipt. In particular, it is intended to address the risk that interest owed by a UK company to a connected person may never be paid but continue to generate a UK tax deduction.

D6.2.3 The rule was originally much wider applying in any case where the connected party creditor was not chargeable to corporation tax. This was changed in 2009 in response to concerns that the original rules were not compliant with EU law. The changes made in FA 2009 mean that in the majority of cases where the creditor is a company, unless that company is located in a tax haven, normal loan relationships principles will apply, and interest will be deductible as it accrues in the accounts, not when it is paid. But a paid basis will apply where the creditor (or one of the creditors) to the relevant loan relationship is a connected party resident in a non-qualifying territory ("NQT").

D6.3 ***The arrangements***

D6.3.1 Company A has entered into loan arrangements (“the Loans”) with various intragroup lenders, based in treaty locations (“Treaty Lenders”), i.e. lenders that will not trigger the late paid interest rules.

D6.3.2 All of the Loans allow for interest to be paid late; and further provide for Company A to pay the accrued interest at the time of its choosing.

D6.3.3 To prevent trapped losses arising, the following transactions are undertaken:

- The group establishes a special purpose company ("X co") in a NQT. X co is connected with Company A and Treaty Lender.
- Treaty Lender makes an equitable assignment in favour of X co of its right to a very small part of some or all of the future interest accruals in respect of the Loans before the accrual dates arise.

D6.4 ***The relevant tax provisions***

Sections 373 and 374 of CTA 2009.

D6.5 ***The taxpayer’s tax analysis***

D6.5.1 Company A contends that the equitable assignment by Treaty Lender of its right to a (small) part of the interest means that all interest is potentially deductible on a paid basis pursuant to s373 CTA 2009 subject to its being paid more than 12 months after it accrues.

D6.5.2 Its analysis is as follows:

- Before the equitable assignment the loan constitutes a loan relationship as defined in s302 CTA 2009. Company A is party to it as a debtor relationship and Treaty Lender is party to it as a creditor relationship. The loan relationship is a connected company loan relationship.
- Following the assignment, Company A remains party to a single debtor relationship. Similarly, Treaty Lender continues to be treated as being a party to a creditor relationship. In addition X co is now also party to a creditor relationship in respect of the same debtor relationship as it stands in the position of a creditor in relation to a money debt (the entitlement to interest) which arises from a transaction for the lending of money (being the Loan).
- The condition in s374(1) CTA 2009 (for the late paid interest rules to apply) will be met because there is a connection between Company A, the company with the debtor relationship, and X co which is a company standing in the position of creditor as respects the loan relationship. In particular following the assignment, both Treaty Lender and X co stand in the position of creditor as regards Company A's single debtor relationship. The condition in s374(1A) CTA 2009 is met because X co is resident in a NQT.
- In addition, condition B in s373(3) CTA 2009 is satisfied because the interest payable by Company A is not brought into account under the loan relationship rules by any of the corresponding connected company creditors.
- It follows that the conditions for the interest long-stop rule to apply are met, with the result that, under s373(1) CTA 2009, debits relating to the whole amount of interest payable under Company A's debtor relationship must be brought into account on the assumption that the interest does not accrue until it is paid.

D6.5.3 The effect of the scheme is therefore that Company A obtains a deduction for the whole of the interest on a paid basis (assuming it is paid after 12 months). Moreover it does not have to account for the withholding tax that would apply if in fact all of the interest were paid to X co.

D6.6 ***What is the GAAR analysis under s204(2) of FB 2013?***

D6.6.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The 1996 loan relationship rules introduced an accounts basis, so that generally interest would be deductible and taxable on an accounts-recognition basis.

In a case where all companies are UK companies this would produce a symmetrical result. However, connected parties would have been able to exploit the rules to avoid this symmetrical treatment. There was a risk that a company could get a deduction under the loan relationships rules for interest payable (but never in fact paid), while the creditor would not be taxed on any corresponding income. This would have allowed the group as a whole to make a profit from an economically neutral intra-group transaction based on the asymmetrical tax treatment of the loan.

The late paid interest rule is a response to the risk of getting an unjustified or inappropriate accruals deduction in the UK. Implicitly, it is an anti- avoidance rule. Originally it applied whenever a connected creditor company was resident outside the UK.

HMRC subsequently received legal advice that it might be held to contravene EU law on freedom of establishment, hence began a consultation which resulted in its current reduced application to cases where the connected creditor is resident in a tax haven.

Many groups had relied on planning around cash deductions for interest paid and they were not clear whether the purpose of the legislative change was to prevent that planning from being effective.

D6.6.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The assignment of a small part of the interest in order to trigger the late paid interest rules is considered to be a contrived or abnormal step in the context of a transaction such as this which has no purpose other than to secure a desired fiscal result.

D6.6.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

It is difficult to see the arrangement as one that exploits shortcomings of the legislation. Rather, the legislation deliberately withdraws the accruals basis for interest where any of the interest is paid to a resident of a NQT. That effect of the legislation in relation to the transaction could not reasonably be regarded as a shortcoming – rather, that is its express object.

D6.6.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

None of the indicators of abusiveness is present. The company obtains relief for an amount that corresponds to a true economic cost.

D6.6.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has in the past indicated its acceptance of similar arrangements, including by the giving of clearances.

D6.7 ***Conclusion***

D6.7.1 On the facts given, a reasonable view can be taken that the arrangement is a reasonable course of action in relation to the relevant tax provisions. Accordingly, HMRC would not seek to apply the GAAR.

D7 Barclays Mercantile Business Finance (“BMBF”) v Mawson

This example is intended to illustrate a complicated arrangement which was found by the courts to comply with the law and did not contain features that could properly be regarded as abusive.

D7.1 ***Background***

D7.1.1 *BMBF v Mawson* [2005] STC 1 involved leasing transactions entered into in 1993 at a time when large value capital allowance-based finance leasing was very common. The Revenue challenged the leasing company's entitlement to capital allowances and the case is now a leading case on the limits of the Ramsay approach and purposive construction of taxing statutes. The Revenue was successful before the Special Commissioners and the High Court but the taxpayer was successful at the Court of Appeal and in the House of Lords. This example considers whether the GAAR would have applied to the transactions had the GAAR been in effect in 1993.

D7.1.2 Capital allowances provide rapid tax relief by comparison with commercial depreciation over the life of the equipment to which they relate. But a potential buyer or operator of equipment is often not in a tax position to benefit fully from the relief. Finance leasing arrangements, usually with a bank owned leasing company, could transfer the capital allowances benefits to the lessor, which could write off the· cost of the equipment for tax purposes before corresponding rental income would be accrued. The lessor would purchase the equipment, lease it to the operator and pass down the benefits in the lease rents. The lessor's tax ownership of the equipment was artificial, however, as compared with the economic and accounting position: under a finance lease the lessee operator had the real economic value and risk in all material respects. The advantages of leasing were (and still are, where finance leasing remains available) timing based advantages only, in the absence of other transactions or special arrangements.

D7.1.3 In 1993 there were:

- Rules that limited or denied a lessor's allowances in certain cases of leasing to non-residents, in order to preclude an "export" of capital allowances benefits. The rules were of some relevance to the leasing structure in BMBF v Mawson, which was designed to step around them by reference to practice that was prevailing at the time.
- No specific finance leasing rules. Finance leasing rules were introduced later, notably in 1996 (when rules were introduced to ensure minimum leasing income accruals based on accountancy earnings) and, more significantly, in 1997, when sale and finance lease-back restrictions were introduced in such a way that allowances would be denied altogether where security arrangements such as those described below were involved.

- No restrictions on leasing over a long term to maximise lease deferral benefits. There was a major overhaul of the law, with the introduction of rules relating to long funding leases in 2006.
- No reduced capital allowances rates for long life assets (such reductions were introduced in 1996).

D7.2 ***The arrangements***

D7.2.1 The arrangements concerned a claim for capital allowances by the bank's leasing subsidiary ("BMBF") in a case where it had purchased a gas pipeline. The pipeline had been purchased from an Irish corporation ("BGE") to which it was subsequently leased back.

D7.2.2 The pipeline had been constructed to transport natural gas to Ireland with the pumping and control station in the UK. BGE owned the pipeline. BGE wished to obtain UK tax based lease finance for the pipeline and entered into arrangements with BMBF, a leasing company in the Barclays group, to sell the pipeline to BMBF and finance lease it back. BGE in turn subleased the pipeline to a UK subsidiary, which was to operate the pipeline and charge fees to BGE that would enable the UK subsidiary to meet lease rents.

D7.2.3 The BGE group did not, however, raise finance from the deal. It had already financed the pipeline from sources that included a syndicate of banks and the finance remained in place. Barclays Bank provided a guarantee to BMBF of the lease obligations, and cash collateral security was provided to Barclays Bank through security arrangements starting with BGE that involved cash placed with a Jersey vehicle and then with an Isle of Man company in the Barclays group. That company in turn deposited its cash at Barclays Bank, which also provided the funding to BMBF for BMBF to acquire the equipment. It could thus be alleged that the purchase price for the equipment (or funds equivalent thereto) moved ultimately in a circle and BGE did not receive it. The arrangements minimised the capital adequacy costs to the Barclays group of its participation in the lease facility, and the capital adequacy benefits were reflected in lease rents. There was thus a commercial benefit to the lessee – because it was able to obtain beneficial UK lease finance whilst also accessing cheaper funding from its more normal source.

D7.3 ***The relevant tax provisions***

Section 24 CAA 1990 (now Section 11 CAA 2001).

D7.4 ***The taxpayer's tax analysis***

D7.4.1 Under s24 CAA 1990 capital allowances were available where a person incurred capital expenditure on equipment for the purposes of his trade and in consequence of his incurring that expenditure the equipment belonged to him.

D7.4.2 BMBF's analysis, therefore, was that it was entitled to capital allowances as a finance lessor, so that it would be taxed in the usual way in its leasing trade; and that its entitlement was unaffected by the circular flow of cash through Barclays Bank, which provided both the guarantee to BMBF and the funding to BMBF.

D7.5 ***What is the GAAR analysis under S204(2) of FB 2013?***

D7.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

It is difficult to see that the leasing was not consistent with the relevant provisions or their policy objectives. Allowances were available to the equipment owner, which in accordance with long standing finance lease practice was not required to be the economic owner. The leasing could as usual provide an investment incentive (albeit after the event, as is typical for sale and leaseback). There were no relevant anti- avoidance rules placing limits on acceptable leasing arrangements.

D7.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

All finance leasing involves somewhat contrived steps, since tax ownership is separated from economic ownership, but the core sale and lease back transactions were in line with widespread finance lease standards and were not, taken alone, abnormal. The wider security arrangements were however contrived or abnormal, including for their circularity. However, the circularity was not necessary to achieve the substantive tax results.

D7.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

In the absence of specific rules on leasing, and in particular on finance leasing, it is difficult to point to specific shortcomings in relevant tax provisions.

D7.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

None of the indicators was present to any material extent. BMBF's expenditure was· ultimately relieved and its income was ultimately brought into account for tax purposes. Timing benefits arose, so that for particular accounting periods the tax loss or tax profit would be regarded as different from the economic profit. But the key timing benefits were simply a feature of a capital allowances regime that involved a clearly intended separation of tax from accounting or other economic measures.

D7.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

There were some other broadly similar "defeased" transactions in the large ticket leasing market but no indications of acceptance by the Revenue. The Revenue challenged other transactions and the Revenue approach could be seen as consistent with reservations that had been expressed in the past about leasing arrangements that did not involve any real financial risk or role for the lessor, such as where the lessor was funded on a non-recourse basis.

D7.6 ***Conclusion***

D7.6.1 There was nothing in the capital allowances legislation at the time that required anything other than capital expenditure to be incurred on equipment and ownership (or in certain cases deemed ownership) to be the result. It was clear that economic ownership was not required; and tax-based leasing was very well established. In the absence of specific finance leasing rules there was nothing to indicate that, where the owner was a lessor, the owner was required to take any particular level of asset or credit risk or to discharge a commercially required role of providing finance (to the lessee or anyone else). In the absence of any other factors (e.g. a sale at an artificially inflated price) and given the long-standing treatment of finance leasing it was not possible for the courts to deny the capital allowances claim.

D7.6.2 It was evident that arrangements such as those actually used in *BMBF v Mawson* were likelier than other arrangements to give rise to concern within the Revenue, given the circularity of cash flows and the absence of, or minimal, financial risk assumed by the lessor group on anyone as a result of the cash collateral coming into the group. But the accepted use of finance leasing and the feature that the core transaction steps taken by BMBF itself (including the way in which it was funded by its parent bank) were common form transactions would lead to the conclusion that a view could reasonably be taken that the leasing arrangements represented a reasonable course of action for s204(2) purposes. They were closely related to long established accepted practice and there was insufficient clarity in the policy background to the law as it stood at the time for the arrangements to be regarded as abusive for GAAR purposes.

D8 Shares as debt

This example is intended to illustrate that a transaction with a commercial driver (group funding) may be structured in a contrived or abnormal way so as to give rise to an abusive tax result.

D8.1 ***Background***

D8.1.1 Following disclosures under DOTAS, legislation (shares as debt rules) was introduced in 2005 to tax companies holding shares with certain debt-like characteristics as if the shares were loan relationships.

D8.1.2 This legislation applies if various conditions are met, one of which is that the value of the shares is likely to increase at a rate which represents a return on an investment of money at a commercial rate of interest. If all the conditions are met then the taxable amounts deriving from the shares are determined on the basis of fair value accounting: that is the charge for an accounting period is based on the difference between the opening and closing fair value of the shares plus income paid in the meantime. The scheme below is intended to exploit those rules.

D8.2 ***The arrangements***

D8.2.1 Company A acquires shares in a connected company (Company B) that have been created for the scheme. The shares meet the conditions of the shares as debt rules and are acquired at fair value of, say, £100m. For the first two months, the shares increase in value in a way that equates in substance to a commercial rate of interest. Shortly afterwards Company B makes a distribution of £95m to Company A, in the form of a bonus issue of debentures. This is a depreciatory transaction; after the distribution is paid the shares have a fair value of approximately £5m.

D8.3 ***The relevant tax provisions***

Section 91B of FA 1996 (as inserted by paragraph 10 of Schedule 7 to F(No.2)A 2005).

D8.4 ***The taxpayer's tax analysis***

D8.4.1 The company contends that the shares fall within s91B FA 1996 and claims a non-trading loan relationship loss of approximately £95m. The basis of the company's claim is as follows:

- Under s91B(3) FA 1996 the deemed loan relationship is subject to tax on the basis of fair value accounting.

- Under s91B(2)(b) FA 1996, a distribution under s209(2) (a) and (b), Income and Corporation Taxes Act ("ICTA") 1988 is for this purpose not a distribution, but the issue of the bonus debenture falls within s209(2)(c) and so retains its character as a distribution.
- Under para 1(1), Sch 9, FA 1996 no credit in respect of a distribution may be brought into account as a loan relationship credit.
- Absent that credit there is a fair value loss of £95m which can be relieved as a loan relationship loss.

D8.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D8.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The common feature of s91B and the provisions with which it was introduced (s 91A, s91C and s91E) is that they aim to treat shares that produce returns economically equivalent to interest as creditor loan relationships.

The principle on which the relevant tax provision (s91B) is based is that under UK tax rules the return arising to a company on debt is to be charged to tax as income. The policy objective is to prevent companies from avoiding corporation tax by dressing up a return on debt as if it were a return on equity (which is exempt from corporation tax to the extent it consists of a distribution or an unrealised capital gain).

The Explanatory Notes for s91B and related provisions confirm that the legislation is targeted at schemes designed to cause the return on what is effectively a loan or deposit to fall outside the scope of the loan relationship provisions by ensuring that the instrument took the form of a share:

> "These paragraphs deal with a number of schemes disclosed under Part 7 FA 2004 and elsewhere which exploit the fact that increases in value and gains from the disposal of shares are subject only to the rules for corporation tax on chargeable gains, if at all. The schemes use derivatives in conjunction with shares, or deferred subscription agreements to create what is in form a share but in economic substance a deposit or loan, since in most of them the risks associated with equity investments, as well as the rewards, are removed or significantly reduced, leaving the share giving a return, either by the payment of "dividends" or by a wholly predictable increase in value, which is the type of return expected from debt."

In this context it is clear that the substantive tax result (a large tax loss matched with a non-taxable distribution) representing the loss of value is not consistent with the principles or policy objectives of the relevant tax provisions.

D8.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The immediate means of achieving the claimed tax result is payment of a distribution that is abnormal both in terms of size and character. Not only does it represent almost the whole of the paid-up value of the shares, but it is also designed to fall within s209(2)(c) – an unusual type of distribution.

The wider context of the arrangement also indicates the presence of contrived or abnormal steps: it appears, taking into account the arrangements of which the arrangement forms part, that the company has deliberately engineered itself into provisions that were introduced as anti-avoidance rules, in order to obtain a tax advantage never envisaged under those rules.

In these circumstances, there is little doubt that the arrangement involves contrived or abnormal steps.

D8.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The Committee Stage debate on the relevant tax provisions explains the rationale for requiring fair value accounting to be adopted in relation to the shares:

> "The legislation imposes fair value accounting for a good reason: the section taxes increases in the value of shares that are interest-like, and fair value will ensure that such increases are brought into account in each period as they accrue. Allowing any other accounting method would enable a company to defer taxation of such value increases to far in the future."[1]

Given this objective, there was a clear shortcoming in the legislation: while s91B(2)(b) allowed distributions within s209(2)(a)and(b) to be taken into account as loan relationship credits, it failed to cater for the possibility that a s209(2)(c) distribution would be paid. This shortcoming is one that the arrangement was intended to exploit.

[1] (http:1/www.publications.parliament.uk/pa/cm200506/cmstand/b/st050628/pm/50628s03.htm)

D8.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

One of the abusiveness indicators is that that the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes (provided that it is reasonable to assume that such a result was not the intended result when the relevant tax provisions were enacted).

In this case the company obtains the value of the share in the form of a large distribution. That payment gives rise to no economic loss but for tax purposes it is claimed that a large loss arises. It is clear that providing this outcome was not the objective of the relevant tax rules.

D8.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has never accepted that the arrangements give rise to the claimed tax result.

D8.6 ***Conclusion***

D8.6.1 On the facts given the arrangement is an abusive one to which HMRC would seek to apply the GAAR. The bonus issue of debentures is an abnormal or contrived step introduced solely for the purpose of creating the tax advantage sought to be achieved.

D8.7 ***Proposed counteraction***

D8.7.1 The counteraction should tax the transaction according to its economic results and disregard the loss.

D9 Unauthorised Unit Trusts

This example is intended to illustrate a highly contrived transaction that uses existing structures in an inappropriate way to produce a tax result that is clearly contrary to the intended consequences of the law.

D9.1 ***Background***

D9.1.1 This scheme seeks to take advantage of the tax rules applicable to Unauthorised Unit Trusts ("UUTs")[2] by using them to convert foreign income subject to withholding tax into receipts of UK income with a UK tax credit attached. The aim of the scheme is either to generate repayment of this credit (though no or only minimal UK tax has actually been paid) or get around the restrictions for claiming double taxation relief ("DTR") that would have been applicable had the overseas income been received directly by the investors (who are financial traders).

D9.1.2 The trustees of a UUT are subject to income tax at the basic rate (20%) on the difference between gross income and the amount of the income distributed to unit-holders in the tax year. So in a case where the income and distribution are equal the trustees will have a nil tax liability in relation to the income that they receive. However, they will have an obligation to deduct and account to HMRC for income tax on the income distributed.

D9.1.3 In a simple case where income is received by a UUT and distributed to the unit holders in the same tax year, the rules provide for symmetry between the treatment of the trustees and the investor. The trustees will have to deduct and account to HMRC for income tax at the basic rate on the gross amount of the distribution. A corporate investor will be liable to corporation tax on the gross income, but will be able to offset the basic rate tax against that liability.

D9.1.4 Even where the distribution is delayed until year two, then, provided that the trustees have in fact paid tax on the full amount of their income in the previous tax year the rules produce the same symmetrical outcome as in the simple case. However, in a case where the tax payment due by the trustees in year one was reduced by a credit for foreign tax then the tax credit attaching to the later distribution of that income will not correspond to actual tax paid to the UK exchequer.

D9.1.5 In the avoidance scheme, the UUTs in question receive foreign income exclusively in the form of manufactured overseas dividends ("MODs"). The foreign tax credit attaching to the MODs reduces the UUT's income tax liability to nil (or nearly nil).

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[2] Unit trusts are collective investment schemes created by deed where the scheme property is held on trust for the investors. Investors pool their money which is then invested by the trustees in a managed pool of assets. UUTs are broadly any unit trust schemes that are not authorised in terms of the Financial Services and Markets Act 2000 provided that the trustees are UK resident.

D9.1.6 In the next tax year that income is distributed, but without triggering any requirement to deduct income tax. In that tax year, the unit holders (which in practice may consist almost entirely of the company that sets up the scheme) become entitled to set-off or repayment of amounts that in substance correspond to the foreign tax.

D9.2 ***The Arrangements***

Outline

D9.2.1 A UUT is created with a twelve month distribution period which does not coincide with the tax year and issues units to UK Bank. UK Bank is a financial trader. The UUT uses the cash to acquire foreign assets (equities or debt securities) which generate income.

D9.2.2 In Tax Year 1 the UUT receives foreign income subject to foreign withholding tax but there is no distribution of that income. This is because the UUT's distribution period does not result in a distribution arising in Tax Year 1.

D9.2.3 In Tax Year 1, the trustees must pay basic rate income tax on the trust income but they can claim full credit against that tax for the overseas withholding tax. As an example: foreign income of 1,000 subject to 15% withholding tax would mean that the trustees received 850 (gross 1,000) and had to account for 20% income tax, i.e. 200. However the 200 would be reduced by the 150 foreign tax credit thus giving a UK tax liability of 50 and leaving 800 of income in the hands of the trustees.

D9.2.4 There is no "collectable amount" (i.e. no requirement to deduct and account for basic rate income tax) as there is no distribution payment in Tax Year 1. At the end of the tax year the undistributed amount is added to the trustees' "income pool" increasing it from zero to 1000. This pool may be used in a later tax year to reduce the amount of income tax that has to be deducted in respect of any income distribution made in that year. However, the recipient of that distribution will still be treated as receiving it under deduction of income tax.

D9.2.5 In Tax Year 2 the UUT receives no further income and, at the end of the distribution period, there is a payment of all available income to UK Bank. Continuing the above example the distribution is 800 net (1,000 gross) which has an income tax credit of 200 attached to it. This can be set off by UK Bank against any tax due or reclaimed.

D9.2.6 The trustees of the UUT do not account for any tax in Tax Year 2 as:

- The UUT has no income.
- The collectable amount in respect of the distribution is also zero as although there are 200 of deemed deductions from the distribution, the collectable amount in respect of the deemed deduction is reduced to zero when the income pool is taken into account.

D9.2.7 The scheme envisages that UK Bank has no net liability to corporation tax (because of trading losses). In consequence, UK Bank claims a "repayment" or set off of 200 against tax it would otherwise have had to account for in respect of amounts withheld from interest paid to savers. By contrast, a direct investment in the underlying investments of the UUT would have entitled it to almost no tax benefit because of the loss position and the restrictions on using DTR in respect of tax on trade income.

The arrangements in detail

D9.2.8 On or before 3rd April in Tax Year 1:

UK Bank sets up a UUT. The Trust Deed provides for virtually all (99%) of the income of the trust to be distributed in tranches in the following tax year on a specified distribution date: 7 April of the next tax year (Tax Year 2).

D9.2.9 On 3rd April Tax Year 1:

- UK Bank subscribes cash of £100m for A-class units in the trust. The A units entitle UK Bank investor to 99% of the income and a share of the UUT capital proportionate to its investment.
- A foreign bank is a partner in the scheme and through a Luxembourg subsidiary it subscribes £2bn for B-class units in the scheme, which entitle it to 1% of the income and a share of the UUT capital proportionate to its investment.
- A Luxembourg subsidiary of the foreign bank ("Luxco") subscribes for £2.1bn of fixed rate preference shares issued by another Luxembourg subsidiary ("Issuer"). UUT acquires the preference shares for £2.1bn from Luxco.
- UUT loans the shares to an Approved UK Intermediary ("AUKI") under a stocklending arrangement.

D9.2.10 On 4th April in Tax Year 1:

A gross dividend of £100m is paid on the preference shares to the AUKI subject to Luxembourg withholding tax at 15% of £15m. Under Luxembourg tax rules the Luxembourg holding company of the dividend-paying company claims a repayment of this withholding tax. The AUKI pays a net manufactured overseas dividend ("MOD") of £85m to the UUT under the lending agreement, representing the actual net dividend. The AUKI is not required to account to HMRC for any tax in respect of the MOD because it is able to offset the overseas tax withheld (despite it having been repaid).

D9.2.11 On 7 April in Tax Year 2:

The deemed (and actual) distribution of income by the UUT occurs.

D9.2.12 Shortly after 7 April Tax Year 2:

The AUKI returns the shares in Issuer to the UUT under the terms of the stock loan, the UUT sells the shares in Issuer back to Luxco for £2bn and any remaining income is distributed to UK Bank as it redeems its Class A units as part of the unwind of the arrangements. The Class B units are redeemed, with the resulting proceeds paid back to the original subscriber (the Luxembourg subsidiary of the foreign bank).

In economic substance, UK bank is commercially almost flat: it pays 100m for its interest in the UUT and receives a gross income stream of £100m.

D9.3 ***The relevant tax provisions***

- Sections, 504, 941, 942 and 943, Income Tax Act ("ITA") 2007; and
- Section 18, Taxation (International and other Provisions) Act ("TIOPA") 2010.

D9.4 ***The taxpayer's tax analysis***

D9.4.1 *UK Bank*

In relation to UK Bank, it receives in Tax Year 2 a distribution of gross amount £100m. It has paid £100m to obtain that income so makes no profit.

The tax deemed to have been deducted by the trustees from the payment under s941 ITA 2007 is treated by s848 ITA 2007 as tax paid by UK Bank. S967 CTA 2010 allows UK Bank to set off the income tax it is treated as having paid against corporation tax to which it is liable or to obtain "repayment" of it.

By contrast, if overseas dividend income had been received directly in these circumstances, s44 TIOPA 2010 (credit against tax on trade income) would have prevented UK Bank from obtaining any benefit from the overseas tax (since the overseas tax could only be set against the UK tax on the "turn" that it had made on the deal).

D9.4.2 *Trustees*

In Tax Year 1, the MOD is treated as overseas dividend income after deduction of deemed overseas tax such that the trustees' income tax liability under s504 ITA 2007 is reduced by the deemed foreign tax in accordance with s26 ITA 2007 and s18 TIOPA 2010. This results in a net tax rate of only 5% on the gross MOD income of the UUT.

No collectable amount arises under s942 ITA 2007 in Year 1 as there is no distribution and the trustees' income pool under s943 ITA 2007 is increased by the gross income received (case 2 of s943 applies).

In Tax Year 2, no liability arises under s504 ITA 2007 on distribution of the income as no income is received by the UUT and the collectable amount is reduced to zero under s 942(4) ITA 2007 by virtue of the income pool created by the undistributed income in Tax Year 1.

D9.4.3 So the overall effect of the arrangements is:

- to convert overseas tax (which would be subject to restrictions if received in that form) into UK tax subject to no such restriction; and

- to result in the UK exchequer giving credit (or "repaying") tax that has never been paid.

D9.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D9.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

From HMRC's perspective there are a number of distinct indications that the claimed tax outcome is not consistent with the relevant tax rules.

- The first is that UK Bank obtains credit for tax that has not and will not be paid. This is not consistent with the principles of the DTR rules that aim to give relief from double taxation but do not aim (absent express provision to the contrary) to result in double non-taxation.
- The second is that the substance of the arrangement is that UK Bank receives overseas dividend income as part of its trade. Normally s44 TIOPA 2010 would have applied. However, as the income is routed through a UUT the actual treatment is not consistent with those rules.
- The final indication is that the implied basis on which the UUT rules reduce the "collectable amount" in relation to a distribution made in Tax Year 2 is that the source income will have given rise to income tax in Tax Year 1. That however is not the case here as the income is covered by deemed DTR.

D9.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Ordinarily, interests in a UUT would be widely held by unconnected investors. This UUT has been set up for a short period, with just two investors. All the income is received in one Tax Year but the distribution date is fixed for the next Tax Year. The income in the first Tax Year gives rise to little UK tax liability because of the availability of DTR. That DTR does not correspond to any actual net payment of foreign tax. The income arising to the UUT then declines so that when the later distribution of income is made, the trustees are not required to account for income tax.

All of the steps appear to be abnormal and contrived, but in particular the setting up of the passive UUT in order to route MODs through it and thus convert non-repayable foreign tax into repayable income tax is a key abnormal and contrived step since there is no other obvious purpose to setting up the UUT.

D9.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The arrangements intended to exploit two shortcomings of the tax provisions.

- The major shortcoming is the defect in the UUT rules that allowed overseas tax (which is subject to stringent offsetting rules and will not give rise to any repayment by the UK Exchequer) to be converted into UK tax that can be offset without restriction and repaid. This was corrected by changes to the legislation in 2009 to ensure that UUT distributions are treated as foreign income to the extent that they ultimately derive from such income.
- The second shortcoming is that the DTR anti-avoidance rules in s85 TIOPA 2010 (anti-avoidance: schemes about effect of paying foreign tax) did not extend to schemes involving deemed foreign tax such as that attributable to MODs. This was remedied in FA 2010 by the inclusion of the new s85A TIOPA 2010.

D9.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

As described above, the arrangements give rise to repayable tax credit when the economic substance is that in fact no tax was paid.

D9.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

Nothing HMRC has said indicates that HMRC accepted at the time that these arrangements were entered into that they gave rise to the claimed tax result.

D9.6 ***Conclusion***

On the facts given the arrangement is an abusive one to which HMRC would seek to apply the GAAR.

D9.7 ***Proposed counteraction***

The appropriate counteraction would be to treat this as a financial investment giving a normal return taxable (on the same basis as the disguised rules) in the hands of investors. The UUT should be treated as a transparent artifice.

D10 Capital Allowances - Double Dip

This example is intended to illustrate an arrangement which is clearly abusive because it is contrived and seeks to produce tax results which are contrary both to the intended effect of the statute and the economics.

D10.1 ***Summary***

D10.1.1 This example illustrates an arrangement intended to exploit a perceived shortcoming in the tax provision for capital allowances and long lease funding. The arrangement was intended to achieve a tax advantage such that tax relief was given twice on the same expenditure.

D10.1.2 The arrangement involved steps which were abnormal and contrived and the substantive result is not consistent with the principles on which the relevant tax provisions were based. On the facts of the example, the arrangement is abusive and HMRC would be expected to apply the GAAR.

D10.2 ***Background***

D10.2.1 The purpose of the capital allowances regime is to give allowances over the life of ownership of certain qualifying plant or machinery for an amount equal to the net capital cost of ownership of the asset (generally the asset cost less any sales proceeds) during that period.

D10.2.2 The long funding lease legislation differs only in that the person who is entitled to the capital allowances is the lessee of the assets rather than the legal owner (generally the lessor). The net cost principle remains except that the amount of capital allowances available to the lessee should equal the lessee's net expenditure under the lease less any finance charges (these finance charges being separately relievable).

D10.2.3 The long funding lease rules define the capital expenditure for the lessee as including the present value of rental payments under the lease plus the amount of financial guarantees ("residual value guarantees" or RVGs) given by the lessee of the value of leased plant or machinery at the end of the lease. So initially the RVG will be included in the amount on which the lessee claims capital allowances.

D10.2.4 When the long funding lease ends, there is a deemed capital allowances disposal event, with a consequent adjustment to the lessee's capital allowance pool. The disposal value for that event (i.e. the amount excluded from the pool going forward) is reduced by any actual payments made by the lessee under the RVG.

D10.2.5 The effect of this adjustment is that after the disposal event the payment made by the lessee under the RVG will continue to be eligible for capital allowances. In normal circumstances, that is the right outcome because the RVG paid by the lessee represents part of the capital expenditure incurred by the lessee in respect of the leased plant during the lease period (so is properly treated as part of the cost that should be eligible for capital allowances).

D10.3 ***The arrangements***

D10.3.1 Company A sells plant or machinery that it owns and uses in its trade to Company B for 100. The arrangements include the following steps:

- Company B leases the plant or machinery back to Company A for a very short term (a few weeks at most) at commercial rent levels.
- Company A grants a put option to Company B under which Company B can require Company A to reacquire the plant or machinery at a predetermined price (say, 98 of the original capital expenditure of 100). This effectively underwrites or guarantees the residual value of Company B's investment and removes significant asset risk from it.
- Company B grants a call option to a company connected to Company A under which the connected party can require Company B to sell it the plant or machinery also for 98.

D10.4 In practice, the terms of the fee arrangements between Companies A and B will lead to the put option being exercised. The call option is a guarantee mechanism to ensure that if that is not the case the group of which Company A is a member will continue to have the use of the plant or machinery.

D10.5 ***The relevant tax provisions***

Sections 11, 70C and 70E, CAA 2001.

D10.6 ***The taxpayer's tax analysis***

D10.6.1 The leaseback (despite its short duration) falls within the long funding lease rules, with the result that Company A is entitled to claim capital allowances on the present value of the rental payments plus the RVG amount. The present value of the rental payment is 2, so in total 100 goes into Company A's capital allowances pool.

D10.6.2 The exercise of the put option is a disposal event with the result that a disposal value has to be calculated. Company A claims that this disposal value excludes the put option payment as a RVG amount. As a result, 98 of the original capital expenditure of 100 remains in the capital allowance pool.

D10.6.3 Company A also claims that the cost of acquisition of the plant under the put option is qualifying expenditure under s11 CAA 2001 with the result that a separate claim arises in respect of the 98.

D10.6.4 Therefore, the residual value guarantee amount of 98 falls to be taken into account in three ways as follows:

- as part of Company A's initial qualifying expenditure under s70C CAA 2001;
- when paid, as reducing the disposal value computed under s70E CAA 2001; and
- when paid, as qualifying expenditure under the normal capital allowance rules in s11 CAA 2001 upon reacquisition of the ownership of the plant or machinery.

D10.6.5 The consequence if these contentions are correct is that the put option payment enables Company A to retain virtually all of the capital allowances for its expenditure of 100, whilst claiming allowances a second time for that payment on regaining ownership of the asset.

D10.7 ***What is the GAAR analysis under s204(2) of FB 2013?***

D10.7.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The purpose of the long funding lease regime is to provide equality of tax treatment between a leasing transaction which essentially amounts to a funding transaction and a transaction involving acquisition of plant or machinery using actual loan finance (see Explanatory Notes to clause 81 and Sch 8 to F(No 2)B 2006).

The principles upon which the long funding lease regime legislation is based are the same as for capital allowances generally. In other words the net amount of relief available should be equal to the net expenditure over the relevant period. In the lessee's case this excludes financing charges and other amounts - which are otherwise relieved or not allowable (akin to the financing and other costs of a purchaser). Expenditure is relieved once, and once only.

In this context it is clear that the substantive tax result (double relief for the RVG payment) is not consistent with the underlying principles or policy objectives of the relevant tax provisions.

D10.7.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The arrangement does contain a number of contrived and abnormal steps:

- The lease from Company B is of an unusually short duration for the type of plant or machinery involved.
- The lease does not provide finance of any substance for the selling company which continues to have full use of the relevant assets throughout.
- Where Company B is an unconnected third party, the arrangements, exclusive of tax relief claimed, create a pre-tax loss for Company A because of the fees required by Company B to enter into the arrangements. The arrangements involve a company that starts with legal ownership of the asset selling it, immediately leasing it back and then almost immediately repurchasing it. There are not, in any of the cases seen by HMRC, any commercial or economic reasons, real or apparent, for selling the plant or

machinery, leasing it back for less than a month and then buying it back again.

In these circumstances, there is little doubt that the arrangement involves contrived or abnormal steps.

D10.7.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The arguments given in support of the arrangements are based on the "mechanistic nature of the legislation" and "plain words on the page". No regard is had to the purpose of the relevant sections in the scheme of the long funding lease, and the wider capital allowances, legislation.

The arguments are based solely on the wording of s70E CAA 2001 and, in particular, on a perceived shortcoming in the definition of qualifying amount (“QA”) in that it does not exclude a payment made for one purpose - the put option payment said to constitute a residual value guarantee – which also has another purpose, namely to reacquire the plant or machinery. HMRC does not accept this analysis but for the avoidance of doubt s70E was amended by s33 FA 2011 with effect from 9 March 2011 so that any amount "otherwise relievable" is excluded from 'QA'.

D10.7.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

One of the indicators is that the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, (provided that it is reasonable to assume that such a result was not the intended result when the relevant tax provisions were enacted).

In this case Company A seeks over the period of its ownership (first legal, then economic, then legal again) to obtain entitlement to capital allowances significantly in excess of the net cost to it of having the use of that asset. In the example above, the claim would result in a tax loss of 98 that did not correspond to an economic loss.

D10.7.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has never accepted that the arrangements give rise to the claimed tax result.

D10.8 ***Conclusion***

D10.8.1 On the facts given the arrangement is an abusive one to which HMRC would seek to apply the GAAR.

D10.9 ***Proposed counteraction***

D10.9.1 The purpose of the counteraction is to deny to the taxpayer the benefit of any abusive tax advantage. In this example this may be to simply ignore the capital allowances claimed under the lease funding arrangement. However if the facts of the transaction are such that the arrangement has had real economic consequences, the counteraction may need to take into account each of the steps; i.e. that Company A started with legal ownership of the asset, sold it, immediately leased it back and then almost immediately repurchased it. The capital allowance computations for those steps would need to be considered. The same end result might be achieved by recognising the full effective disposal cost when the put option is exercised.

Part III – Income tax

D11 Vaccine Research

This example is intended to illustrate an arrangement which was contrived to generate tax allowances contrary to the policy and principles of the law.

D11.1 ***Background***

D11.1.1 S 437 to s451 CAA 2001 provide for 100% capital allowances for persons who incur capital expenditure on research and development.

D11.2 ***The arrangements***

D11.2.1 The example is based on the recent FTT decision in *The Partners of Vaccine Research Limited v HMRC* TC/2010/0041 and TC/2010/09293. The GAAR analysis focuses on the concept of "expenditure incurred" but does not cover other aspects of the decision including whether the partnership was trading.

D11.2.2 A company ("P Ltd") was engaged in research into developing vaccines against major human diseases. The company needed funding to continue its work and approached the M group of companies to arrange a funding scheme that was low risk for potential investors ("the Class B Limited partners").

D11.2.3 A new partnership was formed "VRLP" and various agreements were entered into over the course of two days which governed obligations of the parties under the arrangements. The VRLP partners included N Ltd, the Class A limited partner and the Class B Limited partners (who were individuals). The partnership agreement provided for all profits and losses to be allocated to the Class B Limited partners.

D11.2.4 The R&D work was contracted by VRLP to N Ltd, and N Ltd entered into a subcontract agreement with P Ltd.

D11.2.5 The investment in VRLP from the Class B Limited partners was £107m. Of this £86m was provided by a lending bank ("Bank 1") on full recourse terms.

D11.2.6 N Ltd also invested £86m in VRLP as a Class A limited partner, the same amount as was loaned to the Class B Limited partners by Bank 1. There was no evidence that N Ltd had any assets beyond £2 issued share capital and there was no new money within the arrangement beyond the £107m raised from the Class B Limited partners.

D11.2.7 The total sum of £193m being the combined investment of the Class A limited partner and Class B Limited partners was paid to N Ltd as the R & D contractor and capital allowances were claimed on that amount.

D11.2.8 VRLP was provided with a guarantee from N Ltd to receive licence fees over the course of 15 years which would meet the obligations of the Class B Limited partners to repay the loan and interest to Bank 1. This was secured by way of a deposit with Bank 2 of an amount of £86m. In addition the Class B Limited partners would receive 10% of any income resulting from the R & D.

D11.2.9 £14m was paid to P Ltd, who actually carried out the research, and the remainder of the funds invested by the Class B Limited partners, after the Bank 2 deposit, was incurred in smaller amounts of fees associated with the arrangements.

D11.2.10 The rights created under the arrangements

- P Ltd assigned rights over 4 patents to N Ltd who assigned the rights to VRLP. VRLP then granted licences to N Ltd to use or deal with any products based on any of the patents. In consideration N Ltd would pay guaranteed licence fees to VRLP over 15 years plus a 10% royalty on any sums received by it or subcontractors from the intellectual property.
- The benefit and burden of the licence agreement (save for the obligation to pay the guaranteed licence fees) was assigned to P Ltd. N Ltd was granted an option allowing it to purchase any rights in any intellectual property arising from the vaccine research.

D11.3 ***The relevant legislation***

Sections 437 to 451 CAA 2001.

D11.4 ***The taxpayer's tax analysis***

D11.4.1 The legislation provides for 100% capital allowances for persons incurring expenditure on research and development. This covers expenditure directly undertaken by the person or undertaken on his behalf. As the whole of the £193m, being the investment in VRLP by the Class A and Class B Limited partners, qualified as expenditure incurred on R & D by VRLP the total amount was available for relief.

D11.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D11.5.1 There is a main purpose of obtaining a tax advantage. The Class B Limited partners put up 25% after fees of the total investment from their own resources. Whilst the balance was on full recourse terms the guaranteed licence fees from N Ltd would cover the interest and capital repayments. If the arrangement succeeded the Class B partners would receive a tax repayment of more than 40% of their total investment compared to the 25% investment plus fees from their own resources. The scheme was marketed as having none of the usual risks of an investment in pharmaceutical research.

D11.5.2 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

In the Supreme Court decision of *HMRC v Tower Mcashback LLP* [2011] UKSC 19, Lord Hope confirmed that the question of whether expenditure had been incurred for the purposes of the CAA required a practical, commercial approach to the reality of the expenditure. In *Tower* it had to be demonstrated that the whole of the claimed expenditure was actually incurred on acquiring rights in the software.

In this case the principles and policy objectives of ss437 to 451 on incurring expenditure for the purposes of R & D are the same.

A claim to have incurred £193m of expenditure where the only money which flowed into the arrangements was the £107m from the Class B Limited partners and where £86m of that sum was required to be placed on deposit with Bank 2 to provide for the repayment of the loans to the investors is inconsistent with these principles and policy objectives.

D11.5.3 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The tax result depends upon the investment by the Class A limited partner which derived directly or indirectly from the funds invested by the Class B Limited partners. This means of achieving the tax result is contrived and abnormal.

The only new money in the arrangement was the amount contributed by the Class B Limited partners and of that sum more than 80% was required to be deposited with Bank 2 in order to secure the repayments of the loans to the Class B Limited partners which had formed 80% of their original investment.

Any partnership losses were to be allocated to the Class B Limited partners. This is abnormal in the context of the alleged investment by the Class A limited partner and the claimed tax result.

D11.5.4 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The scheme was put into effect after the judgment of the House of Lords in *BMBF v Mawson* but before the judgment of the Supreme Court in *Tower* (2011). It may have been anticipated that the provisions were to be read in a more mechanistic way than *Tower* indicates.

To that extent the arrangements were intended to exploit the relevant sections of CAA 2001.

D11.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

No. HMRC had never accepted that capital allowances would be due on an amount of £193m in these circumstances.

D11.6 ***Conclusion***

D11.6.1 These arrangements could not reasonably be regarded as a reasonable course of action in relation to the tax provisions having regard to all the circumstances. The GAAR would apply.

D11.7 ***Proposed counteraction***

D11.7.1 Only the £14m paid on to P Ltd was connected with the research. The relief for the partnership expenditure would be limited to £14m.

D12 Huitson – DTAs

This example is intended to illustrate a wholly artificial scheme that purported to prevent people trading in the UK from being taxed in the UK by exploiting the terms of a Double Taxation Agreement in a way that could not have been intended by the UK and the other State.

D12.1 ***Background***

D12.1.1 This relates to an avoidance scheme which it is said enabled UK residents, through certain provisions of the UK/Isle of Man "IOM" DTA, to carry on a trade or profession in the UK at a very low effective tax rate.

D12.1.2 The UK resident contracted to provide his services through an IOM partnership where each of the partners was a trustee of an interest in possession ("IIP") trust of which the taxpayer was the settlor and life tenant.

D12.1.3 The scheme relied on the provision at Article 3(2) of the UK / IOM DTA which it was claimed exempted from UK tax the share of the partnership profits received in the UK in his capacity as a beneficiary under an IIP trust. No tax was paid in the IOM and the tax paid in the UK was at an effective rate of c.3.5%

D12.2 ***The arrangements***

D12.2.1 A UK resident individual carries on a trade of IT consultant in the UK. The individual enters into a contract to provide his services to an IOM partnership consisting of 5 IOM companies which then contracts out his services to end users. Each IOM company is a trustee of an IIP trust of which a UK resident individual is the settlor and life tenant.

D12.2.2 The partnership therefore comprises five trustee companies of five separate IIP trusts in which five separate UK residents are the settlor and beneficiary of their own IIP trust. The end users make payments to the partnership in respect of services provided by the appropriate individual.

D12.2.3 The individual receives an annual fee of £15,000 from the partnership and additional funds from his trust as beneficiary which are equivalent to the partner's share of the profit of the IOM partnership. The annual fee is taxed in the UK at normal rates but the other funds received from the IOM trustee company are claimed to be exempt from UK tax and also attract no tax in the IOM.

D12.3 ***The relevant tax provisions***

- The UK/IOM Double Taxation Agreement; and
- Section 858, Income Tax (Trading and Other Income) Act ("ITTOIA") 2005.

D12.4 ***The taxpayer's tax analysis***

D12.4.1 It was claimed that where the UK individual received funds from IOM trustees in his capacity as beneficiary of the IOM trust, Article 3(2) of the UK/IOM DTA exempted those funds from UK tax because that Article provides that "the industrial or commercial profits of a Manx enterprise shall not be subject to United Kingdom tax".

D12.4.2 The partners in the foreign partnership are trustees of IIP trusts of which UK taxpayers are the beneficiaries. It was claimed that s858 ITTOIA 2005, which refers to members of a firm, should not apply to the beneficiaries of the trust.

D12.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D12.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The express purpose of DTAs is to avoid double taxation and prevent fiscal evasion, not to facilitate double non-taxation. This is clear from the judgment of the High Court and the Court of Appeal in *R (on the application of Huitson) v Revenue and Customs Commissioners* [2010] EWHC 97 (Admin) and [2011] STC 1860, and the Court of Appeal in the case of *Bayfine UK v Revenue and Customs Commissioners* [2011] EWCA Civ 304.

The GAAR will apply to abusive arrangements where UK tax advantages have been obtained through rights or benefits under a DTA.

The Organisation for Economic Co-operation and Development (OECD) commentary on Article 1 of the Model Tax Convention says at para 9.4:

> "States do not have to grant the benefits of a double tax convention where arrangements that constitute an abuse of the provisions of the convention have been entered into."

Further the predecessor of s858 ITTOIA 2005 had been introduced following an earlier avoidance scheme that sought to allow a UK resident to avoid UK tax upon their UK earnings by the use of a foreign partnership and a DTA. The provision made clear that a DTA could not affect the UK's right to tax its own residents upon income earned in the UK.

D12.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The taxpayer had previously carried on a trade in the UK and paid tax on his profits. He then carried on his trade in the same way but through an IOM intermediary, solely to avoid tax through the terms of the DTA as he understood them.

The involvement of an overseas partnership and trust was contrived and abnormal in the context of a UK individual carrying on a trade in the UK and was described as wholly artificial by the High Court and Court of Appeal in the *Huitson* judicial review proceedings.

D12.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The scheme attempts to exploit the provisions of the IOM/UK DTA to claim that a very low effective rate of tax is paid by a UK resident on profits from a trade.

D12.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

The arrangements result in an amount of income for UK tax purposes (£15,000pa) which is significantly less than the amount for economic purposes (i.e. £15,000 plus the amounts received from the IOM trustees). This could not have been the intention when the relevant provisions were negotiated and enacted.

D12.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC had never accepted that the arrangements gave rise to the claimed tax result. On the contrary HMRC had advised taxpayers that the arrangements did not succeed and advised them to pay tax on that basis.

In the judicial review launched by one of the contractors, Mr Robert Huitson, the High Court judge found, as one of a number of incontrovertible propositions that, “At no time did HMRC accept the interpretation advanced by the claimant, or by other taxpayers who were in a comparable position. On the contrary, HMRC challenged that interpretation.”

D12.6 ***Conclusion***

D12.6.1 On the facts given the arrangement is abusive and one to which HMRC would seek to apply the GAAR.

D13 Working wheels

This example is intended to illustrate a wholly contrived and abnormal arrangement designed to produce a tax loss entirely inconsistent with the legal effect and the economic substance of the underlying transactions.

D13.1 ***Background***

D13.1.1 This is a marketed avoidance scheme, disclosed to HMRC under the DOTAS regime.

D13.2 ***The arrangements***

D13.2.1 In broad outline, the aim of the scheme is to recharacterise a payment that is claimed to be representative of interest on overseas debt securities as a fee for which a tax deduction is claimed under s58 ITTOIA 2005 (incidental costs of obtaining loan finance allowable as a deduction in computing trade profits). The users of the scheme do not sustain an economic loss under the arrangement, apart from professional fees.

D13.2.2 *Preliminary steps - creation of loan notes*

- Offshore bank lends £1m to Alpha co.
- Alpha Co lends £1m to Beta Co for the issue of loan notes (the Beta Notes).
- Beta co lends £1m to Gamma co.

Following these steps, Alpha co holds the Beta Notes and Gamma has £1m cash.

D13.2.3 *The scheme itself*

- A enters into a joint venture with a person carrying on a bona fide trade. A also enters into a loan facility arrangement with Gamma. The funding to be obtained under this facility is genuinely needed for the trade and interest on the borrowing would be admissible as a deduction in computing profits of the trade.

- A enters into a £1m loan facility with Gamma and agrees to provide £5,000 of the Beta Notes as collateral. A obtains the Beta Notes from Alpha under a stock loan. A then transfers the Beta Notes to Gamma as collateral under a mortgage arrangement which contingently provides for return of the securities when the loan facility is withdrawn.
- A agrees that the Beta Notes should be delivered cum dividend but in the event because of a delay in execution the securities that are delivered to Gamma are ex dividend (an interest payment of £500 having just been made). Ordinarily A would then compensate Gamma by paying a compensatory manufactured payment of £500, but in this case the agreement under which the collateral securities are transferred requires A to pay an amount 2,000 times greater than the real interest, so a payment of £1m is made.
- A borrows £1m from Gamma A (a subsidiary of Gamma) and makes the £1m manufactured payment to Gamma. As noted the cash that A used to pay the fee is borrowed from Gamma A. But, subject to the fee being paid, Gamma A assigns the benefit of that loan to a person connected with A or a bare trust of A. This means that A has effectively cleared his debt (since beneficially he or a person connected with him has the right to repayment). Gamma A has not received repayment of its £1m loan but an associated company (Gamma) has benefited by receiving a £1m manufactured payment. There is an offsetting arrangement between Gamma and Gamma A
- A borrows under £1m loan facility with lender co but only up to the amount of his collateral (i.e. £5,000) and uses this money in his joint venture trade.

D13.3 ***The relevant tax provisions***

- Sections 581 and 583, ITA 2007; and
- Section 58, ITTOIA 2005.

D13.4 ***The taxpayer's tax analysis***

D13.4.1 A claims that the manufactured payment is representative of the real overseas interest and therefore comes within s581 ITA 2007. There is no mechanism by which A could treat a manufactured overseas dividend as an allowable trade deduction, but s583 ITA 2007 provides that where a manufactured payment exceeds the underlying real interest of which the payment is representative then the excess is treated for income tax purposes as a separate fee for entering into the arrangement under which it was paid. A therefore claims that £999,500 is a fee.

D13.4.2 A also claims that the arrangement under which the fee was paid was an arrangement for obtaining loan finance. A will claim that the fee is therefore an incidental cost of obtaining loan finance which is mandatorily deductible under s58 ITTOIA 2005 in computing the profits of the trade.

D13.4.3 The resulting losses are relieved under s381 ICTA 1988 (or s72 ITA 2007) and s380 ICTA 1988 (s64 ITA 2007) or against capital gains under s261B TCGA 1992 and s71 ITA 2007.

D13.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D13.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

S583 ITA 2007 was previously para 7 Sch 23A ICTA 1988 prior to the income tax rewrite of the Schedule 23 provisions. Para 7 was an anti-avoidance rule introduced in FA 1991 at the same time as Sch 23A to deal with concerns that the basic manufactured payment rules could be exploited under the law as it stood at the time.

At that time, manufactured payments received by a pension fund formed part of its tax exempt income (SI1995/3036 later formalising the position) whereas a stock lending fee was taxable. So it would have been advantageous for a pension fund that had transferred securities under a stock loan to reduce the fee it would normally charge the borrower but to receive an equivalent increase in any manufactured payment. Para 7(1)(a) accordingly provided that where an amount paid by way of manufactured dividend would exceed the amount of the dividend of which it is representative the excess would be treated as a fee.

What is now s58 ITTOIA 2005 was introduced to give relief for the cost of obtaining finance for business purposes where such costs would otherwise be disallowed as incidental costs of the capital transaction. It was not intended to give relief for an amount which in reality is not an incidental cost but an artificial means of reducing tax liability. It follows that seeking a substantial trading deduction for the notional fee is not consistent with the principles or objectives of the relevant tax provisions.

D13.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Every element of the arrangements is contrived and abnormal. The arrangements existed only to create a tax loss greatly in excess of any commercial loss.

- Gamma A assigns the benefit of a £1m loan to a bare trustee where Gamma benefits to the proportion of 99%. This is abnormal.
- Although the transfer of the loan notes should have been on cum dividend terms, the arrangements are designed to ensure that delivery is of ex dividend notes. This is contrived.
- A agrees to make a non standard manufactured payment of £999,500 to Gamma A in respect of £500 worth of interest and then enters into preplanned arrangements so that it is practically certain that this payment will have to be made. This is abnormal and contrived.

D13.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The scheme seeks to exploit the provisions at s583 ITA 2007 on the basis that they will be held to operate in an entirely mechanical and prescriptive way.

D13.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

The arrangements result in a claimed tax loss which is far greater than the economic loss to the taxpayer. This outcome could not have been intended when the relevant legislation was enacted.

D13.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

This is a disclosed tax avoidance scheme. HMRC has never accepted that these arrangements give rise to the claimed tax result.

D13.6 ***Conclusion***

D13.6.1 On the facts given the arrangement is abusive and one to which HMRC would seek to apply the GAAR.

D14 Astall – Relevant discounted securities

This example is intended to illustrate an arrangement which included abnormal and contrived steps designed solely to produce a tax loss which was inconsistent with the legal effect and the underlying substance of the underlying transactions.

D14.1 ***Background***

D14.1.1 Sch 13 FA 1996 introduced new rules for taxation of profits and losses made by individuals on the transfer or redemption of securities which were issued at a discount. This was to provide a parallel but not identical regime as that introduced for loan relationships for corporate taxpayers.

D14.1.2 The legislation (para 1 Sch 13 FA 1996) introduced a much shorter and simpler method of charging income tax on profits on discounted securities held by individuals. As profits on such securities were taxed as income (which largely accrued from the discount – the coupon being taxed as income in any case) the new legislation allowed losses to be relieved against general income (the old rules contained no provisions allowing losses to be relieved).

D14.1.3 The legislation applies if various conditions are met, one of which is that the securities in question qualify as relevant discounted securities (“RDS”). If the relevant conditions are met then any loss incurred on a RDS can be set against general income of that year only but not against chargeable gains.

D14.1.4 Sch 13 FA 1996 introduced a concept of RDS which differed from the previous incarnation of deep gain securities. Discounts are traditionally measured against the redemption sum. Para 3(3) however measures the gain as 'deep' if it is at least 0.5% per year up to a maximum of 15% for notes of 30 year duration or greater. For securities redeemed in less than a year 0.5% is reduced pro-rata for each complete month.

D14.1.5 The scheme below is intended to exploit those rules by creating an artificial loss to offset against taxable income.

D14.2 ***The arrangements***

D14.2.1 An individual sets up a trust to which he lends money in return for a security which it is said meets the criteria for RDS. Under its deed the trust had to borrow on RDS terms from the settlor on receipt of an accountant's letter (which the promoter provided).

D14.2.2 Under the terms of the issue there are two occasions when the securities could be redeemed for a 'deep gain' within the meaning of para 3(3) Sch 13 FA 1996:

- on maturity after 15 years at gain of 18%; or
- within two months after the issue at a gain of 0.1%.

D14.2.3 The terms of issue also provide that the holder, could, subject to a further condition (i.e. the market change condition) transfer the security to a third party. The market change condition was dependent upon the GBP/USD exchange rate remaining within a range of values set to achieve an 85% chance that it would be met in the short time frame for which it applied. The funds lent to the trust were not invested in USD and the market change condition had no commercial function.

D14.2.4 Once the market change condition was satisfied (in the first month) there were three options available to the individual:

- transfer the loan note to a third party upon which its terms changed the redemption date from 15 to 65 years but the third party could redeem at 5% of the original redemption price (or at its then market value assuming it had 65 years to maturity) or redeem the securities after 65 years;
- redeem the security himself at a 0.1% premium; or
- continue to hold the note until the final redemption date (i.e. 15 years).

D14.2.5 The security was sold to a third party for 5%. No possible purchasers for the notes were solicited until after the note had been issued. The third party subsequently redeemed the securities pursuant to the terms of the issue (i.e. at 5% of the original redemption price).

D14.2.6 The taxpayer claimed a substantial loss, set against other taxable income. With no obligation to hold funds to redeem its security the trust is free to appoint capital or provide facilities to or for the individual.

D14.3 ***The relevant tax provisions***

Schedule 13 of FA 1996 (now repealed and replaced by ITTOIA 2005).

D14.4 ***The taxpayer's tax analysis***

D14.4.1 The taxpayer contends that the securities fall within Sch 13 FA 1996. Specifically, the taxpayer's claim is as follows:

- Under paras 3(1) and 3(3) Sch 13 FA 1996 the transactions in question fall within the definition of "relevant discounted security" and involve "deep gain" (and are not subject to restrictions of paras 3(1A) and 3(1D) Sch 13 FA 1996). This is because at the time of issue the notes may or might have been redeemed at a deep gain (para 3(1)(b) Sch 13 FA 1996).
- Under para 2 Sch 13 FA 1996 taxpayers can claim a loss from the discount on RDS against other income.
- The market change condition and the fact that purchasers were not found for the loan notes until after the issue meant that there was no preplanned transaction by which the notes would be sold to a third party at a substantial loss to the subscriber. What happened was that the early redemption gave the third party purchaser a predictable turn or profit.

D14.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D14.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The purpose of Schedule 13 was to introduce a simple method of charging income tax on discounted securities held by individuals. The legislation allowed loss relief to all investors if the security was disposed of or redeemed at a loss. RDS losses were calculated in the same way as RDS profits. Transactions between connected persons were at market value.

The artificial market condition (called “market change” but in fact meant no change) contingency and the fact that a purchaser of the note would readily be found meant that on a realistic view of the facts the scheme would proceed as planned i.e. to create the loss. This is what participants understood, expected and paid fees for.

It is clear that the substantive tax result (a large tax loss) is not consistent with the principles or policy objectives of the relevant tax provisions.

D14.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

If the true transaction is considered, then it is clear that there are a number of contrived steps:

- Market change condition – it was certain (i.e. 85% certain) that this would take place and the securities would be redeemed by the third party.
- Redemption at the end of 15 years or 65 years – this was a hypothetical possibility but no part of the plan.
- The delay in finding a purchaser for the security.
- If the only real possibility of redemption was considered (i.e. only option 1 above) then it cannot be said there would be deep gain within the meaning of para 3 Sch 13 FA 1996. These steps were inserted merely to obtain a tax advantage.

In these circumstances, there is little doubt that the arrangement involves contrived or abnormal steps.

D14.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The scheme sought to exploit para (3)(1)(b) Sch 13 FA 1996 and the words “may or might be redeemed at a deep gain”.

D14.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

One of the indicators is that the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, provided that it is reasonable to assume that such a result was not the intended result when the relevant tax provisions were enacted.

In this case the taxpayers create a near 95% (of the value of securities) loss by inserting a series of steps that were meant to create uncertainty and qualify the securities as RDS. The taxpayer was made economically whole by receiving interest free loans or appointments of capital or other facilities from their trust. Therefore there was no economic loss but instead a large loss for income tax purposes claimed.

It is clear that providing this outcome was not the objective of the relevant tax rules.

D14.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

Although the legislation intended to allow loss relief on RDS HMRC has never accepted that arrangements of this type which include a series of contrived steps (as described above) give rise to the claimed tax result.

D14.6 ***Conclusion***

D14.6.1 On the facts given the arrangement is an abusive one to which HMRC would seek to apply the GAAR.

D15 David Mayes ("Mayes") v RCC

This example is intended to illustrate an arrangement designed to exploit shortcomings in the relevant provisions, where the purposive approach to statutory construction did not prevent a result which Parliament could not have contemplated when enacting the relevant provisions.

D15.1 ***Background***

D15.1.1 *Mayes v RCC* [2011] STC 1269 concerned a scheme involving a series of transactions in life assurance policies, largely implemented in 2003, that was designed to create an artificial loss in the form of "corresponding deficiency relief". It was a marketed scheme, known as SHIPS 2. HMRC challenged the scheme and was successful before the Special Commissioners but the taxpayer was successful in the High Court and the Court of Appeal. An application for leave to appeal to the Supreme Court was refused. This example considers whether the GAAR would have applied had it been in force when the transactions took place.

D15.2 ***The arrangements***

D15.2.1 The scheme involved a claim for corresponding deficiency relief ("CDR") as it was then known) as a result of a series of steps as follows:

(i) A Jersey resident individual purchased single premium life assurance policies (bonds) from an established insurance company.

(ii) Some months later the bonds were assigned to a Luxembourg company for value.

(iii) The Luxembourg company (the following day) paid very large top-up premiums on the bonds.

(iv) The Luxembourg company (about four weeks later) withdrew all the sums paid up at (iii), on a partial surrender of the bonds.

(v) The Luxembourg company assigned the bonds to a UK LLP (which was related to a promoter of the scheme).

(vi) The UK LLP assigned the bonds to the taxpayer, for a profit. The taxpayer paid about £133,000 to the LLP.

(vii) The taxpayer surrendered the bonds for the remaining available proceeds (by then only some £2,000) and claimed a corresponding deficiency relief of a little under £2m. He also claimed a CGT loss in respect of the difference between the amount actually received on surrender and the amount paid at step (vi). The corresponding deficiency relief, which did not reflect any actual loss, was however what mattered and it was said to arise because of the computational implications of the partial surrender at step (iv).

The law was changed in 2004 to counter tax planning in this area.

D15.3 ***The relevant tax provisions***

Sections 539-554 ICTA 1988.

D15.4 ***The taxpayer's tax analysis***

D15.4.1 The taxpayer contended, broadly, that a mechanistic set of rules provided only for the computation of deemed gains and losses that were treated as arising on particular events. A substantial deemed gain was computed on the surrender at step (iv), because only a very small part of the premium payments was allowed against the partial surrender proceeds. On a partial surrender the life policy rules limit the amount of premium allowed against the surrender proceeds to 1/20 of the premium for each year that has passed, until 20 years have expired. The gain did not produce a tax charge in view of the non-UK taxpayer status of the bondholder at that time but the computational process in turn led to a deemed loss for the taxpayer on the final surrender at step (vii), when the remainder of the premium payments could be taken into account and the gain computed at step (iv) reversed.

D15.4.2 In the *Mayes* case, the High Court and the Court of Appeal accepted the taxpayer's analysis from the viewpoint of the purposive construction of the relevant provisions. Although the courts saw that actual overall gains should be taxed eventually if there was a UK taxpayer bondholder throughout, and identified a legislative policy of discouraging early partial surrenders in excess of the allowable amounts, they also identified arbitrary or unfair results in a variety of circumstances. In the High Court it was said that the rules showed a lack of interest in (a) attributing gains to the person who made them, (b) not attributing them to a person who did not make them or (c) timing the taxation of the gain fairly. Since the legislation did not seek to tax real or commercial gains the view was taken that it made no sense to say that the legislation should be construed to apply to transactions by reference to commercial substance, and an underlying or overriding purpose could not be extracted that would lead to parts of the scheme being ignored.

D15.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D15.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

On the courts' approach the results could be seen as consistent with the mechanistic principles on which the relevant provisions were based, and were not convincingly shown to be inconsistent with any underlying policy objectives. It was the case however that the deemed gain to which the deficiency relief corresponded was never taxed. In the Court of Appeal it was noted by Toulson LJ that "the particular consequences in the present case were obviously not foreseen or intended by the legislature; but legislation, especially highly engineered legislation, can have unintended consequences".

D15.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The transaction steps were contrived and abnormal, especially the large top-up premiums and the surrender at steps (iii) and (iv). Those contrived and abnormal steps were required for the tax result that would then follow, as expected, at step (vii).

D15.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The arrangements were intended to exploit shortcomings in mechanistic rules, designed for life assurance policies that were acquired and dealt with by individuals as ordinary savings products, based on the rules being applied to extraordinary facts and contrived circumstances.

D15.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

The indicators of abusiveness were present. In particular, the arrangements resulted in deductions or losses of an amount for tax purposes that was significantly greater than the amount for economic purposes. In addition, although the courts may be said to have taken the view that the taxpayer analysis could not, as a matter of conventional statutory construction, be shown to be inconsistent with the intention of Parliament, it is clearly reasonable to assume that the result on the extraordinary facts and contrived circumstances was not anticipated at the time when the relevant provisions were enacted.

D15.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

There was no HMRC acceptance of any avoidance schemes designed to exploit the life tax CDR rules.

D15.6 ***Conclusion***

D15.6.1 The taxpayer sustained no economic loss beyond the fees for the scheme, which consisted of abnormal and contrived transactions, including circular and self-cancelling steps. All of the transactions were created solely for tax reasons with a view to the generation of the tax loss. The scheme could not reasonably be regarded as a reasonable course of action and the GAAR would apply.

D15.7 ***Proposed counteraction***

D15.7.1 In the circumstances the just and reasonable counteraction would be to treat the taxpayer as having entered into an arrangement with the scheme provider with no tax consequences (or as having entered into no arrangement).

Part IV – Capital gains tax

D16 Simple QCB/NQCB

This example is intended to illustrate a straightforward legislative choice which may be offered to taxpayers disposing of shares.

D16.1 ***Background***

D16.1.1 The capital gains tax code contains provisions which prevent a capital gain being triggered on a "reorganisation" of share capital. "Reorganisation" treatment usually involves any capital gain on the original asset being "rolled over" into the new asset, i.e. there is no disposal of the original asset but rather the new or altered asset is treated as the same asset as the original asset (s127, TCGA 1992).

D16.1.2 This treatment becomes problematic if shares are exchanged for qualifying corporate bonds ("QCBs"), because gains on QCBs are exempt from capital gains tax (s115, TCGA 1992). If a shareholder disposed of shares in exchange for QCBs, then, on the redemption of the QCBs the capital gain would disappear. Likewise, if non qualifying corporate bonds ("NQCBs") into which a gain had been rolled over were converted into QCBs, normal "reorganisation" treatment would mean that the gain on a disposal of the QCBs would again become exempt.

D16.1.3 Parliament anticipated this problem by enacting special provisions for "reorganisations" involving QCBs. Under these rules, the original asset (e.g. the shares or the NQCBs) is treated as if it had been disposed of for a consideration equal to its market value immediately before the transaction (s 116(10)(a) TCGA 1992). Any chargeable gain or allowable loss that has accrued is postponed, for tax purposes, until the disposal (e.g. the sale or redemption) of the QCBs which represent the original asset (s116(10)(b) TCGA 1992).

D16.1.4 What would happen if the acquiring company became insolvent before the QCBs were redeemed? In that case, the holder of the QCBs would be taxed on the "frozen" gain even though, in economic terms, he or she had sustained an economic loss when the QCBs turned out to be worthless.

D16.1.5 To guard against this risk, many transactions which involve a shareholder selling shares in exchange for loan notes are structured so that the loan notes are NQCBs. If the issuer of the loan notes becomes insolvent before redemption the inherent gain that was rolled over into the loan notes is reduced or eliminated if the loan note holder receives reduced proceeds on redemption. The loan notes can be structured as NQCBs by ensuring that they contain an option permitting redemption of the loan note in a foreign currency fixed by reference to an exchange rate shortly before (but not on) the redemption date. This has the effect of taking the loan notes out of the statutory definition of QCBs at s117 TCGA 1992.

D16.2 ***The arrangement***

D16.2.1 Company B wishes to acquire the entire shareholding in Company A. The offer made to the shareholders is an immediate cash payment of £2m plus £6m payable in 3% loan notes issued by the B group. £2m of the notes are redeemable on each of the first three anniversaries of the completion of the takeover.

D16.2.2 The company A shareholders are concerned that the value of the notes might fall before redemption and wish to ensure that the possible fall in value will be reflected in calculating their capital gains. They ask that the notes include a provision for redemption in a foreign currency so that they are not treated as QCBs.

D16.2.3 Some time after the exchange of the shares for the loan notes one of the former shareholders in Company A decides to leave the UK permanently for Spain and two tranches of his notes, totalling £1m are redeemed while he is resident there. The other former shareholders in Company A redeem their shares whilst UK resident.

D16.3 ***The relevant tax provisions***

Sections 10A and 116 TCGA 1992.

D16.4 ***The taxpayer's tax analysis***

D16.4.1 The cash consideration is charged to CGT on disposal of the shares. The loan notes are not QCBs and therefore part of the gain on this part of the transaction for the former shareholders is deferred until the loan notes are redeemed. Because the notes are not QCBs, the gain will be reduced if they are not repaid in full.

D16.4.2 In the case of the shareholder who became non resident after the exchange of his shares for loan notes, tax is not payable on the redemption of some of the notes because he is not UK resident at the time.

D16.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D16.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The substantive results of the transactions are consistent with the principles on which the relevant provisions are based. All of the shareholders pay CGT on the cash element of the transactions. The UK resident former shareholders pay tax based on any gain calculated using the redemption proceeds from the loan notes. The non resident former shareholder is not regarded as a temporarily non resident and is therefore not liable to pay UK tax on the disposal of his notes.

D16.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

No. The disposal of shares for loan notes is a normal commercial transaction and was initiated by the buyer of the shares. The tax treatment of share exchanges differs depending on whether QCBs or non-QCBs are issued in exchange and the parties may agree to structure the notes in a way that reflects the commercial risks. The taxpayer who moves to Spain has made a decision to leave the UK permanently and as such he is not within the charge to capital gains tax when the notes are redeemed.

This is not a situation where a shareholder intending to leave the UK has asked to receive consideration in loan notes in order to avoid paying tax. The intention to leave the UK could not be regarded as part of the arrangement which included the disposal of the shares for loan notes.

D16.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

No

D16.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

No.

D16.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

Yes. HMRC accept that chargeable gains might be deferred by shareholders accepting loan notes on the disposal of shares. Those notes may be structured as QCBs or NQCBs.

D16.6 ***Conclusion***

D16.6.1 On the facts the arrangements are not abusive and HMRC would not seek to apply the GAAR.

D17 Unconditional contract

This example is intended to illustrate standard tax planning where arrangements are structured so that the disposal of an asset falls within a particular period.

D17.1 ***Background***

D17.1.1 The Government announces at Autumn statement that, from 6 April 20XX, the rate at which chargeable gains are charged to tax will be reduced from the current level.

D17.2 ***The arrangements***

D17.2.1 By the following March, Taxpayer A has concluded negotiations to dispose of land and buildings to Taxpayer B, but ensures that there is no unconditional contract for that disposal until 6 April.

D17.2.2 The sale is completed on 10 May which results in a substantial capital gain to Taxpayer A.

D17.3 ***The relevant tax provisions***

Sections 1, 2 and 28 TCGA 1992.

D17.4 ***The taxpayer's tax analysis***

D17.4.1 The gain should be taxed according to the new rate of CGT in force from 6 April.

D17.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D17.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The substantive results of the transactions are consistent with the principles on which the relevant provisions are based. The rate of capital gains tax has been reduced from 6 April and the disposal is charged according to the rule in s28 TCGA 1992 that a disposal by way of unconditional contract is treated as taking place at the time of the contract.

D17.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Yes. The contract was delayed so as to take advantage of the reduced rate of tax applying from April.

D17.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

No. The gain is charged to tax at the rate of tax in force at the time.

D17.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

No.

D17.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

Yes. Gains are charged at the rate of tax in force at the time of the contract for disposal.

D17.6 ***Conclusion***

D17.6.1 On the facts the arrangements are not abusive and HMRC would not seek to apply the GAAR.

D18 Main residence relief

These two examples are intended to illustrate standard tax planning using claims to principal private residence relief.

D18.1 ***Background***

D18.1.1 S222 TCGA 1992 provides relief from capital gains tax where an individual (or in some cases the trustees of a trust) dispose of a dwelling house which has been the only or main residence of the individual.

D18.1.2 The policy behind the relief is, where property prices are generally rising, to prevent the proceeds of sale of a home - which will typically be invested in a new home – from being depleted by capital gains tax.

D18.1.3 Where an individual has only one home which has been his or her main residence throughout his or her ownership then relief is given in full. Relief may be restricted where a house has not been the individual's main residence throughout his or her ownership, although a number of exemptions are allowed (for instance to allow temporary absences and to allow a grace period to sell an old house after moving into a new one).

D18.1.4 There may be occasions where it is necessary to determine which of two or more residences is a person's main residence for any given period. This question is usually a question of fact to be determined in accordance with the practical reality of where the individual's main home is located. However, within 2 years of acquiring a new residence[3], the legislation (s222(5)) permits the individual conclusively to determine which of two or more residences is his or her main residence. This election may be made for any residence irrespective of the fact that, viewed objectively, a different house is clearly more central to the individual's life.

D18.2 ***The arrangements***

D18.2.1 *Example 1*

H who lives 10 months of the year in his home in Manchester, acquires a holiday home in Cornwall. The holiday home is not let out and H spends 2 months of the year there. H keeps a number of possessions in the Cornwall house and HMRC accepts that the Cornwall house can be considered a residence. Within 2 years of acquiring the Cornwall house, H notes that property prices in Cornwall are rising significantly and believes that he may sell the house within the next few years.

He therefore makes an election – backdated to the date of purchase – to treat the Cornwall house as his main residence even though, viewed objectively, the Manchester house is the centre of H's life. H sells the Cornwall house 4 years' later making a large capital gain. The capital gain is exempt from CGT under main residence relief.

[3] Which may, for instance, include a temporary rented property which the individual does not own.

D18.2.2 *Example 2*

R is extremely wealthy and has several houses outside the UK in which she spends five months of the year with the rest of the time in the UK. She acquires a London flat and she makes a main residence election in respect of it. Four months later, she acquires a country house in Surrey and makes a main residence election in respect of that instead. A year later, she acquires a country house and makes a main residence election in respect of that. Eight months' later she decides to acquire a Scottish estate as many of her friends enjoy countryside pursuits. She makes a main residence election in respect of that. She divides the seven months she spends in the UK between her various residences, spending the week in London and the weekend in her country home and holidays in Scotland. Hence all of them are occupied as a residence.

Dissatisfied with the London flat, a year later, she sells that and buys a larger house in Chelsea, again making a main residence election in respect of that. Shortly afterwards, fed up with the British weather she sells the country home and purchases a property in the south of France instead. However, she does not make a main residence election in respect of the French property. Within the next two years she decides that she prefers France and sells all her properties in the UK.

D18.3 ***The relevant tax provisions***

Sections 222ff TCGA 1992, particularly s222(5)(a).

D18.4 ***The taxpayer's tax analysis***

D18.4.1 In both examples the taxpayer contends that the effect of the s222(5) election is conclusively to determine the question of which of several residences is the main one for the purposes of these CGT rules.

D18.4.2 In example 2, R is likely to claim that once a property has been a main residence by election the last three years of ownership will count even though, with the changing the election, that property had ceased to be her main residence.

D18.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D18.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

In example 1, the substantive results of the transactions are consistent with the principles on which the relevant provisions are based. S222(5) conclusively allows a taxpayer to determine which of several residences is their main one for the purposes of the relief, even though – viewed objectively – another residence is far more clearly the centre of the person's life.

In example 2, the policy of s222(5) is to allow a person who genuinely acquires multiple residences for her occupation to determine which of them should qualify for the relief.

D18.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The fact that (in each example) the election is for a property which is not (viewed objectively) the centre of the person's life might be considered to be abnormal, but as this is the specific effect of the legislation, this would not be considered to be abnormal on its own. Nor is it considered that submitting an election or claiming a relief is itself an arrangement or a contrived step. Buying properties that are occupied as residences and then using the main residence election is using a relief afforded by statute and is not an abusive arrangement. The legislation places no limit on the number of times the election may be swapped.

Consequently in examples 1 and 2 the making of elections does not involve contrived or abnormal steps and is not an arrangement.

D18.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The elections involve making a choice that is clearly afforded by the legislation.

D18.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

It is not thought that making an election is an arrangement in any case.

D18.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has previously indicated its acceptance of the practice of making multiple elections.

D18.6 ***Conclusion***

D18.6.1 On the facts example 1 is entirely uncontroversial and a long way from the type of egregious planning which the GAAR seeks to target. The inclusion of example 1 should not suggest that facts along these lines are even close to the GAAR borderline. Example 1 is simply included to show the range of circumstances which may apply and all the relevant circumstances which must be taken into account.

D18.6.2 For the reasons indicated above, the GAAR would also not apply to example 2, albeit that the facts are more extreme; that R regularly changes main residence election and that properties are sold within 3 years.

D19 Gifts between spouses

> *This example is intended to illustrate standard tax planning on gifts between spouses.*

D19.1 ***Background***

D19.1.1 This example considers the capital gains tax position on an arrangement involving a gift of shares between spouses, followed by death of the transferee.

D19.2 ***The facts***

D19.2.1 In January 2012 Mr and Mrs Jones are told that Mrs Jones is terminally ill. In February Mr Jones gives his shares in an investment company, which are standing at a significant gain, to his wife. Under the terms of her Will as drafted at the date of the gift he will inherit those shares when she dies. Mrs Jones has full capacity at the time of the gift.

D19.2.2 Mrs Jones dies in June and the shares pass to Mr Jones under the terms of her Will. Mrs Jones has not executed a new Will since the gift.

D19.3 ***The relevant tax provisions***

Sections 58, 62(1)(b) and 62(4)(a) TCGA 1992.

D19.4 ***The taxpayer's tax analysis***

D19.4.1 The gift of the shares is a transfer between a husband and wife who are living together. This transaction is treated by s58 TCGA 1992 as taking place for such consideration as will give rise to neither a gain nor a loss.

D19.5 All the assets of the deceased which pass to his or her personal representatives are deemed to have been acquired by them at market value at the date of death under s62(1)(b)TCGA 1992. When beneficial ownership of any asset of the estate passes from the personal representatives to a legatee, S62(4)(a) TCGA 1992 provides that no chargeable gain shall accrue to the personal representatives.

D19.5.1 In summary, there is no chargeable gain on the gift of shares by Mr Jones to Mrs Jones and Mr Jones re-acquires the shares at market value at the date of his wife's death. In effect, the gain that has accrued during the earlier ownership of shares by Mr Jones has disappeared.

D19.6 ***What is the GAAR analysis under s204(2) of FB 2013?***

D19.6.1 The main purpose of the arrangement is to obtain a tax advantage. The gift of shares was made by Mr Jones in the hope of washing out the gains on the understanding that his wife would leave them back to him.

D19.6.2 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

Yes. The principle of s58 TCGA 1992 is to allow assets to be transferred between spouses and between civil partners on the basis of no gain/no loss.

Assets passing on death to personal representatives are treated as taking place at market value and no gain is charged when the assets are passed to the legatees.

D19.6.3 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The means of achieving the tax results depend upon the gift, the death of Mrs Jones and her choosing to leave the shares to Mr Jones in her Will. There are no abnormal or contrived steps here; the transactions are normal arrangements between spouses or civil partners.

D19.6.4 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

No.

D19.6.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

Yes. HMRC sets out in its instruction manuals how these transactions are to be treated for CGT purposes.

D19.7 ***Conclusion***

D19.7.1 These arrangements can reasonably be regarded as a reasonable course of action in relation to the tax provisions having regard to all the circumstances. The GAAR would not apply.

D19.8 ***An alternative arrangement - What if the facts were the same as those above but the gift of shares was made on the day of Mrs Jones' death?***

D19.8.1 HMRC's view is that so long as Mrs Jones was in full capacity at the time of the gift the analysis would be the same and that the GAAR would not apply. This assumes of course that the gift was validly completed prior to death.

D20 Offshore trust and washing out gains – example 1

This example illustrates that where the legislation sets precise boundaries the GAAR will not be in point where taxpayers satisfy the statutory conditions.

D20.1 ***Background***

D20.1.1 S87 TCGA 1992 imposes a capital gains tax charge on UK resident beneficiaries who receive capital payments (whether capital distributions or benefits) from certain non-UK resident trusts once the trust realises capital gains. Hence the capital gains tax charge arises not when the trust gain is made which simply goes into a trust "pool" but when capital is distributed.

D20.1.2 The capital payment is, in the first instance, matched with trust gains arising in the same tax year as the capital payment and reduces those gains accordingly. If the amount of trust gains is less than the payment or nil, that payment is carried back and set against trust gains made in previous tax years. Previous tax years are taken in reverse date order so the surplus payment is first set against the trust gains (if any) of the immediately preceding tax year before any less recent year is looked at. This is called last in first out ("LIFO"). Capital payments to non-residents can also be matched against trust gains even though the non-resident does not pay capital gains tax. This matching without a tax charge is often referred to as "washing out".

D20.1.3 If, after this process is completed, some or all of the capital payment is still unmatched, the surplus is carried forward and matched against trust gains realised in subsequent years. Should more than one capital payment be made in a tax year, all are matched first to the pool of trust gains realised in that tax year. Should the aggregate capital payments to beneficiaries be more than the pool of trust gains, a pro rata proportion of each payment is matched. The rate of tax is increased if trust gains are made but not matched to a capital payment until later years and the rate of capital gains tax is currently a maximum of 44.8%.

D20.1.4 It is therefore possible to wash out trust gains by making a capital payment to a non-resident beneficiary in one tax year and then delaying a capital payment to a UK resident beneficiary until the following tax year when there are no trust gains left to be matched.

D20.2 ***The arrangements***

D20.2.1 A trust resident outside the UK was set up by a now deceased foreign domiciled settlor. The trust is worth £4m, has a pool of trust gains of £2.5m and no accumulated income or offshore income gains. There are no Sch 4C gains.

D20.2.2 There are four beneficiaries, two of whom are resident and domiciled in the UK and two of whom live permanently outside the UK. The trustees have made no capital distributions in recent years and it has been decided to end the trust. The trustees have three options and the taxpayer's analysis on each is as follows:

- **Option 1** - End the trust in Year 1 paying £1m to each beneficiary. The UK resident beneficiaries will each pay UK tax on one quarter of the trust gains i.e. £625,000, at the appropriate rate, since the gains are allocated pro rata to the beneficiaries. The non-resident beneficiaries will pay no UK tax although half the trust gains are allocated to them.
- **Option 2** – Pay the UK resident beneficiaries £2m in Year 1 and the non-resident beneficiaries £2m in Year 2. The UK resident beneficiaries will each pay UK tax on £1m of gains since all the gains are allocated to them on a LIFO basis. The non-UK resident beneficiaries pay no UK tax and no gains are allocated to them.
- **Option 3** – Pay the non-UK resident beneficiaries £2m in Year 1 and the UK resident beneficiaries £2m in Year 2. The non-UK resident beneficiaries pay no UK tax but the pool of trust gains that can be allocated to payments in the following year is reduced to £500,000. £2m of gains have been "washed out". The UK resident beneficiaries each pay capital gains tax on £250,000.

D20.2.3 The trustees therefore choose option 3 resulting in the least amount of tax for the beneficiaries. The UK resident beneficiaries receive their payment later but with less tax payable.

D20.3 ***The relevant tax provisions***

- Sections 87 – 96 TCGA 1992;
- Section 65 IHTA 1984; and
- Annual Tax on Enveloped Dwellings.

D20.4 ***The taxpayer's tax analysis***

D20.4.1 The taxpayer's analysis is as set out above. The taxpayer contends that LIFO should be applied.

D20.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D20.6 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether expressed or implied) and the policy objectives of those provisions?*

The trustees are entitled to organise distributions in a way that minimises tax for the beneficiaries within the range of normal tax planning.

In relation to option 3 the substantive results of the transactions are consistent with the principles on which the relevant provisions are based. The trustees have three different ways of achieving the same result *viz* to end the trust and distribute property equally to the beneficiaries. They are not compelled to choose the one that raises the most tax or the "middle" option. Provided the payments to the non-resident beneficiaries in Year 1 are genuinely intended to benefit them (and the cash will not simply be passed back to the UK residents later) HMRC would not seek to invoke the GAAR. It is clear that the policy of the capital gains tax legislation in relation to capital payments to beneficiaries is to operate a LIFO policy and in some cases this will result in greater tax on UK residents and in some cases less.

D20.6.1 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Delaying payment to UK resident beneficiaries by a year might be regarded as an abnormal step but as this is the specific effect of the legislation it is not regarded as abnormal in the context of achieving the substantive tax results.

D20.6.2 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The anomalies that may arise under the LIFO rules are not seen as shortcomings in themselves but just a necessary result of having a system that allocates gains to capital payments in a certain order.

D20.6.3 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

The arrangements accord with established practice and HMRC has indicated acceptance of the practice.

D20.7 ***Conclusion***

D20.7.1 This is not regarded as an abusive tax arrangement and HMRC would not seek to invoke the GAAR.

D21 Offshore trusts and washing out gains – Example 2

This example illustrates that the inclusion of abnormal steps may cause the arrangement to become abusive in its own context.

D21.1 ***Background***

D21.1.1 As above for example D20. In summary, s87 TCGA 1992 imposes a capital gains tax charge on UK resident beneficiaries who receive capital payments (whether capital distributions or benefits) from certain non-UK resident trusts once the trust has or does realise capital gains. Hence the capital gains tax charge arises not when the trust gain is made which simply goes into a trust "pool" but when capital is distributed. As a result of the way in which the gains are matched with distributions, it is possible to wash out trust gains by making a capital payment to a non-resident beneficiary in one tax year and then delaying a capital payment to a UK resident beneficiary until the following tax year when there are no trust gains left to be matched.

D21.2 ***The arrangements***

Mrs X is non-UK resident and domiciled. Her son Y is UK resident but foreign domiciled and occupies a house owned by a non-UK resident company that is held within a trust. The trustees own no other assets. The property is worth £10m. Gains that have accrued post April 2008 are £4m (£2m on property and £2m on company). The property has not increased in value since April 2013.

The trustees do not want to pay the annual tax on enveloped dwellings and decide to end the trust by liquidating the company. The intention of the trustees and family is that the son should own the property. There is no accumulated income or offshore income gains.

The trustees are advised on two options and the taxpayer's analysis on each is as follows:

- **Option 1** - Trustees pay the property to the son. He receives a capital payment of £10m in the UK to which gains of £4m are attributed. He will pay tax on all the trust gains at 28%. The remittance basis does not apply. There is also a small inheritance tax exit charge.
- **Option 2** – The settlor adds £4m cash to the trust in year 1. In the same year the trust liquidates the company and holds the property direct thus realising the £4m gain. It then pays the £4m cash back to the settlor in the same year. Year 2 - the property is distributed to the son with a small amount of inheritance tax. The £4m cash payment made in Year 1 washes out the trust gains and so on the distribution of the property to the son there is no capital gains tax.

The trustees therefore choose option 2.

D21.3 ***The relevant tax provisions***

- Sections 87 – 96 TCGA 1992;
- Section 65 IHTA 1984; and
- ATED.

D21.4 ***The taxpayer's tax analysis***

D21.4.1 The taxpayer's analysis is as set out above. The taxpayer contends that LIFO should be applied.

D21.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D21.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether expressed or implied) and the policy objectives of those provisions?*

The trustees are entitled to organise distributions in a way that minimizes tax for the beneficiaries within the range of normal tax planning.

However, option 2 is not consistent with the principles on which the relevant tax provisions are based. LIFO was intended to operate on distributions of capital to beneficiaries by matching gains in a certain order. In this case the settlor has added the cash to the trust as part of a pre-arranged scheme to wash out the gains that she knows will be realised and on the basis that she will receive the cash back again. HMRC would seek to invoke the GAAR. The legislation was not intended to allow settlors to add cash to trusts on a short term basis only to receive it back again shortly thereafter and simply as an exercise to wash out gains.

D21.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The addition of cash followed by the payment out is an abnormal step that is contrived.

D21.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

This does intend to exploit a shortcoming in the legislation in a manner where the transactions are intended to have no economic consequences. The settlor has made the gift in the full expectation of receiving the monies back shortly and therefore not losing out.

The position would be different if the settlor had made the gift of cash and the trustees later independently decided in the exercise of their discretion to pay that cash out to other beneficiaries rather than as part of a pre-arranged circular scheme to pass the cash back to the settlor. Then the same issues would not arise.

D21.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has never accepted such practice.

D21.6 ***Conclusion***

D21.6.1 HMRC would seek to apply the GAAR to such arrangements.

D21.7 ***Proposed counteraction***

D21.7.1 The likely counteraction would be that the addition to the trust and payment of cash to the settlor would be ignored and the son will pay tax as under option 1.

D22 Blumenthal – QCB/Non-QCB

This example illustrates a case where the end result is inconsistent with the economic substance of the transactions.

D22.1 ***Background***

D22.1.1 The background to reorganisations involving the issue of QCBs/NQCBs is covered in the simple QCB example (D16) above.

D22.2 ***The arrangements***

D22.2.1 A taxpayer exchanges his shares for cash and loan notes. The loan notes were NQCBs because there was an option permitting redemption in a foreign currency calculated at a rate of exchange three days before redemption.

D22.2.2 Some time later arrangements were entered into with the purpose of temporarily reducing the market value of the loan notes. This was achieved by a Deed of Variation which provided that for a period of about a month the issuer could redeem loan notes at 3% of their par value, but only for new holders of loan notes. The aim was that the new redemption right did not apply to existing loan note holders and so their ability to redeem their loan notes at par was retained, but it was intended that any potential buyer of the loan notes would be subject to the risk of having any loan notes they acquired redeemed at 3% of par. Thus the argument was that the market value of the loan notes, defined by the amount they would fetch on a sale in the open market, would be 3% of par value.

D22.2.3 Immediately afterwards the terms of the notes were varied by removing the option to redeem in a foreign currency thus converting the notes to QCBs.

D22.2.4 The s116(10) TCGA 1992 “frozen gain” was calculated by reference to the low market value of the NQCBs so that a loss for TCGA 1992 purposes was shown on the taxpayer’s SA return.

D22.3 ***The relevant tax provisions***

Section 116 TCGA 1992.

D22.4 ***The taxpayer's tax analysis***

D22.4.1 The loan notes were originally NQCBs and became QCBs when the terms of the notes were varied to remove the option to redeem in a foreign currency. The temporary reduction in value under the Deed of Variation resulted in the frozen gain being calculated using that low value with the result that on redemption a capital loss rather than a chargeable gain arose.

D22.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D22.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

As above, allowing "reorganisation" treatment to apply to transactions involving QCBs would give rise to scope for tax avoidance as it would be possible to avoid realising a capital gain inherent in shares. Parliament anticipated this problem by enacting special provisions for "reorganisations" involving QCBs.

Under s116 TCGA 1992, the gain or loss on the original asset is calculated by reference to its market value immediately before the "reorganisation", but that gain or loss is "frozen" (that is to say it is not recognised for tax purposes) until the QCB is sold or redeemed. The underlying principle is that the actual gain or loss inherent in the original asset at the date of the reorganisation is eventually realised by the taxpayer.

In this context it is clear that the substantive result (a tax loss) where the intention was that the notes would be redeemed at par (such that no actual loss would be realised) is not consistent with the principles or policy objectives of the relevant tax provisions.

D22.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The temporary reduction in value of the notes, in the hands of anyone who acquired them within the one month window, was contrived to reduce the frozen gain. This reduction was also abnormal in the sense that note holders would not normally wish to reduce by 97% the amount they might expect to receive on the disposal of an asset. And the loan notes were in any case to be redeemed at par shortly afterwards. There were contrived and abnormal steps in these arrangements.

D22.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The scheme relies on the rules determining how to compute market value at a point in time, by a temporary and wholly artificial reduction in value and seeks to exploit both the market value provision and the calculation of the s116(10) “frozen gain.“

D22.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

When the notes are redeemed the taxpayer receives par value, which represents a substantial economic gain on the cost of the original shares. Yet for tax purposes he claims a tax loss. This outcome could not have been intended when the relevant provisions were enacted.

D22.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has never accepted that these arrangements give rise to the claimed tax result.

D22.6 ***Conclusion***

D22.6.1 On the facts the arrangements is an abusive one to which HMRC would seek to apply the GAAR.

Part V – PAYE & NICs

D23 Earnings paid by way of a vintage car

This example illustrates how the NIC rules apply when an employer provides a payment in kind to an employee.

D23.1 ***Background***

D23.1.1 Class 1 National Insurance contributions (NICs) are due when a payment of earnings is made to or for the benefit of an employee. "Earnings" includes any remuneration or profit derived from an employment.

D23.1.2 Regulations made under s3(3) of the Social Security Contributions and Benefits Act ("SSCBA") 1992, disregard some payments of earnings for Class 1 NICs purposes. Para 1 of Part 2 of Sch 3 to the Social Security (Contributions) Regulations ("SSCR") 2001 (SI 2001 No 1004) specified the types of payments disregarded, including certain payments in kind. Where a person is provided with a benefit in kind which is disregarded from earnings Class 1 NICs are not due. Rather, Class 1A NICs (employer only liability) are due on the amount chargeable to income tax.

D23.1.3 The scheme below was designed to ensure that no primary (employee) Class 1 NICs are due on the acquisition of an expensive vintage car.

D23.2 ***The arrangements***

D23.2.1 By way of a bonus the employer purchased for its senior employee, who was a vintage car enthusiast a vintage car which he then retains in his collection. The main motive for paying earnings in this form is that the employee does not have to pay primary Class 1 NICs. The bonus is therefore cheaper to fund.

D23.3 ***The relevant NICs provisions***

- Sections 3(1), 3(3) and 6 SSCBA 1992; and
- Reg 25 and para 1 of Part 2 of Sch 3 to SSCR 2001.

D23.4 ***The employer's NICs analysis***

D23.4.1 Although what is provided is earnings what is provided is a payment in kind. The employer contracts with the supplier to provide the vintage car. The supplier bills the employer. The car is a payment in kind specifically disregarded from earnings.

D23.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D23.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant NIC provisions are based (whether express or implied) and the policy objectives of those provisions?*

The substantive results of the transactions are consistent with the principles on which the relevant provisions are based which is that payments in kind are excluded from Class 1 NICs but attract Class 1A NICs. The car was not readily turned to cash and simply formed part of the employee's collection.

D23.5.2 *Do the means of achieving the substantive NICs results involve one or more contrived or abnormal steps?*

No. The payment in kind is not one which was the subject of highly abnormal arrangements resulting in the employee receiving a cash sum.

D23.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant NICs provisions?*

Para 1 of Part 2 of Sch 3 to SSCR 2001 provides that certain payments in kind are disregarded from earnings so that Class 1 NICs are not due on the benefits provided. The cost to the employer to provide the car will be subject to Class 1A NICs liability, which is an employer only liability.

If cash had been paid to the employee, Class 1 NICs would have been due, but it is likely that such an employee would earn above the upper earnings limit for Class 1 NICs and consequently the loss to the NI Fund is 2% of the value of the vintage car.

Although in this case there is a tax advantage because the amount of Class 1 primary National Insurance is reduced, the arrangement lacks contrived and abnormal steps and is consistent with the intended result when the relevant tax provision was enacted. That intention was that employees could be rewarded by way of a payment in kind and that payment would attract Class 1A rather than Class 1 National Insurance. If the car formed part of an abusive arrangement in which the employee then obtained cash for the car, then it would be within the ambit of the GAAR.

D23.6 ***Conclusion***

D23.6.1 On the facts given the arrangement is not an abusive one to which HMRC would seek to apply the GAAR.

D24 XT Logistics – Earnings paid by way of commodities

This example illustrates an arrangement with contrived steps designed to get it within a legislative framework, but which is contrary to the policy and principles of the relevant provisions. The arrangement could also be regarded as an attempt to exploit shortcomings in the relevant provisions, given the statements from ministers at the time.

D24.1 ***Background***

D24.1.1 Class 1 NICs are due when a payment of earnings is made to or for the benefit of an employee[4]. "Earnings" includes any remuneration or profit derived from an employment.

D24.1.2 Regulations made under s3(3) of SSCBA 1992 prescribe that certain payments are disregarded as earnings for Class 1 NICs purposes. Reg 19 of SSCR 1979 (SI 1979 No 591) prescribed that certain payments in kind would be disregarded. However, payments in kind which were commodities capable of being sold on a recognised investment exchange were not disregarded, so where a person was paid earnings by way of such a commodity Class 1 NICs were due.

[4] Includes company directors

D24.1.3 The scheme below was designed to exploit the gaps in the list of payments in kind excluded from the payment in kind disregard so that there was no Class 1 NICs due.

D24.2 ***The arrangements***

D24.2.1 On three occasions between January 1994 and March 1995 XT Logistics ("XT") conferred bonuses on its directors in the form of beneficial interests in platinum sponge. Platinum sponge was not a commodity sold on a recognised investment exchange.

D24.2.2 Two of XT's directors decided how to allocate a pool of money made available for bonuses. The bonuses were calculated in cash and would have been paid in cash but for an intention to minimise liability for Class 1 NICs. Under a plan devised by XT's advisers, XT bought platinum sponge from a bank. On the following day, XT resolved to transfer a quantity of platinum sponge to each director and notified the bank and directors. On the same day each director asked the bank to sell the platinum sponge and to transfer funds to their bank accounts and the bank did as requested.

D24.2.3 The platinum sponge remained throughout in the custody of a bank.

D24.2.4 The draft documentation did not oblige the directors to sell the platinum sponge but that was what was intended.

D24.3 ***The relevant NICs provisions***

When these payments were made the relevant provisions were:

- Section 6 of SSCBA 1992; and
- Reg 19(1)(d) (payment in kind disregard) and 19(5) and Sch 1A to SSCR 1979.

D24.4 ***The employer's NICs analysis***

D24.4.1 The company accepted that a payment of earnings had been made to or for the benefit of the directors when the beneficial interest in the platinum sponge was transferred to them. They did not accept that it was always the intention that the directors would sell back the platinum sponge to the bank to realise cash and contended that what was provided was:

- a payment in kind specifically disregarded from earnings under Reg 19(1)(d) of SSCR 1979; and
- not excluded from being a payment in kind because it was a commodity which was not capable of being sold on a recognised investment exchange.

D24.4.2 The company asserted that the *Ramsay* principle should not be applied to NICs as the answer to whether NICs liability arose was complex and involved "community" law.

D24.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D24.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant NIC provisions are based (whether express or implied) and the policy objectives of those provisions?*

Class 1 National Insurance was levied mainly on a person's cash earnings. The purpose of Reg 19(1)(d) of SSCR 1979 was to disregard non-cash payments from earnings, such as the use of a company asset. It was not anticipated that employees would be remunerated by way of commodities such as platinum sponge, rhodium, cobalt, etc under arrangements whereby they could immediately be converted into cash.

Before these arrangements were used legislation had been introduced on a number of occasions to exclude certain payments from the scope of Reg 19(1)(d). For example, The Social Security (Contributions) Amendment (No. 7) Regulations 1993 (SI 1993 No 2925) inserted legislation which excluded from its scope payment in commodities capable of being sold on a recognised investment exchange ("RIE"). This was on the basis that the provision of such commodities was equivalent to cash payment. All such payments accordingly had to be included in gross pay when calculating Class 1 NICs.

The principles behind the legislation introduced in 1993 were to ensure that where a person was paid earnings by way of commodities capable of being sold on a RIE, such payments of earnings were treated in the same way as payments of cash earnings, i.e. included in gross pay when assessing Class 1 NICs. Ministers made public statements that they had acted to prevent unfair avoidance schemes paying in exotic assets which were then turned to cash.

D24.5.2 *Do the means of achieving the substantive NICs result involve one or more contrived or abnormal steps?*

If the true transaction is considered, then it is clear that there are a number of contrived steps

- purchasing the platinum sponge from the bank
- conferment of the beneficial interest in the platinum sponge to the directors
- sale of the platinum sponge back to the bank.

These steps were inserted merely to obtain a NICs advantage. It was intended that the directors would receive bonuses of a certain cash value and that was what they got.

In these circumstances, there is little doubt that the arrangement involves contrived or abnormal steps.

D24.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant NICs provisions?*

Everything that was done following the company's decision to pay bonuses of a given cash amount was done to ensure that the amount (or very close to it) was received by the directors. The purchase, transfer and re-purchase of the platinum sponge had no commercial or business purpose at all. Neither XT nor the directors had any use for platinum sponge. Platinum sponge is an asset that is an industrial commodity used in the automotive industry.

XT's arrangements sought to exploit a gap in the list of payments excluded from the payment in kind disregard. Platinum sponge is a commodity that is not capable of being sold on a RIE and therefore was not specifically disregarded from earnings for Class 1 NICs purposes. The directors received their cash bonuses by immediately selling the platinum sponge.

D24.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

One of the abusiveness indicators is that that the arrangements result in a taxable amount (i.e. an amount subject to NICs) that is significantly less than the amount of earnings for economic purposes. These arrangements sought to ensure that no Class 1 NICs were due on the value of the platinum sponge and so that the earnings for NICs purposes were less than total earnings.

D24.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has never accepted that where such arrangements were used no Class 1 NICs liability arose.

D24.6 ***Conclusion***

D24.6.1 On the facts given the arrangement is an abusive one to which HMRC would seek to apply the GAAR.

D25 MFC Design – Earnings paid by way of a reversionary interest in an offshore trust

This example illustrates an arrangement which is contrived and abnormal and produces a tax result that is inconsistent with the legal effect of the underlying transaction.

D25.1 ***Background***

D25.1.1 Class 1 NICs are due when a payment of earnings is made to or for the benefit of an employee[5]. "Earnings" includes any remuneration or profit derived from an employment.

D25.1.2 Regulations made under s3(3) of SSCBA 1992 disregarded some payments of earnings for Class 1 NICs purposes. Reg 19 of SSCR 1979 (SI 1979 No 591) specified the disregarded payments, including certain payments in kind. Payments of earnings made through arrangements which are for the purpose of enabling the person to whom the asset is provided to obtain an amount similar to the expense incurred in the provision of the asset are not disregarded from earnings.

5 Includes company directors

D25.1.3 The scheme below was designed to exploit a weakness in the definition of 'trading arrangements' and gaps in the list of payment in kinds excluded from the payment in kind disregard.

D25.2 ***The arrangements***

D25.2.1 The scheme involved a number of distinct steps or transactions set out below, the purpose of which was to pay a cash bonus to one of MFC Design's ("MFC") directors.

D25.2.2 MFC contemplated paying one of the company's directors a bonus of £100,000. The bonus would have been paid in cash but for an intention to minimise liability for Class 1 NICs.

D25.2.3 Under a plan devised by MFC's advisers, a discretionary offshore trust was established. A contribution was made to the trust (borrowed by the settlor). The settlor became entitled to a contingent reversionary interest in a sum equal to the intended bonus, plus a sum in respect of costs. The interest was "contingent" in a theoretical sense only, in reality there was no risk of the contingency not occurring. For all practical purposes the contingent reversionary interest was an entitlement to a specified sum of cash on a future date. The specified sum was the amount of the intended bonus and the specified date being the date on which MFC wished the director to receive the bonus.

D25.2.4 The reversionary interest was assigned to MFC for a consideration equal to the amount of the intended bonus (plus an additional sum representing the fee for entering into the scheme) which was then assigned to the director. The settlement provided that the interest could only be assigned twice, so once assigned to the director there could be no further assignment. On the specified date the director received a cash payment equal to the amount of the intended bonus.

D25.2.5 The series of transactions took place over a period of seven days.

D25.3 ***The relevant NICs provisions***

When these payments were made the relevant provisions were

- Section 6 SSCBA 1992; and
- Reg 19(1)(d) (payment in kind disregard) and 19(5) and Sch 1A to SSCR 1979.

D25.4 ***The employer's NICs analysis***

D25.4.1 MFC contended that the assignment of the interest in the offshore trust to the director, was a payment in kind disregarded from earnings under Reg 19(1)(d) SSCR 1979.

D25.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D25.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant NIC provisions are based (whether express or implied) and the policy objectives of those provisions?*

Class 1 National Insurance was charged mainly on cash earnings. The purpose of Reg 19(1)(d) SSCR 1979 was to disregard non-cash payments from earnings, such as the use of a company asset. It was never envisaged that employees would be remunerated by means of assignment of reversionary interests that then, within 7 days, delivered a sum of cash earnings to the employee.

Before these arrangements were used, legislation had been introduced on a number of occasions to exclude certain payments of earnings from the payments in kind disregard. For example, The Social Security (Contributions) Amendment (No. 4) Regulations 1995 (SI 1995 No 1003) inserted legislation which excluded from this disregard payments for which trading arrangements existed. Ministers had made clear statements that the intention behind those amendments was to prevent the delivery of remuneration in exotic assets which could then be realised for cash.

D25.5.2 *Do the means of achieving the substantive NICs result involve one or more contrived or abnormal steps?*

If the true transaction is considered, then it is clear that there are a number of contrived steps:

- the establishment of a reversionary interest in an offshore trust ('RIOT');
- the purchase by MFC of the contingent RIOTs; and
- the assignment of the interest in the RIOTs to the director.

These steps were inserted merely to obtain a NICs advantage. It was intended that the director would receive bonuses of a certain cash value and that it was what they got.

In these circumstances, there is little doubt that the arrangement involves contrived or abnormal steps.

D25.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant NICs provisions?*

Before these arrangements were used, legislation had been introduced on a number of occasions to exclude certain payments of earnings from the disregard of payments in kind. For example, The Social Security (Contributions) Amendment (No. 4) Regulations 1995 (SI 1995 No 1003) inserted legislation which excluded from this disregard payments for which trading arrangements existed.

MFC's arrangements sought to exploit a gap in the list of payments excluded from the payment in kind disregard and consequently the arrangements were not consistent with the principles on which the NIC provisions are based and the policy objectives of these provisions.

D25.5.4 *Does the arrangement include any of the indicators of abusiveness within s204(4) of FB 2013?*

One of the abusiveness indicators is that that the arrangements result in a taxable amount (i.e. an amount subject to NICs) that is significantly less than the amount of earnings for economic purposes. These arrangements sought to ensure that no Class 1 NICs were due on the value of the reversionary interest in the offshore trust and so that the earnings for NICs purposes were less than total earnings.

D25.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has never indicated its acceptance of these arrangements.

D25.6 ***Conclusion***

D25.6.1 On the facts given the arrangement is an abusive one to which HMRC would seek to apply the GAAR.

Part VI – Inheritance tax

D26 Pilot trusts

This example illustrates a long-established practice approved by the Courts in an area where the law provides deliberately precise boundaries.

D26.1 ***Background***

D26.1.1 Settled property may be chargeable to IHT under the relevant property regime. A charge to tax will arise on the value of the settled property on every tenth anniversary of the settlement and a pro-rata charge will arise whenever property comprised in a settlement ceases to be relevant property. In determining the rate at which tax is charged on settled property, the value of all the property in settlements established by the same settlor on the same day – ‘related settlements’ – is taken into account.

D26.2 ***The arrangements***

D26.2.1 C wishes to leave his estate in trust for his 7 grandchildren. He wants to ensure that these settlements are not subject to IHT after his death. C establishes one settlement per day over a period of 7 days, settling £100 on each. He revises his Will so that he leaves a specific legacy of £250,000 free of tax to each settlement. Following his death, his executors pay the legacies to each of the trustees.

D26.3 ***The relevant tax provisions***

Sections 62, 66 and 68 IHTA 1984.

D26.4 ***The taxpayer’s tax analysis***

D26.4.1 On C’s death, his estate will be subject to IHT and the tax will be borne by the residuary estate. But going forward, each settlement will benefit from its own nil-rate band and the funds added to each of the other settlements will not be taken into account in arriving at the rate of tax as the settlements are not related settlements. Provided that the value of the settled property remains below the IHT nil-rate band, the trusts will not pay any tax.

D26.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D26.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The relevant property regime was introduced in 1982, imposing two charges on property held in settlements. The primary charge is a charge to tax on the value of the property in the settlement once every ten years, with a pro-rata charge on assets ceasing to be relevant property – usually when assets leave a settlement – in the interim. Settlements that are established on the same day are related settlements and the value of property, immediately after they commenced, in related settlements is taken into account in determining the rate of tax that is charged on each settlement.

Because the settlements were created on consecutive days, they are not related settlements and so the rate of tax is calculated without reference to the other settlements, notwithstanding that the substantial addition of funds came about as a result of a single event - C's death.

D26.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Had C's Will established a single settlement for the benefit of all of his grandchildren that trust would have been subject to IHT. And if seven separate settlements had been established by his Will, they would have been related settlements so each would have been taken into account with the other to establish the rate of tax. Establishing the 'pilot' trusts on separate days before death had no purpose other than to put the trusts in a tax-advantaged position.

D26.5.3 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

The practice was litigated in the case of *Rysaffe Trustee v IRC* [2003] STC 536. HMRC lost the case and having chosen not to change the legislation, must be taken to have accepted the practice.

D26.6 ***Conclusion***

D26.6.1 The arrangements accord with established practice accepted by HMRC and are accordingly not regarded as abusive.

D27 Discounted gift schemes and the scope of reservation of benefit

This example illustrates the scope of the gift with reservation of benefit rules as the same have been approved in case law and accepted by long-established practice.

D27.1 ***Background***

D27.1.1 IHT is charged when an individual makes a transfer of assets - either whilst the individual is alive or on death. A number of exemptions and reliefs can reduce that charge, in some cases to nil. Assets that are transferred to another individual outright, or to certain favoured trusts, are exempt from IHT provided the donor survives for 7 years, so reducing the IHT exposure on death. Where, however, an individual gives assets away, but continues to use or enjoy the assets or otherwise benefit from them, the assets are treated as if they were still owned by the donor and are subject to IHT on death under the reservation of benefit provisions. These provisions were introduced in 1986 and (subject to certain statutory let outs) generally prevent the taxpayer from enjoying property after he has given it away. The aim is to stop what are termed “have your cake and eat it” arrangements.

D27.2 ***The arrangements***

D27.2.1 The settlor makes a gift into settlement but retains certain rights in the insurance bond. Typically the rights retained may be in a series of single premium policies maturing on successive anniversaries of the creation of the settlement or to future capital payments if the settlor is alive at the prospective payment date.

D27.2.2 The arrangement is viewed as a "carve-out" or "shearing arrangement" so that provided the rights in the bond retained by the settlor are sufficiently clearly defined he is not taxed on the value of the gifted property. The rights are therefore split into a retained fund for the settlor which is effectively held on a bare trust and a settled fund from which he is excluded and which is held for other beneficiaries such as his children. The retained fund comprises the right of the settlor to withdraw a certain fixed amount – usually 5% from capital each year for the next 20 years if alive. The transfer of value he is treated as making for inheritance tax purposes is the value of the settled fund that he gives away and is substantially discounted as a result of his retained rights.

D27.2.3 ***The relevant tax provisions***

- Section 3A IHTA 1984;
- Section 102 FA 1986; and
- Schedule 15 FA 2004.

D27.3 ***The taxpayer's tax analysis***

D27.3.1 Within the arrangement , B has precisely defined the interest he has retained and the interest he has given away. He cannot benefit in any way from the gifted interest and so there is no reservation of benefit. As the bond has been transferred into the trust, there will be an immediate charge to tax, subject to the value transferred (discounted as noted above) exceeding the nil-rate band. The gift will cumulate with the estate should B die within 7 years.

D27.3.2 As he has effectively 'carved out' an interest for himself within the trust document, the transfer of value for IHT purposes is not the full value of the property transferred to the trustees, but is reduced by the value of the retained interest.

D27.3.3 The arrangements do not give rise to a charge under the pre-owned assets regime.

D27.3.4 HMRC have confirmed in guidance that the retained fund is held on bare trust for the settlor. Hence the para 8 Sch 15 FA 2004 pre-owned assets charge does not apply to this fund and nor does it apply to the settled fund given that the settlor is excluded from this.

D27.4 ***What is the GAAR analysis under s204(2) of FB 2013?***

D27.4.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

Capital Transfer Tax had been a comprehensive cradle to grave tax whereby transfers both *inter vivos* and on death were taxable. With the introduction of the potentially exempt transfer in 1986, however, the majority of *inter vivos* transfers ceased to be immediately taxable and escaped tax altogether provided that the transferor survived the transfer by seven years. This raised the possibility of taxpayers giving away their assets and suffering no IHT charge on that gift but retaining the use of those assets until death. Such arrangements would have driven a coach and horses through the tax and it was to deal with them that the reservation of benefit rules were introduced in 1986. S102 FA 1986 imposes a charge on death where the individual disposes of gifted property and enjoys a benefit in the 7 years prior to death.

In the *Ingram* case, the House of Lords held that the policy of the legislation was to identify precisely what property had been given away by the donor and what (if anything) was retained. They noted that there is nothing in principle behind the "gifts with reservation" provisions that stops the donor carefully dividing up his cake, giving away a slice and retaining the remaining cake. Continued enjoyment of the latter does not amount to a reservation in the former. Arrangements of the type adopted are known as "shearing" operations.

Ss102A–C FA 1986 were introduced to stop shearing arrangements in relation to certain carve out schemes over land. Hence the policy on such arrangements has clearly been altered by legislation and the effect of the GAAR in relation to such tax schemes must be considered in this light. However, this does not mean that all "carve out" arrangements have been stopped. The House of Lords has indicated that such arrangements are not necessarily against the principles behind the legislation and no legislative action has been taken in relation to other types of assets to stop such arrangements. The discounted gift scheme can be seen as a classic shearing operation on property other than land.

D27.4.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Creating two distinct funds or a carve out may be considered contrived.

D27.4.3 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

These arrangements accord with established practice. HMRC's manuals do not suggest that the reservation of benefit provisions should apply in B's situation and confirm that the pre-owned assets regime does not apply. HMRC's Technical Note of May 2007 provides guidance on how the value transferred should be calculated. HMRC will challenge cases where this methodology is not adopted.

D27.5 ***Conclusion***

D27.5.1 Arguably, B's scheme contains a contrived step. It may be argued that it is outside the "spirit" of the reservation of benefit rules in allowing the taxpayer to give away property but still benefit from it. However, the House of Lords has held that carve out arrangements where the taxpayer has carefully defined what he has given away are not caught by the reservation of benefit rules and HMRC has not sought to disturb this ruling in relation to assets other than land. In addition the arrangements accord with established practice and so are not within the scope of the GAAR.

D28 Excluded property trust and debt

This example illustrates how the addition of significant steps to what is otherwise standard tax planning may be sufficient to cross the boundary between the reasonable and the unreasonable while noting that each case will be highly fact dependent.

D28.1 ***Background***

D28.1.1 Settled property may be chargeable to IHT under the relevant property regime. A charge to tax will arise on the value of the settled property on every tenth anniversary of the settlement and an exit charge will arise whenever property comprised in a settlement ceases to be property subject to the relevant property regime.

D28.1.2 Non-UK assets held directly by the trustees in a settlement made by a settlor who was neither domiciled nor deemed domiciled in the UK are excluded from inheritance tax under the relevant property regime. Such trusts are called excluded property settlements. However, where the trustees of such a settlement own UK land or other UK assets directly, those assets are (with limited exceptions) property subject to inheritance tax under the relevant property regime. The exit charge will not apply where such settled property ceases to be relevant property by reason of ceasing to be situated in the UK.

D28.2 ***The arrangements***

D28.2.1 The trustees of an excluded property settlement buy a property in the UK and hold it directly. At the ten year anniversary, the UK property (in the absence of any other arrangements) will be subject to inheritance tax at a maximum of 6%. Shortly before the ten-year anniversary, the trustees borrow funds from a bank and secure the debt on the property. The cash is paid out to the settlor on the understanding that the money will be returned. Shortly after the ten-year anniversary, the settlor adds the funds back to the trust and the trustees use it to repay the loan, freeing the UK property from its charge.

D28.3 ***The relevant tax provisions***

- Sections 48(3)(a), 64, 65(1), 65(7), 162(4) IHTA 1984; and
- FB 2013.

D28.4 ***The taxpayer's tax analysis***

D28.4.1 The value of the UK property that will be subject to tax on the ten-year anniversary is reduced to nil as a result of the debt secured against it, so no tax will be payable in respect of the UK property. The cash borrowed by the trustees is excluded property at the time of the ten-year charge and not subject to tax. The taxpayer claims that he has effected the scheme in such a way that the new anti-avoidance legislation in Sch. 34 to FB 2013 does not apply.

D28.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D28.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The relevant property regime applies to excluded property settlements only if UK property is owned by the trustees directly on the relevant date such as on the ten year anniversary.

By charging the UK property with debt and paying the cash out to the settlor abroad, the trustees have tried to avoid the ten-year charge.

Even if the taxpayer has found a way to circumvent the specific provisions of FB 2013 it is clear that the policy intent expressed there is to prevent a deduction against UK property except where the loan was taken out to acquire the UK property. Using contrived borrowing that is not genuinely used to acquire UK property is clearly against the intent of the legislation.

D28.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Borrowing with the intention of removing the cash from charge and then repaying the loan shortly thereafter is not a normal transaction. Borrowing taken out simply to avoid tax may in this context be regarded as a contrived step.

D28.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The ten-year charge is based on a 'snapshot' of the assets and liabilities of the settlement at the time of the charge. Until FB 2013 there was no specific provision dealing with the deduction of liabilities against settled property, nor could regard be had to the reasons behind borrowing the money. FB 2013 makes it clear that the general intention of the legislation is to grant inheritance tax deductions only in respect of borrowing taken out to acquire the particular property, with only limited exceptions, for example, where the value of the property acquired with the borrowings at the relevant time of charge is less than the amount borrowed (and not artificially devalued) in which case the excess may be set against other property.

If the UK property was sold just before the ten year anniversary, HMRC accepts that the sale proceeds (if retained abroad) would not be subject to inheritance tax. Similarly, if the trustees had borrowed and lost the money on a poor investment the liability could be deducted against the house.

However in this case the UK property continues to be owned before and after the ten year anniversary and one would therefore expect inheritance tax to be due on its value. The real economic value of the UK property has not been reduced; it is always intended to use the cash borrowed to repay the debt as soon as the anniversary has passed and the cash has been paid out of the trust in an attempt to circumvent the provisions but with the parties agreeing in advance that the monies will be resettled shortly thereafter. FB 2013 makes the regime for deduction of liabilities clear and attempts to circumvent this through insertion of more abnormal steps will be caught by the GAAR. In looking at the application of the GAAR it is appropriate to look at the wider context of the transaction before and after the ten year anniversary and in the light of FB 2013 to consider the context in which liabilities have been incurred.

D28.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has not indicated its acceptance of this practice and in the light of FB 2013 it is clear that liabilities may be deducted only if certain principles are satisfied.

D28.6 ***Conclusion***

D28.6.1 On the facts given, the arrangements are abusive arrangements to which HMRC would seek to apply the GAAR.

D28.7 ***Proposed counteraction***

D28.7.1 The liabilities would be ignored in calculating the tax due on the house and the transaction counteracted on this basis.

D29 Bypassing the charge on death with an Employee Benefit Trust

This example illustrates arrangements which are demonstrably contrary to the spirit of the legislation.

D29.1 ***Background***

D29.1.1 IHT is charged when an individual makes a transfer of assets – either whilst the individual is alive or on death. A number of exemptions and reliefs can reduce that charge, sometimes to nil. Transfers of business assets and unlisted shares may qualify for business property relief. Transfers of shares to a trust for the benefit of employees may also qualify for exemption under s28 IHTA 1984. Such a trust is excluded from the relevant property trust regime and gifts to it are not subject to reservation of benefit. The principle behind this part of the legislation is clear in that it is intended to facilitate the future development and succession of a business by providing benefits and incentives for its employees without the overhead of an IHT charge.

D29.2 ***The arrangements***

D29.2.1 S (a widow) wants to minimise her estate's exposure to IHT on her death. She could alter the spread in her investment portfolio by investing in AIM shares, but does not want to take the commercial risk and given her poor health is unlikely to survive 2 years. So she arranges for a private company, ABC Ltd, to be incorporated with an authorised share capital of 20,000 £1 shares. Her advisers initially subscribe for one share each at par. S and her advisers are the only three employees of the company. S then subscribes for 19,990 shares at a premium of £100 per share. The company does not trade, but holds the money on deposit. The directors of ABC Ltd establish an employee benefit trust ("EBT") for the benefit of the employees of the company and their families, whilst at the same time participators, former participators and members of their families are expressly excluded from benefiting from the trust, other than in a way that would give to an income tax charge. S transfers her 19,990 shares to the trustees. S dies.

D29.2.2 Although S established the EBT prior to her death, the same result could have been achieved by including the terms of the EBT in her Will, or the beneficiaries of her estate could have executed a Deed of Variation to establish the trust.

D29.3 ***The relevant tax provisions***

Sections 3, 28, 72 and 86 IHTA 1984.

D29.4 ***The taxpayer's tax analysis***

D29.4.1 When S subscribes for the 19,990 shares, there is no loss to her estate. The terms of the EBT are such that it satisfies the provisions of s86 and does not infringe the provisions of s28, so the transfer of the shares to the trust is exempt under s28. There is no requirement for S to have held the shares for any qualifying period of time or for her to survive 7 years after the gift.

D29.4.2 Following her death, the family are no longer connected to a former participator, so they can now benefit from the trust by way of capital distributions like any other beneficiary. There is a small charge to tax when there is a payment out of the settled property that ceases to be held on an EBT but considerably less than the 40% that would otherwise have been due on S's death. S's investment in ABC Ltd has enabled a significant sum to pass to her children largely free of IHT.

D29.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D29.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

A transfer of shares in a company to a trust for the benefit of all or most of the employees of that company may be exempt under s28, provided that a number of conditions are met, primarily that the trustees hold at least 50% of the shares and the terms of the trust do not allow the settled property to be applied for the benefit of participators, former participators or their families. The intention of the legislation is to provide an incentive to diversify share ownership or at least the benefits of share ownership among a wider group of people who are then incentivised to run the company profitably.

The company has not traded and the only 3 employees of the company are S and her advisers. As a participator, S cannot benefit under the trust (other than receiving income) and she does not intend that her advisers should benefit to any substantial extent. Whilst S is alive, therefore, the trust serves little purpose, other than to provide an income to S. However, on her death, her children are no longer connected to a former participator in the company. Provided that they are employees or otherwise within the permitted class of beneficiaries set out in s86, there is then nothing to prevent the trustees from distributing the trust assets to them with only minimal IHT under s72 IHTA.

Incorporating a company and establishing an EBT in this way where the only people who are ever likely to benefit from the trust property are S's children is plainly contrary to the principles behind the legislation which is to give favoured treatment to trusts for employees of a genuine business. In this case, there is no genuine business that is set to continue and no genuine employees.

D29.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The scheme as a whole is contrived, serving no real purpose other than to allow wealth to pass from S to her children without an IHT charge on her death.

D29.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

Although the definition of "connected persons" is extended for IHT purposes by s270, the normal interpretation, which breaks a connection with someone who has died, continues to apply. S28 does not limit the exemption to employee trusts with a minimum number of unrelated employees.

D29.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has not indicated its acceptance of this practice.

D29.6 ***Conclusion***

D29.6.1 On the facts given, the arrangements are abusive arrangements to which HMRC would seek to apply the GAAR.

D29.7 ***Proposed counteraction***

D29.7.1 The likely counteraction would be to ignore the fact that the trust qualified as an EBT and impose an immediate entry charge on S in respect of the purchase of the trust interest and a further charge if she died within 7 years.

D30 Property excluded from charge

This example illustrates arrangements which seek to circumvent existing targeted anti-avoidance rules in a situation where Parliament has repeatedly provided a "keep off the grass" sign.

D30.1 *Background*

D30.1.1 IHT is charged by reference to a taxpayer's domicile. If a taxpayer is UK domiciled, their worldwide estate is subject to inheritance tax at death or on lifetime transfers. However, a number of specific statutory exemptions and reliefs mean that inheritance tax is often not charged on transfers of wealth. The most obvious is the exemption on transfers of property between spouses and civil partners. Another is the exemption on outright lifetime gifts to individuals provided the donor survives 7 years and does not receive any benefit from the gifted property in the 7 years prior to his death. Gifts into trust are generally taxed less favourably and in particular may be subject to an immediate entry charge of 20%.

D30.1.2 On the other hand, if the taxpayer is neither domiciled nor deemed domiciled in any part of the UK, only transfers of assets situate in the UK are subject to inheritance tax (subject generally to the same exemptions as apply to a UK domiciliary). As far as settled property is concerned, if such property is situated outside the UK it is excluded from IHT if the settlor was not domiciled in any part of the UK when he made the trust. There are certain statutory exceptions to this (for example s48(3A) or ss81 and 82 IHTA that are not dealt with here.)

D30.2 *The arrangements*

D30.2.1 A non-UK domiciled settlor settles £1m on trust for Y (often a company) such that Y Ltd is entitled to the income as it arises for the entire trust period, say 125 years, subject only to the trustees' right to withhold it and accumulate it, with remainder to Z Ltd.

D30.2.2 Y Ltd's income interest lasts 125 years and is assignable but is not sufficient to give rise to an interest in possession for IHT purposes since Y Ltd does not have a present right to present enjoyment of the income; it is sometimes described as an intermediate or *Pearson* type interest.

D30.2.3 The trustees' powers include the power to nominate another person who can then become entitled to the reversionary interest in the trust in place of the current remainderman, Z Ltd. As the trust assets are situated abroad and the settlor was not domiciled in part of the UK, the trust assets, whilst they remain offshore, are excluded from an IHT charge.

D30.2.4 D is a UK domiciliary who wishes to transfer £1m cash to his heirs without having to worry about surviving 7 years. He wishes to retain some benefit from the gifted property and he wishes the gifted property to be placed in trust without an entry charge. Y Ltd and Z Ltd agree to allow D to acquire their interests in the trust in such a way so as to meet those objectives.

D30.2.5 The trustees exercise their powers to nominate D as the reversionary beneficiary under the trust in place of Z Ltd, which nomination becomes irrevocable after a given period of time (effectively after D has acquired the option). Y Ltd grants D the option to purchase its income interest for £1m, exercisable on the payment of a further nominal sum. D transfers his newly acquired reversionary interest to a UK trust, with his heirs as beneficiaries, and then exercises his option to acquire the income interest.

D30.2.6 The right to receive the income from the trust is now part of D's estate but, separate from the reversionary interest, has little or no value since he has no entitlement to the income. Hence it escapes inheritance tax on death. He nevertheless can enjoy the income during his lifetime or it goes to the UK trust.

D30.2.7 Moreover the income interest does not cease on D's death and so devolves under his will to his heirs – usually the beneficiaries of the UK trust. In effect D's heirs have access to both property interests in the trust. £1m has been transferred to D's heirs with no IHT being paid. There are a number of variants of this sort of scheme.

D30.3 *The relevant tax provisions*

Sections 5(1B), 48(3B), 55A, 74A-C and 81A IHTA 1984.

D30.4 *The taxpayer's tax analysis*

D30.4.1 The value of D's estate has been reduced by the £1m used to purchase the trust interests. At the time of the purchase, D exchanged £1m for rights that would enable him to access the £1m in the trust, so there is little or no loss to his estate. As D did not purchase the reversionary interest in the offshore trust, it is not prevented from being excluded property, so no account is taken of the value of the interest when it is transferred into trust, and no charge to IHT arises.

D30.4.2 The purchased income interest is not an interest in possession for IHT purposes, so despite s5(1B) the underlying trust assets do not form part of the taxpayer's estate. The provisions in s48(3B) apply only to purchases of interests in possession in excluded property trusts not to the purchase of other types of interest in such trusts. The nature of the reversionary interest is that alone, it has little or no value, so the charges that normally apply when assets leave a trust will not apply either. The taxpayer has not purchased any settlement powers or a reversionary interest in relevant property.

D30.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D30.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

This scheme is designed to allow a UK domiciled individual to transfer assets into trust for the ultimate benefit of his family avoiding the risk of failing to survive 7 years and the immediate entry charge that should arise on settlement of property into trust or the inheritance tax charge on his death. This is contrary to the long standing basic principles and policy objectives of IHT.

In 2005, Parliament legislated to stop UK domiciliaries from buying interests in possession in excluded property trusts and thereby avoiding inheritance tax in a way similar to that outlined above. Further legislation stopping similar schemes was passed in 2010 and 2012. Therefore even if the taxpayer devises a scheme that is not caught by the specific terms of existing anti-avoidance legislation or he purchases slightly different types of interest or acquires similar interests in a slightly different way this is clearly contrary to the policy and intent of Parliament as expressed by legislation introduced by several different governments.

HMRC does not consider such schemes generally work on their own merits. A number of technical issues have been seen to arise including the fact that the taxpayer may in fact be buying a valueless trust interest if the trustees retain power to alter the trust interests. Therefore immediate tax charges may arise under general principles.

In any event since 2005 Parliament has introduced a number of anti-avoidance provisions – s48(3B) in 2005, s5(1B) in 2010 and s74A-C in 2012 specifically to stop purchases of interests in excluded property settlements.

The arrangements described above are caught by the anti-avoidance legislation in s74A-C introduced in FA 2012.

D30.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Absent the scheme, had D transferred £1m directly to his heirs, there would have been no immediate charge to tax; but had he failed to survive 7 years, it would have been subject to IHT. He would not have been able to benefit from the income.

Had D transferred £1m into trust, there would have been an immediate charge to tax at up to 20% of the value transferred, topped up to a full charge on death within 7 years subject to taper relief if he survived 3 (Section 7(4) IHTA). If he had continued to benefit from the trust then D would have been subject to tax at 40% on his death even on death after 7 years.

These could be described as the “normal steps” that D might take. The steps taken by D are significantly different to these normal steps and can therefore be called abnormal.

The scheme is contrived in that it involves a number of steps that must be executed in a particular order and to a specific time frame to gain the tax advantage.

D30.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

Although it is considered that the above arrangement is caught by the FA 2012 legislation the taxpayer may devise even more complex and contrived variants whereby he acquires a slightly different type of interest in the trust without falling foul of the existing anti-avoidance provisions and thereby exploits shortcomings in the provisions.

D30.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has not indicated that these arrangements give rise to the claimed tax result. Indeed Parliament has repeatedly indicated by passing further anti-avoidance legislation that it is not an acceptable practice.

D30.6 ***Conclusion***

D30.6.1 On the facts given, the arrangements are abusive arrangements to which HMRC would seek to apply the GAAR.

D30.7 ***Proposed counteraction***

D30.7.1 The likely counteraction would be to adopt the policy approach taken in the legislation and impose an immediate entry charge on D in respect of the purchase of the trust interest and a further charge if he died within 7 years.

D31 Lending to fund UK real estate by foreign domiciliary

This example illustrates how standard tax planning may have increasing levels of abnormality attached to it. A number of the alternatives are, nonetheless, clearly on the non-abusive side of the GAAR boundary. However, the example aims to illustrate at approximately what point that boundary is crossed, although – given the condensed nature of the illustration – this will always be highly fact dependent. The example also aims to demonstrate a situation (option 7) where the arrangements might fail a single reasonableness test, but be saved by the double reasonableness test.

D31.1 ***Background***

D31.1.1 IHT is charged on the worldwide assets of someone who is domiciled in the UK, and on the UK assets of someone who is domiciled abroad. Similarly, property situated abroad and held in a trust that was set up by someone who was domiciled abroad is excluded from charge, whereas UK assets owned by such a trust are subject to IHT.

D31.1.2 Foreign domiciled individuals and the trusts created by them may therefore consider using borrowing when acquiring UK real estate, particularly where residential property will be occupied by the individual or their family. Borrowing is now more likely because the alternative strategy to mitigate IHT by property ownership through a corporate structure may trigger the new annual tax on enveloped dwellings and potentially also capital gains tax.

D31.2 ***The arrangements***

D31.2.1 R is domiciled abroad and wishes to buy a valuable house in the UK for his occupation. He has a number of options

1. R buys the house in his own name, using his own cash resources to fund the purchase.
2. R settles cash from his own resources into a trust that purchases the house. R is a beneficiary of the trust. The reasons for using a trust may be partially non-tax related and may include a desire for confidentiality, to avoid complex probate procedures, or to provide an automatic succession plan on R's death.
3. R even if he could have funded the purchase from his existing resources, chooses to borrow from a bank to fund a large part, say 70%, of the purchase price.
4. R (as in 2. above) partially funds the trust. The trustees (as in 3. above) then borrow the remainder of the purchase price from a bank.
5. R deposits foreign investments with a bank thereby enabling the bank to lend a greater amount (say 95%) to fund the purchase of the property. The borrowing is again secured on the property.
6. R having funded a trust to the value of, say, 5%, of the purchase price of the house, agrees to guarantee the trustees' borrowing. This enables R's trust to borrow the remainder of the purchase price from a bank. The borrowing is again secured on the property.
7. R has an existing substantive discretionary trust which he settled many years ago. R is a beneficiary of the trust, but his adult children are also beneficiaries and they have all benefitted from the trust over the years. The trustees previously owned a UK house, but sold it a couple of years ago. The trustees have been looking around for a new UK property suitable for R and his children to use as each of them visit the UK for a few weeks a year. The trustees could afford to buy the new house using existing resources but instead they accept an offer from R to lend them the purchase price via an offshore company that is wholly owned by R. The loan is interest free and repayable on demand. The company owned by R secures the loan on the house.

8. R settles cash from his overseas resources into a newly established trust which then lends it back to him via an underlying company for the purchase of the house in his own name.

9. R adds cash from his overseas resources to a trust, known as the Loan Trust, where he is settlor and beneficiary. His spouse or other relative sets up another trust, known as the Property Trust, which is funded with, say, £1000 cash. R adds no funds to the Property Trust. The Loan Trust forms an overseas company into which the cash is transferred and the company lends the cash to the Property Trustees who acquire the UK property that R wishes to occupy. The loan is repayable on demand and may be interest-free, interest-bearing or index-linked. The Property Trustees incur no personal liability as the lender may have recourse to the house only.

D31.3 ***The relevant tax provisions***

- Sections 48(3)(a) and 162(4) IHTA 1984;
- Sections 102(3) and 103 and para 5(4) Sch 20 FA 1986; and
- Para 11 Sch 15 FA 2004.

D31.4 ***The taxpayer's tax analysis***

D31.4.1 In options 1 and 2 above there is no tax advantage and indeed additional ten year charges arise in relation to option 2. These options are included to illustrate the range of alternatives which R has and by way of contrast with the following options.

D31.4.2 In options 3 and 4 the borrowing provides a clear inheritance tax advantage compared to options 1 and 2. As R is not domiciled in the UK the cash he retains personally abroad is not subject to inheritance tax and the UK property is devalued by commercial borrowing.

D31.4.3 The same tax advantage, albeit to a greater extent, is claimed to apply in options 5 to 9.

D31.4.4 The reservation of benefit rules do not apply to options 1, 3, 5 and 8 because R owns the property. There is a reservation of benefit in options 2, 4, 6 and 7, but the taxpayer argues that this is only on the net value of the property.

D31.4.5 In option 8, the liability is not, it is claimed, caught by s103 FA 1986 as a self-generated liability due to it being funded with excluded property (see s103(4) FA 1986).

D31.4.6 In option 9, there is no charge on the death of R because he has not gifted any property to the Property Trust (so the reservation of benefit provisions do not apply) and he is a beneficiary only of the Loan Trust that holds excluded property. As he has made no gift to the Property Trust, s102 and para 5(4) Sch 20 FA 1986 are not in point. If he has made such a gift then it is argued that the UK property is devalued by the loan taken out to acquire it.

D31.4.7 Pre-owned assets charge does not apply to options 1, 3, 5 and 8 since R has made no disposal of the property and does not satisfy the contribution condition since the property has been acquired by him and not a third person. It does not apply to the other options on the basis that even if the contribution condition is satisfied, the loan in which R reserves a benefit (or in the case of option 2 the house itself) derives its value from the house and therefore protection under para 11(3) Sch 15 is available.

D31.4.8 The liabilities are incurred to buy the UK property and therefore on the face of it are not disallowed by Sch 34 FB 2013.

D31.4.9 HMRC does not accept R's analysis of the legislation and in particular the deductibility of loans against UK property in which he reserves a benefit under options 2, 4, 6 and 7. The GAAR analysis below should be read with this point in mind.

D31.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D31.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

D31.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

It is reasonable to conclude that the obtaining of a tax advantage was the main purpose or one of the main purposes of options 7 to 9. This may not be so in relation to options 3 to 6. R might prefer to borrow from a bank to allow him more flexibility to make other investments with his cash or to preserve his liquidity.

The intention behind the inheritance tax legislation is to tax UK assets and UK domiciliaries. The foreign assets of foreign domiciliaries are excluded property being outside the territorial scope of inheritance tax in the first place, whereas any UK assets they own are subject to tax.

Options 3 and 4 are an application of the rules whereby IHT is chargeable on the net value of UK assets. The fact that R or his trustees could have funded the purchase using foreign investments is irrelevant: R is not compelled to turn assets which are outside the territorial scope of the tax into assets which are subject to tax, whatever his motivation for the borrowing. R's or the trustees' borrowing is a normal commercial transaction and is not contrived or abnormal. While reservation of benefit may be in point the GAAR is not thought to apply.

Options 5 and 6, similarly, represent a commercial decision by R or his trustees. R or his trustees take the commercial risks associated with the additional borrowing and R takes the economic downsides of depositing funds in support of the borrowing/guarantee. Choosing to borrow a higher amount is similarly neither contrived nor abnormal. R takes the economic consequences of borrowing commercially. He may lose the cash he has chosen to place elsewhere. It can reasonably be regarded as a reasonable course of action.

In option 7, loans to trusts do occur for all sorts of non-tax reasons and therefore cannot be considered in themselves to be necessarily abnormal or contrived. Even though the loan is tax-motivated and (in some senses) self-generated, it involves a single straightforward step. The position might well be different, however, if the trust were not established for some time already or substantive: for instance if R were the sole or principal beneficiary or able to direct the trustees or revoke the trust. A loan to such a newly created trust might be considered a contrivance. In the above example the loan may not be mainly tax motivated anyway e.g. the trustees may wish to preserve cash for liquidity purposes, but even if it were the arrangement is still not necessarily abusive.

In option 8, the cash goes in a circle back to the settlor via a trust and loan arrangement. The position might be different under the GAAR if the trust had been in existence for some time so the gift was not made in contemplation of a loan back. The settlor sets up a trust as a vehicle to lend to himself. The setting up of the trust and company is done simply to enable a loan to be made back to the settlor and this is a contrived step. S103 FA 1986 was designed to stop assets being given away that are then lent back by the donee and it may be thought that option 8 is using a possible loophole in s103 to circumvent the intended policy.

In option 9, the combination of a nominal-value settlement specifically set up to own the property coupled with the establishment of a separate loan trust and a corporate vehicle underlying it which is then used to make a loan which is on a non-recourse basis is on these facts set up only to achieve an artificial tax deduction. And, while taken individually, the steps may be considered normal, when taken in combination they may be considered abnormal. However, each case would be taken on its own facts and a situation where, for instance, both trusts were substantial and existing trusts or where the loan was on fully commercial terms or where the property trust was established for a different beneficiary apart from the settlor might be considered differently (see option 7 above).

D31.5.3 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

Neither of the last two options accord with established practice and HMRC has not indicated acceptance of the interpretation that foreign domiciliaries are not caught by s103 as a matter of principle.

D31.6 ***Conclusion***

D31.6.1 Options 1 and 2 do not result in a tax advantage and are included above merely to illustrate the tax advantage of the following options.

D31.6.2 Options 3 and 4 are straightforward applications of the legislation and would not be caught by the GAAR. Similarly, options 5 and 6 involve commercial arrangements which are neither contrived nor abnormal and HMRC would not seek to invoke the GAAR against them.

D31.6.3 With option 7, while economically the liability appears to be self-generated, the trust is of substance and the arrangements are not necessarily contrived or abnormal.

D31.6.4 Options 8 and 9, on these particular facts, would be caught by GAAR. The liabilities would be ignored in calculating the tax due on the house and the transaction counteracted on this basis. However, as with option 7, each case would have to be considered on its full facts and it is not impossible that different scenarios might potentially be saved from the GAAR by the double-reasonableness test.

D31.6.5 With all the options (but particularly options 7, 8 and 9) HMRC would consider whether other legislative means at their disposal should be used to challenge the claimed tax treatment.

Part VII – Stamp duty land tax

D32 Sale and leaseback

This example is intended to illustrate normal tax planning where a taxpayer makes a legitimate choice.

D32.1 ***Background***

D32.1.1 The SDLT legislation contains several reliefs and provisions which determine how the chargeable consideration is calculated.

D32.1.2 One relief is provided for in s57A FA 2003 (sale and leaseback relief). This provides for no SDLT to be charged on any premium payable or on the rent payable under the lease granted to the vendor by the purchaser. The purpose is to avoid an SDLT charge on what is essentially a financing transaction – the vendor obtains a lump sum and pays "interest" in the form of rent to the purchaser. However, once the lease expires, the purchaser will have acquired an unencumbered freehold and so it is appropriate for SDLT to remain due on the purchase price paid to the vendor.

D32.1.3 Another relief is provided for in s62 and Sch 7 FA 2003 (group relief). This provides for no SDLT to be due on transactions between group companies as defined. Schedule 7 contains its own anti-avoidance provisions and for recovery of relief if certain circumstances arise. Group relief has been provided for in stamp duty (the predecessor to SDLT) since 1930 and achieves the policy objective of not imposing a transaction tax where there is no effective change of ownership outside the group, even if the ownership alters as between individual group companies.

D32.1.4 One of the requirements of s57A relief is that the vendor is also the person who takes the leaseback (see s57A(2)(b) FA 2003).

D32.2 ***The arrangements***

D32.2.1 A vendor (X1) wishes to enter into a sale and leaseback arrangement with an unconnected third party (Y) but wants the lease to be vested in X1's subsidiary (X2).

D32.2.2 XI could either:-

- first assign or transfer the property to X2; X2 would issue a debenture to X1, as the consideration for that transfer; X2 sells the property to Y; Y grants the lease back to X2; and in due course X2 satisfies the debenture either out of its own funds or from the cash paid by Y to X2; or
- enter into the sale and lease back in the normal way so that the lease is granted by Y to X1; and then X1 immediately transfers or assigns the lease to X2.

D32.3 ***The relevant tax provisions:***

Sections 53, 57A and 62, Sch 7 and para 11 Sch 17A FA 2003.

D32.4 ***The taxpayer's tax analysis***

D32.4.1 In the first example X2 will seek to rely on group relief so that no SDLT is paid on the assignment or transfer of the property to X2 and that the requirements of sale and leaseback relief are satisfied (so that Y pays SDLT on the purchase price but X2 does not pay SDLT on the premium or rent due under the leaseback).

D32.4.2 In the second example X1 will claim that sale and leaseback relief is satisfied; and X2 will claim that group relief is available so that no SDLT would be payable on any consideration X2 paid (or was treated as paying by s53 FA 2003) to X1.

D32.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D32.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

Looking at the transactions as a whole the property was owned by X, but the leaseback from Y is to X2. Had the transaction taken the form that X1 sold to Y but the lease was granted to X2, sale and leaseback relief would not have been available. Taking account of the fact that, within limits, SDLT group relief is intended to prevent a charge arising where an asset remains within a group, transfer of the property before the sale and leaseback, or assignment of the lease following the leaseback, would seem to be consistent with the principles and policy behind the legislation.

This conclusion is supported by the fact that the anti-avoidance provision contained in paragraph 11 of Schedule 17A FA 2003 (which treats a lease previously granted without SDLT under a sale and leaseback as if newly granted when it is assigned) would apply if X2 assigned the lease outside the X group of companies.

D32.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

While it is commonplace for companies in a group to enter into transactions to cause property, or interests in property, to be transferred to or to become held by other group companies, one view might be that the proximity of the two transactions is abnormal. However in many commercial transactions it is necessary to have sequences of transactions which follow closely upon each other, particularly where outside finance is required and lenders require security over assets.

The creation of a debenture is not unusual although many transactions involving group companies may be carried out in an informal manner.

D32.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

No. X1 and X 2 are just seeking to avoid a “bear trap” insofar as s57A does not permit the leaseback to be granted to any other person than the vendor. They are merely seeking to combine two reliefs.

D32.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

No. The claimed tax result is not in line with any established practice, although the claimed result (subject to any consideration by HMRC of the requirements of Schedule 7, including paragraph 2(4A)) is consistent with the statutory reliefs.

D32.6 ***Conclusion***

D32.6.1 On the facts, the arrangements are not such that HMRC would seek to apply the GAAR.

D33 Extending long lease

This example is intended to illustrate normal tax planning where a taxpayer makes a legitimate choice.

D33.1 ***Background***

D33.1.1 A has leased a property to B, a connected person. B wishes to lengthen the lease (to 35 years) which is assumed to have a further term of 20 years. A could agree that in consideration of A accepting B’s surrender (and B’s agreement that it will take a lease from A) A will grant B a 35 year lease. A and B take tax advice and decide instead that A will grant a 15 year reversionary lease to B (i.e. a 15 year lease which commences when B’s lease expires in 20 years time).

D33.2 ***The arrangements***

D33.2.1 A agrees to grant a reversionary lease to B. The lease terms (apart from the commencement date) could be the same or A could choose to charge a higher rent under the new lease than it currently charges under the existing lease.

D33.2.2 Accordingly, B holds two consecutive leases from A, one for 20 years and the second for 15 years.

D33.3 ***The relevant tax provisions***

Sections 50 and 53, para 5 of Sch 4 and paras 9 and 16 Sch 17A FA 2003.

D33.4 ***The taxpayer's tax analysis***

D33.4.1 The only SDLT liability is on the rent payable under the new lease for the new term of 15 years.

D33.4.2 Had the transaction been carried out by B surrendering to A and A granting a new lease for 35 years then the taxpayer would assert:

- Para 16 Sch 17A has the effect that the value of B's existing lease which B surrenders is not consideration (i.e. a non-monetary premium) for the grant of the new lease by A and that the value of A's promise to grant a new lease to B is not consideration for the surrender of B's old lease.
- If the old lease had attracted SDLT then SDLT would only be due on the additional rent under the new lease compared with that paid under the old lease (if the old lease had attracted stamp duty no "overlap relief" would be available - see para 9(4) Sch 17A – so that SDLT would be due on 35 years rent).

D33.4.3 HMRC's published position is that where A and B are connected persons the consideration is not less than the market value and that the specific provision in paragraph 16 (providing that the new lease is not chargeable consideration for the surrender of the old lease and the value of the old lease does not constitute chargeable consideration for the new lease) has no effect. The language of para 9(2) Sch 17A ("for the purpose of this Part") means that HMRC would accept for the purposes of s53(1A)(b) the rent is taken to be as reduced by the operation of paragraph 9, i.e. SDLT charged on rent as reduced by any overlap relief.

D33.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D33.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The SDLT provisions are designed to charge transactions where interests in land are acquired, whether by grant, transfer or surrender; and to impose SDLT on the consideration (as prescribed by the legislation) provided for leases.

Focussing first on rent, it could be said that by structuring the new lease as a reversionary lease, SDLT on the new lease is reduced as compared with the SDLT that would have been payable under a new 35 year lease where the old lease had attracted stamp duty.

The taxpayer would argue that it has a choice under UK land law in England, Wales and Northern Ireland whether to surrender and obtain a re-grant of a 35 year lease or retain the old lease and obtain a new 15 year lease.

We would accept that the approach in respect of rent is consistent with the policy objectives of the tax.

Focussing on the decision whether to surrender and re-grant, while it could be said that the policy objective is to impose SDLT at a minimum by reference to market values where transactions are between connected persons, HMRC recognise that there are arguments that a general rule (such as s53) is subject to any specific statutory provision also dealing with consideration.

We would accept that a reasonable view of these transactions is that they are consistent with policy and principles.

D33.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Surrenders and re-grants, and the grant of reversionary leases as part of portfolio management, are neither contrived nor abnormal steps.

D33.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

No.

D33.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

Practitioners would argue that until HMRC's stance on the application of s53 became public in 2011, the practice of applying para 16 Sch 17A to transactions between connected parties was understood to accord with HMRC's established practice. HMRC would contend that there was no established practice in this area.

D33.6 ***Conclusion***

D33.6.1 HMRC would not seek to apply the GAAR.

D34 Deferred consideration

This example is intended to illustrate an arrangement which involves inserting abnormal steps into a commercial transaction in order to avoid a TAAR and thereby achieve a result which is inconsistent with the underlying policy of the legislation.

D34.1 ***Background***

D34.1.1 A purchaser who wishes to acquire the property obtains shares for a deferred consideration payable at a specific date in the future. Prior to the purchaser's share acquisition a nominee company unconnected with the property's seller, is granted a long lease for a peppercorn rent.

D34.1.2 This scheme claims to bypass the SDLT anti-avoidance legislation at s75A FA 2003 because of the conditions at s75C(1) FA 2003.

D34.2 ***The arrangements***

D34.2.1 The basic details of the scheme are as follows.

- The seller ("A") enters into a contract to sell the property to the purchaser, ("B") and B pays a deposit to A.
- A then establishes an offshore company (X Ltd.) Initially A owns 100% of the share capital in X Ltd. but before the contract for the land transaction completes, B agrees to buy all the share capital of X Ltd. from A.
- B then arranges for a separate, third party company, (Y Ltd.), to act as bare trustee for X Ltd. in relation to the grant of a lease.
- The money for the shares in X is paid by B to A, the amount involved being the same sum as the price of the property under the "A" to "B" contract. On the same day and as a consequence, the contract between "A" and "B" is rescinded and a 999 year lease at a peppercorn rent is granted by "A" to Y Ltd. to hold the property for X.

D34.2.2 "B" therefore has acquired an interest in the land it wished to acquire albeit via a more complex structure involving a subsidiary company and a bare trustee.

D34.3 ***The relevant tax provisions***

Sections 53, 75A and 75C(1) FA 2003.

D34.4 ***The taxpayer's tax analysis***

D34.4.1 It is claimed that SDLT is not due on any amount paid relating to what is effectively B's acquisition of an interest in the land albeit via a subsidiary company and bare trustee, because a 999 year lease has been granted for no premium at a peppercorn rent.

D34.4.2 S 53 FA 2003 applies where the purchaser is a company connected with the vendor and imposes a market value charge to SDLT on the property transferred. However in this scheme it is said that s53 is not triggered when the lease is granted by A to Y Ltd as para 3(3) Sch 16 FA 2003 is said to treat Y Ltd as the purchaser, and neither X Ltd nor Y Ltd, at the time the lease is granted, has a connection with the vendor, A.

D34.4.3 S75A FA 2003 would seek to impose a notional transaction between the person who has disposed of a property, and the person who acquired it. S75A also sets out the chargeable consideration for the notional transaction.

D34.4.4 However it is claimed that the amount paid for the shares, which is the only activity for which money or money's worth has been paid, cannot be treated as chargeable consideration for any notional transaction under s75A because of the conditions at s75C(1).

D34.4.5 The provisions at s75C(1) say that consideration for the transfer of the shares, which was the first of a series of scheme transactions, ought to be ignored for the purposes of s75A. Hence, s75A does not result in a greater tax liability for the parties than arises under the scheme undertaken.

D34.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D34.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

S75A FA 2003 was introduced to impose a notional transaction in circumstances where:

- a person disposes of land (V);
- a person acquires that land (P);
- there are a number of transactions or steps involved in connection with the disposal; and
- the end result is that a reduced SDLT liability arises.

In those circumstances, s75A imposes a notional transaction between V and P, the aim being in simple terms for the chargeable consideration to the notional transaction to be the higher of the amount that V received for the scheme transactions or any person gave for the scheme transactions.

S75C(1) FA 2003 states: “A transfer of shares or securities shall be ignored for the purposes of s75A if but for this subsection it would be the first of a series of scheme transactions.”

When s75A was introduced there was concern it could possibly attack some unintended targets. For example, a property may have been held by a company as its only asset for many years. The shares in that company may then be acquired by new parent, P Ltd, which then liquidates the company and the property is distributed to P Ltd.

Whilst the transfer of the property to P Ltd on liquidation may be for no consideration, s53 of FA 2003 may impose a market value charge. However s54(4) disapplies s53 on the distribution out of the assets of a company.

HMRC did not want s75A to change the policy, however, this scheme seeks to apply s75C(1) to a company that has not had a long standing interest in property thereby undermining s75A. HMRC would seek to invoke to the GAAR for this scheme.

This is because the additional steps involved:

- B acquiring X;
- the third party company, Y Ltd at B’s instruction acting a bare trustee for X;
- rescission of the original contract; and

- the grant of a 999 year lease for no consideration and a peppercorn to the bare trust;

would seem to be entirely contrived to gain a tax advantage, especially as B's original intention, by entering into a contract for a land transaction with A and paying a deposit, would appear to have been to acquire the property in the usual way.

D34.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Yes.

In this scheme the seller owned the property and has disposed of all but a reversionary interest in it, receiving a sum of money equating to what is envisaged to be the desired price, albeit via a share purchase and a long lease rather than an outright freehold sale.

B has acquired a valuable interest (the 999 year lease) in the property albeit via a more complex structure involving a subsidiary company (X Ltd.) and a bare trust.

If the property transfer had involved a straightforward land transaction in the usual way, HMRC expects that A would have sold the property and B would have acquired it having paid the purchase price and having become liable to SDLT. If the transaction the parties had intended to enter into involved the grant of a lease to X or a bare nominee for X, that would have attracted SDLT (and/or, if the vendor was a company, a degrouping charge, depending on the order of events).

The steps in the scheme are contrived compared with the steps that would be followed if the land was acquired in the ordinary way.

D34.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

Not shortcomings in the legislation necessarily, rather abnormal steps have been taken by B.

By claiming the acquisition of the shares in X is the first scheme transaction for the purposes of s75A, B seeks to invoke the conditions at s75C(1), B then argues that the amount for the transfer of shares should be ignored as a scheme transaction under s75A to reduce the chargeable consideration under a notional transaction.

D34.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

No, the claimed tax result is not in line with any established practice.

D34.6 ***Conclusion***

D34.6.1 On the facts given, these arrangements are abusive tax arrangements to which HMRC would seek to apply the GAAR.

D34.6.2 The only or significant purpose of these arrangements would appear to be SDLT avoidance which is inconsistent with policy and involves contrived or abnormal steps.

D35 Sub-sales

This example is intended to illustrate an arrangement where contrived or abnormal steps have been inserted into a transaction to avoid tax in a manner inconsistent with the policy and principles underlying the relevant legislation.

D35.1 ***Background***

D35.1.1 S42 FA 2003 introduced SDLT, providing for it to be charged in respect of UK land transactions from 1 December 2003.

D35.1.2 S45 FA 2003 provides relief where a purchaser's rights under a contract for a land transaction are transferred to a third party before the contract is completed. The intention is that where a purchaser is essentially acting as a conduit for an ultimate purchaser of all or part of the land, there should not be a double charge to SDLT.

D35.1.3 Such a transfer can take the form of a sub-sale, assignment, or any other transaction that results in the third party being entitled to acquire all or part of the subject matter of the contract. Any such transaction is referred to for SDLT purposes as a ‘transfer of rights’.

D35.1.4 If the original transaction ("the A to B transaction") completes at the same time as (and in connection with) the second transaction ("the B to C transaction") then the completion of the A to B transaction is disregarded and there is no charge on B. The intention, however, is that ordinarily there should be a charge on C.

D35.2 ***The arrangements***

D35.2.1 A agrees to sell land to B, and B agrees to sell the same land to C.

D35.2.2 At the same time as the completion of the A-B contract, the B-C contract completes. This acquisition is effected by means of a 'transfer of rights'. B argues that no SDLT is due as the completion of the A-B contract is disregarded by s45 FA 2003, whilst C argues that he has no or a reduced SDLT liability because of the application of the conditions at s45(3) FA 2003 (see the examples below for more detail).

D35.3 ***The relevant tax provisions***

Sections 45 and 75A FA 2003.

D35.4 ***The taxpayer's tax analysis***

D35.4.1 B contends that no SDLT arises because of s45 FA 2003 as his rights to the property acquired from A were transferred at the same time and in connection with B's immediate/subsequent sale to C. However, C then contends that it has no or a reduced liability to SDLT and this could be for a number of reasons, e.g. because of C's connection with B or because of a relief that C states it is entitled to claim or because the payment made by C is within the zero rate SDLT band.

D35.4.2 *Examples*

- B and C are husband and wife respectively. Hence C contends that no charge to SDLT arises because she has not paid anything to her husband for the land, and therefore has no tax liability.
- Company B, owned by the purchaser C, enters a contract to buy the property but then claims to distribute this property as a dividend to C. B and C claim that Company B's purchase is disregarded under the SDLT rules at s45 FA 2003, and, as C itself has not paid anything for the property, it doesn't have to pay SDLT either.

- A agrees to sell land to B, and B agrees to sell the same land to C which is a partnership where the partners are B and persons connected with him. At the same time as the completion of the A-B contract, the B–C contract completes. B argues that no SDLT is due as his contract is disregarded by s45 FA 2003 whilst C argues that it has no or a limited liability to SDLT because of the connection with B under the provisions of Part 3 Sch 15 FA 2003.
- C is a trust that is connected with B who is the beneficiary and settlor of the trust. B acquires the land from A (an unconnected third party), then takes advantage of the transfer of rights rules at s45 FA 2003 to sell the land to C, who purchases the land for a small sum. B argues that no SDLT is due as his contract is disregarded by s45 FA 2003, C contends it has paid the full asking price in the contract with B and, as the amount involved is within the SDLT zero rate band, no tax liability arises.

D35.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D35.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The provisions at s45 FA 2003 apply where, broadly speaking, person A agrees to sell land to person B, but before that original transaction is completed, person B agrees to sell the same land to person C (or person B agrees to transfer its rights under the original contract to C).

The transfer of rights to C is not regarded as a land transaction – rather C is treated as the purchaser under a notional "secondary contract". On completion of C's acquisition, C is charged SDLT on the aggregate of the consideration given for the transfer of rights plus any consideration given by C (or any connected party) under the original contract.

If the A to B transaction completes at the same time as (and in connection with) the B to C transaction, then the completion of that transaction is disregarded and there is no charge on B, only on C.

Hence, the transfer of rights rules were intended to prevent a double charge to SDLT when a person B has entered into a contract to buy land but wishes to pass some or all of that land on to another person, C, without ever actually taking possession of the land. In the absence of the transfer of rights rules, a double charge could arise if B substantially performs or completes its contract at the same time as the land is conveyed to C.

Situations where these rules in practice prevent a charge applying to an intermediate purchaser of land are:

- a contract for a parcel of land is entered into but B only wants part of this land and, before substantial performance of the contract, B enters into an agreement to sell the unwanted part to C;
- B contracts to buy land on behalf of another person C who may at the time not exist (a new charity, for example);
- it is desirable to keep C's identity secret; or
- a person buys land "off plan" before construction is complete and then is unable or unwilling to take possession (say, because of a deterioration in the person's finances) but immediately conveys the land to a third person C instead.

The underlying principle of the provisions at s45 FA 2003 is therefore to avoid a double charge to SDLT. In all of the above scenarios, however, a charge to SDLT does eventually arise to C. The distinction between these commercial situations when compared to examples 1-4 in section D35.4.2 above is that, in the examples, no charge to SDLT arises on C because:

- C is connected with B;
- C states it is entitled to claim a relief;
- The payment made by C is within the zero rate SDLT band; or
- C has entered into arrangements under which there is no change in beneficial ownership of the property despite the transaction involving the trust, as it is a nominee for B, and hence there is no real B to C transaction consistent with policy.

D35.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Yes, SDLT subsale avoidance involves the contrived insertion or presence of an extra, unnecessary step in the transaction. There is no obvious commercial reason for transferring the property twice – the purpose appears to be entirely to mitigate the SDLT charge. Hence if the property was acquired in the normal way, this extra step would not be usual or necessary, so with regard to examples 1-4 above:

- C (the wife) could have purchased the property directly;
- Since C would have needed to put Company B in funds to pay A, C could have purchased from A direct;
- In the partnership example, B and his partners could have bought direct; and
- Either B as beneficiary or C as trustee could have paid the arms length price direct.

D35.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

Yes. S45 FA 2003 is in place to assist bona fide transactions and prevent a double charge to SDLT, not to exempt land transactions entirely from SDLT.

D35.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has never accepted that the arrangements give rise to the claimed tax result. HMRC has published advice to this effect in its technical guidance about s75A FA 2003 and in Spotlights Article 10.

D35.6 ***Conclusion***

D35.6.1 HMRC considers that the transfer of rights rules have been subject to abuse that seeks to remove not just a potential double SDLT charge, but even a single charge on purchases of property.

D35.6.2 On the facts given, the various SDLT subsale avoidance schemes involve abusive arrangements to which HMRC would seek to apply the GAAR.

D36 Partnership and bare trust over property

This example is intended to illustrate an arrangement where a taxpayer has sought to obtain a result not intended by Parliament by using an anti-avoidance provision with a view to securing a tax advantage.

D36.1 ***Background***

D36.1.1 S42 onwards of FA 2003 implemented SDLT for UK land transactions from 1 December 2003.

D36.1.2 This avoidance structure seeks to exploit the (artificially created) connection between vendor and purchaser in order to ensure that the transaction falls within the legislation at Schedule 15 (for the partnership computational rules) and paragraph 3 (3), Schedule 16, FA 2003 (relating to bare trusts).

D36.2 ***The arrangements***

D36.2.1 This scheme has several different variants but by way of a simple example is structured as follows.

D36.2.2 Instead of a usual land transaction between the seller and purchaser, the parties instead form a partnership, where the seller is the 99% partner and the buyer the 1% partner. The purpose of the partnership is to act as bare trustee for the buyer.

D36.2.3 The seller then grants a long lease, say for 999 years, to the partnership in return for a premium which is paid either by the buyer directly to the seller, or the partnership, having been funded by the buyer. The amount of the premium is the same as the price the seller required for the property if they had sold the property in the usual way.

D36.2.4 Provided the buyer and seller can live with being in partnership with each other, the buyer has acquired the interest in land they desired, albeit through the partnership, and the seller has received the capital sum they wanted from the sale.

D36.3 ***The relevant tax provisions***

Part 3 of Schedule 15 and paragraph 3(3) of Schedule 16 FA 2003; and

D36.4 ***The taxpayer's tax analysis***

D36.4.1 The partnership acts as a bare trust and the provisions at paragraph 3, Schedule 16, FA 2003 apply. The grant of the lease involves the acquisition of a SDLT chargeable interest. Paragraph 3(1) of Schedule 16 provides that where a person acquires a chargeable interest as bare trustee, the SDLT legislation applies as if the interest were vested in the trustee, and the acts of the trustee in relation to it were the acts of the person or persons for whom he is trustee.

D36.4.2 Para 3(3) states that sub-para 1 does not apply to the grant of a lease. Therefore, the purchaser, i.e. the tenant under the lease, for SDLT purposes in this scheme is claimed to be the partnership and not the buyer.

D36.4.3 The provisions at part 3 of Schedule 15, FA 2003 are in point. The seller is a member of the partnership and paragraph 10(1)(a) of Schedule 15 applies. The chargeable consideration is determined by the formula at paragraph 10(2): this legislation provides that the chargeable consideration = MV x (100-SLP)%. The figure representing the SLP (sum of the lower proportions) is determined by the formula in paragraph 12 of Schedule 15, FA 2003.

D36.4.4 For the purposes of paragraph 12, the seller is the relevant owner and the only corresponding partner, entitled to the chargeable interest out of which the lease was granted, and is a member of the partnership. Paragraph 12 requires that the lower proportion for each corresponding partner in relation to the relevant owners is the proportion of the chargeable interest attributable to the partner or if lower, the partner's partnership shares immediately after the transaction.

D36.4.5 The seller is a 99% partner and the proportion of chargeable interest attributable to it before the transaction was 100%; therefore the lower figure is 99 which is the SLP.

D36.4.6 The proportion of the market value of the lease taken to be chargeable consideration is 1% of the premium or MV x (100-99)%, which results in a SDLT liability on the buyer of 1% of the total premium paid.

D36.5 ***What is the GAAR analysis under s204(2) of FB 2013?***

D36.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

The structure of the scheme combines SDLT provisions contained in Schedule 15 part 3 and Schedule 16 to achieve the desired result.

HMRC would argue this is an entirely artificial structure designed to avoid SDLT. The tax would have been paid had buyer and seller undertaken a land transaction in the usual way. On the facts there appears to be no other reason for buyer and seller to form a partnership other than to enter into a scheme whose only purpose is to avoid SDLT, and by having the partnership holding as nominee for the buyer in effect the seller has no rights to income to justify the charge on the acquisition by the partnership being limited to 1% of the premium paid.

D36.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

Yes.

In this scheme the seller owned the land and has disposed of it, receiving a sum of money equating to what is envisaged to be the desired price, albeit via a long lease and a continuing interest via a partnership, rather than an outright freehold sale.

The buyer has acquired a valuable (999 year leasehold) interest in the land albeit via a more complex structure involving a minority partnership interest and a bare trust.

If the property transfer had involved a straightforward land transaction in the usual way, HMRC expects the seller would have sold and the buyer would have made the purchase paying the purchase price and becoming liable to SDLT.

The steps in the scheme:

- setting up a partnership with the seller holding the overwhelmingly major share,
- having this partnership act as bare trust for the buyer,
- then transferring almost all of the value in the land by granting a 999 year lease,

are additional and unnecessary compared to those that would be taken if the land was acquired in the usual way.

D36.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

Not shortcomings in the legislation necessarily, rather abnormal steps have been taken by the parties to enable the buyer to avoid SDLT.

Paragraph 3(3) was intended to prevent avoidance but because it operates automatically, rather than only where there is an avoidance motive, it can be combined with other provisions at Part III of Schedule 15 to achieve an unintended result.

D36.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

No, the claimed tax result is not in line any established practice.

D36.6 ***Conclusion***

On the facts given the arrangement is an abusive one to which HMRC would seek to apply the GAAR.

Part VIII – Commencement

D37 Commencement provision: section 214 of FB 2013

D37.1 The GAAR applies to all tax arrangements entered into on or after the day on which Finance Act 2013 is passed, which is the day on which Finance Bill 2013 receives royal assent.

D37.2 It does not apply to any tax arrangements entered into before this date.

D37.3 A tax arrangement entered into on or after the day on which Finance Act 2013 is passed (a "Post-Commencement Tax Arrangement") may form part of a broader arrangement which was entered before this date (a "Broader Arrangement"). This results from the broad and flexible meaning of "arrangements" (see Part B of the Guidance).

D37.4 The Broader Arrangement cannot be taken into account by HMRC for the purposes of allowing HMRC to show that the Post-Commencement Tax Arrangement is abusive. This prevents HMRC being able to use a pre-commencement event to taint a Post-Commencement Tax Arrangement and thus extend the scope of the GAAR.

D37.5 The taxpayer can take into account a Broader Arrangement for the purposes of showing that a Post-Commencement Tax Arrangement is not abusive.

D37.6 The effect of these rules is that where it is not possible to determine whether a Post-Commencement Tax Arrangement is abusive in its own right (without reference to the Broader Arrangement) then the taxpayer can refer back to the Broader Arrangement to show that the later arrangement was not abusive, but HMRC cannot use the Broader Arrangement to show that the later arrangement was abusive.

D37.7 However, where a Post-Commencement Tax Arrangement is by itself abusive, regardless of any earlier steps taken as part of the Broader Arrangement, HMRC can still apply the GAAR.

D37.8 The GAAR has effect only in relation to tax advantages arising from abusive tax arrangements. Where an abusive tax arrangement is a Post-Commencement Tax Arrangement forming part of a Broader Arrangement, counteraction can apply only to any tax advantage arising from the Post-Commencement Tax Arrangement. To the extent that the tax advantage arises from the Broader arrangement entered into before commencement, the GAAR can have no effect.

D38 Example 1: post-commencement arrangement abusive in its own right

D38.1 Please see example D8 above for more details. In summary, the steps are as follows.

- **Pre-commencement** → Company A acquires shares in a connected company, Company B, which have been created for the purposes of the scheme in order to meet the conditions of the shares as debt rules.
- **Post-commencement** → Company B makes a distribution in the form of a bonus issue of debentures with the effect that Company A recognises a fair value loss on the shares which is deductible under the loan relationship rules.

D38.2 The first question is whether the payment of the distribution can be regarded as a "tax arrangement" which is "abusive" on a standalone basis, without taking account of the pre-commencement steps and the payment of the distribution together, to the extent they form a single arrangement.

D38.3 The second question is, if the payment of the distribution can be regarded as an "abusive tax arrangement" on a standalone basis, can those pre- and post-commencement steps taken into account together make the payment non-abusive?

D38.4 The payment of the distribution constitutes an arrangement. The main purpose of paying the distribution was to cause the shares to drop in value and so crystallise the tax advantage. That arrangement is in itself a tax arrangement that is contrived and inconsistent with the policy principles of the shares as debt rules. The post-commencement tax arrangement is therefore by itself an abusive arrangement to which the GAAR would apply. Taking into account the pre-commencement steps and payment of the distribution together does not prevent the payment of the distribution from being abusive.

D39 Example 2: no tax advantage arises from post-commencement arrangement

D39.1 The arrangements are as follows:

- **Pre-commencement** → A taxpayer enters into an abusive intragroup convertible loan relationship scheme. Loan relationship debits arise from the scheme prior to commencement.
- **Post-commencement** → Debits continue to arise from the loan post-commencement. As part of the original scheme, the loan notes are then sold by the intragroup creditor and the notes then redeem. The disposal and redemption do not increase the amount of any debits that have already accrued up to that date.

D39.2 The later disposal constitutes an arrangement in its own right. However, no tax advantage arises from this arrangement and it follows that it would not be reasonable to assume that obtaining a tax advantage was a main purpose of that arrangement. Consequently, the post-commencement arrangement is not a tax arrangement, so the GAAR does not apply.

D40 Example 3: post-commencement arrangement part of a broader abusive arrangement

D40.1 Company A is a trading company that is expecting to receive a lump sum trading receipt from Customer X in the near future. In the ordinary course it would be required to bring this receipt into account in computing its trading profits for the purposes of corporation tax. Company A has a wholly owned subsidiary called Company B.

- **Pre-commencement** → In order to avoid liability in relation to the receipt, Company A enters a contract with Customer X and Company B. Pursuant to the contract, the parties agree that Company B is entitled to any payments which Customer X becomes liable to make to Company A. In return, Company B agrees to issue shares to Company A in respect of these receipts.
- **Post-commencement** → Customer X signs a deal with Company A pursuant to which Customer X becomes liable to make, and does make, a trading payment to Company A. In accordance with the contract, Company A has no entitlement to retain the payment so in accordance with GAAP it does not recognise the income from the receipt in its accounts (instead it shows an investment in a subsidiary) and Company A argues that in consequence the payment is not taxable.

D40.2 Assuming that the post-commencement arrangement is a tax arrangement, it is not, of itself, abusive. The broader arrangement is an abusive one but this cannot taint the post-commencement arrangement because of s212(2) FB 2013. Therefore, notwithstanding that the tax advantage arises post-commencement, the arrangements are outside the scope of the GAAR.

D41 Example 4: post-commencement tax arrangement abusive in its own right

D41.1 Please see paragraph 30 of the Court of Appeal judgment in Mayes for more details. In summary, the steps are as follows.

- **Pre-commencement** →
  - Step 1: A Jersey resident individual purchases bonds comprising several life assurance policies.
  - Step 2: The individual assigns the bonds to a Luxembourg company.

- **Post-commencement →**
    - Step 3: The Luxembourg company pays top-up premiums in respect of each policy.
    - Step 4: The company withdraws the sums paid at Step 3. The repayment is treated as a partial surrender of the policies reflecting the amount of top-up premiums paid and the investment return from the issue of the policies to the date of partial surrender.
    - Step 5: The company assigns the bonds to a UK LLP.
    - Step 6: The LLP assigns the bonds to the taxpayer.
    - Step 7: The taxpayer surrenders the bonds in whole and claims income tax relief arising from the surrender.

D41.2 The transactions which occurred post-commencement can clearly be regarded as an "arrangement" and it is clear that the steps were undertaken with a main purpose of achieving a tax advantage. That arrangement involves contrived steps designed to exploit shortcomings in the legislation. The post-commencement arrangement first concludes the groundwork for the generation of the tax loss not corresponding to an economic loss and then crystallises that loss. The arrangement is therefore one that is abusive in its own right and one that is not saved from being abusive by reference to the whole of steps 1 to 7.