Minutes of WG1 meeting on 24 September 2014

HMRC noted that they were still working through the points made at the last meeting in relation to derecognition. A couple of people submitted written representations following that meeting and HMRC confirmed that they would still welcome further comments.

As regards progress for Finance Bill 2015, the position is still as described at the last meeting. The intention is still for all draft legislation to be ready for "L-Day" but other options are being considered in case the legislation is not ready. In this case, the decision as to what to do would be with others. From HMRC's perspective, the intention is for the legislation to be ready by L-Day and for the draft clauses to be included in the first Finance Bill in 2015. A number of areas are reasonably well progressed in terms of draft legislation and HMRC will be asking OPC to start drafting the relevant Part 7 provisions as well. This is not expected to require a significant amount of work. OPC will also be drafting transitional provisions but again these are not expected to require a lot of work; the main issue should relate to the move to a P&L approach.

Regime TAAR

The key questions from HMRC are as follows:

- Is there anything in the draft provisions that causes particular concerns?
- Is this draft legislation in accordance with the previous discussions?
- To what extent does the legislation deal with the concerns / points previously raised?
- How far from being final is it?

Overview

HMRC drew attention to the use of the phrase "advantages…are to be counteracted". This is important in light of previous discussions on the objective of the TAAR, which should be solely to eliminate the advantage. There was a concern that the provision would enable HMRC to go further if they so wished but the language should make it clear that the provision only allows HMRC to counteract the specific advantage in question.

The provision, like other anti-avoidance provisions, uses the term "just and reasonable" since, as discussed, it is clearly not feasible to provide for specific counteraction. The rule does specify, however, that the just and reasonable adjustments must be in relation to CRs and DRs under Part 5. This should help to make sure that the rule is kept with intended bounds though the nature of the counteraction is kept open through the standard language – "an assessment, the modification of an assessment, amendment or disallowance of a claim, or otherwise". The intention is that the adjustment should apply to the mischief and HMRC thinks this is clear from language. It shouldn't be possible to disallow a "proper" debit rather than imputing a credit but, in any case, it would not be just or reasonable to disallow the debit and impute a credit.

Importantly, the purpose test is attached to the arrangements rather than the individual parties to the arrangements. This is designed to cover complex offset arrangements where it may be difficult to ascertain motives of parties.

Application

Draft section 455B(1) refers to the making of adjustments to the credits and debits brought into account under Part 5. It was queried whether this should be "otherwise brought into account" but it was noted that there may still be credits and debits brought into account but in different amounts. The definition of "advantage" includes avoiding a credit so there may be a point here. It was noted that it will not be possible to cover all eventualities and the intention was really for the provision to refer to the amounts actually brought into account. The provision refers to adjustments "in relation to the credits and debits brought into account". This is not a reference to the specific credits and debits in question but all

amounts brought into account under Part 5. It was suggested that the "the" before “credits and debits” should be deleted as the “the” suggests that only the credits and debits specific to the arrangements can be adjusted. Alternatively, the provision could refer to credits and debits "to be" brought into account. It was also suggested that "just and reasonable" should come after “adjustments to the credits and debits” as otherwise it implies that HMRC can adjust anything. HMRC agreed to discuss the language with OPC.

“Arrangements”

As regards the definition of "arrangements", the question was asked as to whether HMRC will be able to pick out an element of a broader arrangement and focus on purpose of that particular step. The view put forward by the working group was that the wording on arrangements in the GAAR might be better. This ensures that the arrangements may be broad or narrow depending on context but requires regard to be had to wider arrangements. The risk is that, in a particular situation, one might take a narrow view inappropriately when taking a wider view would show that the purpose is commercial. HMRC was of the view that the requirement to have regard to the wider arrangements is limited to consideration of whether the arrangements are reasonable but it shouldn’t influence the purpose test.

It was agreed that it probably didn’t matter materially but it might give some comfort to taxpayers and HMRC could not see any particular downside to including the wording. It is not clear that it adds anything as it just specifies that one can take a broad or narrow view but there is no particular objection. It was suggested that the current wording may allow HMRC to ignore the wider arrangements and may also allow for multiple testing at different levels. HMRC noted in this context that the possibility of a single TAAR to cover both loans and derivatives had been discussed. The conclusion was that it would be sensible to have two separate rules but there is an open question as to whether some cross-reference is needed to avoid a gap between the rules. The fact of having two tests implies that one might have to look at the same arrangements twice but one would still have to consider whether overall purpose of wider arrangements influences purpose / outcome. The initial reaction from HMRC is that they would have no particular objection to GAAR wording.

Potential exclusion

There is a potential exclusion in draft section 455C(4) –

> *“arrangements are not relevant avoidance arrangements if the obtaining of the loan-related tax advantage as a result of the arrangements can reasonably be regarded as consistent with any principles…”*

The question was asked as to the reason that the phrase "as a result of the arrangements" was included here. It suggests a potential narrowing of the exclusion and also the opportunity for multiple testing of the arrangements. If one is looking at the effect of one particular step in the wider arrangements, it might fall within a particular relief when it shouldn’t otherwise but, if the wider arrangements are taken into account, the availability of the relief in the circumstances is in line with the underlying principles of the relieving provision. Why the words "as a result"? There is no particular motive behind this wording. The risk of using these words is that it may import whatever uncertainty there might be in defining the scope of the arrangements or at least highlight the potential issue. Subsection (4) uses a slightly different formulation than subsection (3) and this creates uncertainty.

The group asked whether the test in draft section 455C(4) could be expressed negatively, i.e.

> *“arrangements are relevant avoidance arrangements if the obtaining of the loan-related tax advantage cannot reasonably be regarded as consistent with the principles…”*

It was noted that this would move the burden of proof from the taxpayer to HMRC. HMRC confirmed that the provision is deliberately written so that the burden of proof is on the taxpayer and this is in line with all other similar anti-avoidance provisions. It was suggested that the target of the TAAR is supposed

to be "abusive" transactions but HMRC reiterated that the TAAR does not have the same target as the GAAR; the target is transactions which achieve a result that is not in accordance with the principles, etc. It is for the taxpayer to prove that the result is in accordance with the principles and policy, etc.

The reason why the potential exclusion is included in the draft legislation is in an effort to accommodate the concerns raised by WG1 regarding the fact that the definition of tax advantage generally (if not universally) does not distinguish between "good" and "bad" tax advantages. Once there is any advantage, the hurdle set by the anti-avoidance has been passed. HMRC's starting point was that no other rule makes this distinction between different kinds of advantages and therefore this rule should not make the distinction either. However, WG1 noted that the regime TAAR is different to other rules as the latter tend to be more targeted / aimed at specific kinds of avoidance activity. The broad scope of the regime TAAR creates a significant additional degree of uncertainty and loans and derivatives are such a fundamental part of commercial life that the degree of potential uncertainty would be amplified even further.

HMRC has tried to deal with this concern by making it clear in the legislation that if it is possible for the taxpayer to demonstrate that the particular tax advantage was intended by Parliament then it falls outside the scope of the rule. The ordering of the words is deliberate. HMRC noted that the group wants to change the order such that inconsistency with principles effectively becomes a condition for the rule to apply in the first place. This is a policy point which has been discussed previously and likelihood of this being reversed now is very low. The group acknowledged this but reiterated that their view that the policy should be that HMRC should have to prove that an advantage is inconsistent with the principles of the regime. HMRC noted that the inclusion of subsection (4) is somewhat of a concession already as nothing similar appears in any other anti-avoidance provision. It is designed to give comfort in cases where there is a relief / deduction which is intended to be available that this rule should not impugn that availability and it is intended to enshrine the right that a taxpayer has to argue that the particular transaction is not something that should be caught by the rule.

It was noted that the potential exclusion only works if the policy and principles on which Part 5 is based are clear. One of the key concerns is the interaction with the unallowable purposes rule. The group asked whether the rule was intended to catch "thinning out" transactions as described in the original Consultation Document in the context of section 441. HMRC said that the policy intention is that the regime TAAR is not intended to police the boundaries of debt and equity; this will continue to be a section 441 question. If it is decided that section 441 does not apply as there are no incremental debits but there is a tax purpose, could HMRC then seek to apply the regime TAAR? HMRC understood the question and the need to say something on this but there is a question as to whether the legislation is the place to say this. It is difficult to set out quite fuzzy distinctions in legislation but this point could be made more clearly in the guidance.

HMRC noted that the use of the phrase "reasonably be regarded" is intended to soften the question of fact issue as to whether something is or is not consistent with the legislation. This should make it easier for a taxpayer to argue that exclusion applies without going as far as the GAAR's double reasonableness test. It was suggested that the provision should assist in bringing guidance into point; it gives the Court a lead into guidance and gives it more weight. HMRC's view is that subsection (4) should be regarded as a helpful provision even if it is not exactly what was wanted by taxpayers.

The question was asked as to whether the policy and principles of Part 5 will be clearer following Finance Bill 2015. It would be nice if it was possible when the legislation is enacted, to be able to say the exercise as a whole has clarified the policy and principles so that the regime TAAR makes sense rather than have a new law that is totally uncertain. It was noted that the consultation should clarify some of the principles underlying the regime, e.g. the foreign exchange rules should be more principles based themselves. There is still an open question as to how easy or difficult it will be to identify the principles and policy of older legislation.

Definition of loan related advantage

Tax advantage is defined in subsection (5) in terms of credits and debits and so links back to counteraction. The definition refers to a "debit to which it would not otherwise be entitled". There is a

question as to what the comparator is in this case. It was noted that subsection (5) is not meant to restrict the application of the TAAR so "otherwise" should refer to what the position would have been if the company had not entered into the arrangement.

If the arrangements involve a reduction of credits but result in a corresponding credit elsewhere, it is not clear whether the main purpose test would be satisfied. However, it is conceivable that there would be situations where there would be main purpose of achieving a loan related advantage. If the credit is not taxed under the loan relationship code, the just and reasonable adjustment might be to impose taxation.

HMRC confirmed that the reference to timing differences in the definition of loan related advantage was intended to target loss planning transactions. HMRC also noted that the definition of a loan related advantage was intended to be widely drafted and to cover all cases where a company's position has been improved in respect of amounts to be brought into account under the loan or derivative regimes.

Examples

The target of the rule is anything that gives a different / more favourable tax answer than commercial answer. It was noted that it will be important that this provision cannot prevent companies from making the argument as regards consistency with principles and policies. There is a risk that this could be the case due to the use of the word "may" – *"each of the following is an example of something that may indicate that the obtaining of the advantage is not consistent with the principles and policy objectives"*. The group would prefer to use the word "might" instead. The difficulty is the use of the permissive "may" as this can mean "shall". GAAR uses "might". HMRC noted that the intention is for the list to be a "grey" [DN: 'Dark Grey'?] list, highlighting that there could be an issue but with a little bit of flexibility, rather than "black" list.

It is intended that accessing a specific relief or election should not be within the scope of the regime TAAR. In the GAAR, there is a caveat that ensures that the GAAR only applies where a specific rule was not intended to give the benefit claimed. It would be important to get this concept included in the regime TAAR. It is not necessarily about the relief being available but steps taken by a taxpayer to put itself in a position to get the relief. HMRC noted that this should come through from the reference to principles and policies but the concern was raised that draft section 455D could override draft section 455C(4). HMRC didn't think that this was the case but agreed to take the point away. HMRC confirmed that they are happy to take suggestions as to what should be contained in guidance. It is understood that there shouldn't be any doubt that a taxpayer can make election where the legislation states that the taxpayer can make an election but it is difficult to include this concept in legislation and may be better to include in guidance.

HMRC guidance on the regime TAAR will not have the same force as GAAR guidance. The concern was raised that HMRC guidance just sets out Revenue's view and not the intentions of Parliament and a Court may ignore it on this basis. However, it will be a key source of information for taxpayers on the policy and principles. It was suggested that the legislation could include a provision to say that the courts may look to HMRC guidance. However, it was noted that this may work against a taxpayer if HMRC guidance states that something is inconsistent with the principles and policy. GAAR guidance is framed in particular way and it was agreed it should have quasi-statutory status. It was suggested that the reference to principles and policy in the legislation may mitigate the *Pepper v Hart* restriction. HMRC agreed to take the point away as to whether it is necessary to include anything in the legislation to enable court to look further to determine the principles and policy.

HMRC noted that the repealing clause says that the provisions being repealed are "superseded" by the TAAR so it should be clear that these are in scope.

The group noted that draft section 455D is quite a long list. HMRC was surprised by this comment as genesis of the list was the comments made by WG1. The issue is that the list is now quite generic. It is not clear that including or omitting the list would make any difference. HMRC noted that the list was included at the request of WG1 to give comfort to taxpayers. The concern is that any potential transaction could probably fit into one of the categories so it may not give any comfort to taxpayers. It is also odd that

positive examples will be included in guidance but negative examples will be included in the legislation. It was noted that if the status of guidance was clear then this provision wouldn't be needed. HMRC noted that the list was intended to be helpful but it could be excluded if preferred by the group.

The group noted that examples (a) and (b) in particular were too widely drawn and therefore not particularly useful. It was also noted that the use of the word "economic" would cause difficulties. HMRC asked whether the inclusion of the list could do any harm. This will depend on the force that HMRC guidance will carry.

Commencement

At the moment, the intention is that the rule will apply from Budget Day, though this is in square brackets. This is intended to be a compromise between L-Day (which would be the normal start date for anti-avoidance legislation) and 1 January 2016 (which is the start date for the other FB15 changes but which would be a longer gap than preferred). There was a concern raised as to the link with “fairly represents” for the period between Budget Day and 1 January 2016. Also, it was queried as to whether similar language to the GAAR would be required to deal with post-commencement arrangements which are related to pre-commencement arrangements.

Next meeting

The main outstanding for WG1 is derecognition and there is still some development to do on this. This is the focus for next meeting. HMRC has received some written comments but would welcome further comments in advance of the meeting.