Minutes of WG1 meeting on 22 January 2014

General update

HMRC noted that the consultation Response Document was published before Christmas. This stated the intention to include in FB14 material on partnerships and bond funds. This legislation has now been published and will be available for comment until 14 February. There is also some draft guidance regarding bond funds on the HMRC website. The draft clauses on partnerships will be discussed in WG2 on Friday. It deals with the core approach to loan relationships of firms but doesn't yet address derivative contracts or changes in apportionment of partnership shares. The intention is to address these issues - the derivative contracts companion piece should be reasonably straightforward. It is not clear whether one or both of these pieces will be tagged on to FB14, but this is the current intention. However, there shouldn't be any issues if this cannot be done until next year.

Budget Day is 19 March, and the deadline for getting submissions to Ministers is 13 February. The intention is to publish a technical note which will give some clearer / more definite steers on the direction of travel of various strands. A second consultation document was considered but it seems unnecessary in light of the ongoing working group process and other discussions with interested parties. A formal consultation is very time-consuming and this time is better spent working out policy and legislation. However, the published note may include some questions.

Finance Act 2015

2015 is an election year. This means, first, that the Autumn Statement is likely to be a little earlier this year and this may restrict the timescale available. Second, the legislative process will be affected. In advance of the election, it is likely that there will be a discussion between the Government and the Opposition to agree what should be included in FB15. There is a question as to whether the LR/DC changes will be included in this first FB or whether it will be deferred. The new Government may have new priorities so there is some uncertainty. HMRC's current assumption is that the LR/DC changes will go forward on the basis that it is difficult to see why a Government wouldn't want to further the aims set out in the condoc but there is some uncertainty on timing and how much Bill space may be available.

The implication is that there is a need to "triage" the various strands, i.e. identify three categories of issues.

1) Flagship issues which are the priorities for FB15;
2) Strands which could be characterised as not core policy changes, but perhaps tidy up / clarification points. This would be the focus area if there was pressure on FB space.
3) Issues where the benefit in terms of achieving the stated objectives of the project might not outweigh the resource implications, upheaval or potential uncertainty. There are already points which were mentioned in the condoc but have been dropped so in effect this process has started.

Characteristics of flagship issues include:

- Clearly furthering stated aims of consultation
- Positive balance of benefits against resource, uncertainty, upheaval
- High value return for effort required

Based on responses / discussions, the following might be flagship issues:

- Profit and loss account rather than full accounts
- Debt restructuring and possibility of corporate rescue measure
- Sorting out "fairly represents"/looking behind/core structure
- Anti-avoidance cover, i.e. TAAR

Category B might include:

- The proposed changes to s441 (the "unallowable purpose" rule)
- Aligning amortised cost basis.

Category C might include significant changes to group continuity (the Response Document has already stated that there is no intention to do anything radical here).

The group agreed to share comments with HMRC by email as to where they think the various issues should fall between the categories.

Combining Parts 5 & 7

The responses and discussions have identified that the process of moving to a complete single regime would have a number of downsides. If this is really the case, as HMRC needs to focus resource on getting maximum benefit, it may mean that the focus is on improving areas of existing legislation rather than total rewrite. The expectation is that many people will think that this is not a bad outcome.

Conceptually HMRC considers a combined code to be a desirable objective, but the responses to the condoc were mostly ambivalent. The general sense is that no one feels very strongly about this and it is not essential to the operation of the regime. HMRC is moving towards the view that combining the codes is probably best retained as an aspiration for the medium term, which might be looked again once the substantive policy changes have been implemented. This is not to say that there is nothing they would want to do in FB15 as regards aligning the two regimes better. There is no reason why the working groups shouldn't be looking to identify where possible alignments might be made. No decision has been made yet; this is just an indication of direction of travel at this point.

Timing of changes

Some changes will take effect from 1 January 2016. The second FB in an election year has typically been enacted a few months after the election. It is possible that there will be a quick post-election budget, in which case the timetable would be compressed further and ongoing issues could get pushed into a third FB. However, the assumption is that there should still be time for this to be enacted in 2015 prior to 1 January 2016.

The group noted that it would be useful to know now when the rules are expected to come into force, i.e. 1 January 2016 or Royal Assent. Royal Assent would not be typical for these types of these changes, so it should be accounting periods starting from a certain date. This should be made public. It was noted that comment on this is likely to be included in the Technical Note.

It was noted that anti-avoidance provisions often take effect from the date of announcement. However, the regime TAAR is not emergency anti-avoidance but part of a wider package, so it may have the same start date.

Regime TAAR

A number of key questions arose:
- What is it for?
- How will it relate to other anti-avoidance rules including the GAAR and s441?
- What existing rules will be affected or no longer required?
- What form will it take?

Tax avoidance arrangements generally falls into three categories:

1) Making inappropriate use of a tax rule to manipulate the amount arising for the purposes of the LR/DC regime;
2) Seeking to avoid a particular rule in the LR/DC regime, which should apply; or
3) Seeking to apply a particular LR/DC rule which shouldn't apply.

The scope of the regime TAAR should encompass all three categories.

Relationship with GAAR

A number of the consultation responses alluded to the GAAR. There was some disappointment that such a provision was being discussed so soon after the introduction of the GAAR, and there was a lack of understanding of how the role of the regime TAAR would be different in relation to LR/DCs.

HMRC said that the GAAR is aimed at the most abusive schemes. There are many schemes, at which the existing TAARs are aimed, that would not have triggered the GAAR. The concern is that there may be some brand new exploitation which operates at a sub-GAAR level but which are clearly designed to exploit the rules in unintended ways. The Government did make it clear that the GAAR is intended to sit alongside more narrow anti-avoidance rules. HMRC is still seeing schemes, disclosed or not, which seek to exploit the LR/DC rules, and this continues to tie up a lot of resource. The condoc made clear that improved anti-avoidance protection was a significant part of the basis of the review, And something which needs to be delivered. Hence, the regime TAAR is correctly sitting in Category A.

The regime TAAR fits into an anti-avoidance hierarchy. First, there is a rule which states what is meant to happen – the line between this rule and a specific anti-avoidance rule may be blurred, i.e. if the scope and operation of the rule is clear enough to preclude manipulation, then it is fulfilling an anti-avoidance function. Above the basic rule, there may be an associated TAAR designed to deal with a particular set of scenarios. If the specific TAAR doesn't catch a scheme, then the next step would be to consider whether the regime TAAR, with its wider and less specific scope, applies. It may be that scheme doesn't fall squarely within the specific TAAR but it will fall within the regime TAAR. Then, as a last resort, for the most egregious schemes, consider the GAAR.

One of the advantages of the regime TAAR is that is shouldn't be necessary to constantly revisit the legislation to introduce new TAARs, e.g. the total return swaps legislation in the Autumn Statement 2013.

The concern from the group was not so much that the GAAR should catch everything, it is accepted that there is a still a need for specific anti-avoidance but this is different to a broad TAAR such as is being suggested; this was seen as introducing uncertainty. The reason the GAAR was targeted at the most abusive schemes is that it was thought too difficult to apply a wider rule. It is not obvious that just limiting the application of the broader rule to the LR/DC regime solves the issues that were put forward in connection with the GAAR. It is not clear that the regime TAAR can be drafted with a sufficient amount of certainty so as to eliminate the need for clearances.

Relationship with other provisions

Some people had thought that one possible advantage of the regime TAAR was that it would allow HMRC to repeal a number of specific TAARs. HMRC agreed that this is a possible advantage but further consideration is required to decide what can actually be repealed.

There may be some read across to the intangibles TAAR in section 864 CTA2009 – this applies across the regime and is a fairly simple rule. The counteraction element may be of questionable efficacy but the basic approach is something that might be adopted for LR/DC. It was suggested that the intangibles regime lends itself more easily to this type of rule. LR/DC matters are far more common and more likely to generate losses for commercial reasons – this would cause far more uncertainty than intangibles. HMRC pointed out that s441, for example, was broadly drawn. Although uncertainty about its application arose in a small number of cases (and this is probably inevitable with any rule), it presented no difficulty in the vast majority of transactions; and if losses arise for commercial reasons, the arrangements would not be caught.

One of the other points which needs to be discussed is the interaction of the regime TAAR with other

provisions, e.g. “fairly represents”, looking behind the accounts, etc. There is also a question as to how far the regime TAAR should replace or supplement existing rules. It may be that an existing anti-avoidance rule is simple and clear, and the counteraction unproblematic. HMRC would welcome views on whether it would be possible or preferable to retain such a rule, because it works, or to subsume its function into the regime TAAR, which would be less specific? A possibility might be for the regime TAAR to specify particular counteractions in certain cases.
A lot of concern has been expressed on “fairly represents” and looking behind accounts (Chapters 3 and 4 of the condoc) regarding the fact that, in both cases, they involve rules which will apply in circumstances which are not be precisely defined, regarded as generating uncertainty. The general view seems to be that people would prefer to deal with specific eventualities through specific rules and not have a “catch all” to deal with unknown unknowns. HMRC has made it clear that to the extent a non-specific rule might have an anti-avoidance function, this is not something they can do without so, if the view is and remains that the preference is not to have a general rule potentially overriding the accounts, then any anti-avoidance functions of such a rule will need to be subsumed into the regime TAAR. This was still regarded by group members as introducing potential uncertainty, but at a lower level than a “fairly represents” rule, because the trigger provisions for the TAAR would act as a filter. For the vast majority of current LR/DC transactions, it is not necessary to consider s441, for example, and HMRC’s expectation is that this will operate in same way.

Will the regime TAAR replace group mismatch (GMS), risk transfer, etc? It is first necessary to work out what the rule will cover and then it will be possible to decide whether existing anti-avoidance legislation can be repealed. It may be that people will prefer to keep some of these specific rules. It was noted that GMS doesn't necessarily need a tax avoidance purpose to apply and risk transfer schemes is not phrased in terms of tax advantage. It was suggested that GMS was a “classic example” of something that should be covered. If GMS doesn't catch a scheme, it is not clear why the regime TAAR would need to be considered.

One possibility is that the trigger for the rule could be quite broadly written in terms of purpose and then, rather than having the counteraction be “just and reasonable”, there could be more detail to deal with specific instances or perhaps non-exhaustive examples of appropriate counteractions. It might then be possible to draw in some existing rules, thus restricting their number.

HMRC noted that, from an Exchequer point of view, the purpose of the regime TAAR is to increase and not reduce protection. GMS, etc plainly extends to transactions which would fall outside a purpose based TAAR so relying on the TAAR in such cases, unless it were significantly widened in scope, would be contrary to the objectives of the review. The original expectation was that the regime TAAR would encompass some of the narrower rules, e.g. s363A, which are themselves purpose based. It is essential that nothing is lost in terms of protection. It is unlikely that a TAAR could sweep up every anti-avoidance rule in the regime.

Some group members suggested that improved clarity over the scope and purpose of the regime as a whole would serve to reduce any uncertainty arising from the TAAR. It is a lot more difficult to manage a regime TAAR where the overarching purpose of the regime is not obvious. The alternative view that one of key reasons for introducing a regime TAAR is to reduce the need for more patchwork legislation in the future. There is no reason why a regime TAAR should be incompatible with a more limited reworking of the regime. It was agreed that if one is trying to determine whether a particular tax outcome is appropriate, then a clear idea of purpose would be helpful. However, if an anti-avoidance rule is based on the purpose of a taxpayer in entering into the arrangements, that concept should stand alone and it doesn't need to refer to purpose of legislation. It was also noted that a full rewrite is not required in order to clarify the underlying principles of key pieces of the regime.

As regards the concerns on the scope of regime TAAR, the group view seemed to be that some further filtering is required beyond a main purpose of obtaining a tax advantage. This was seen as broad. The condoc did express the rule in terms of arrangements designed to exploit the regime itself. This is why there would still be a need for rules such as s441. There is then a question as to how schemes which are

exploiting the regime can be identified. HMRC noted that it is usually obvious what the intention of an avoidance scheme is; taxpayers do not find themselves being caught by purpose tests by accident.

However, there are many commercial considerations for groups when structuring transactions, and there may be more than one way of doing things. There may be some difficulty in relying on purpose to fall outside the TAAR when one is choosing the more advantaged route. Taxpayers take steps solely to avoid tax on FX – while this works both ways, someone might argue that gains are more likely than losses. What about steps taken to access normal losses? Even if HMRC confirms now that this is not the target of the rule, what happens in five years? The risk is that the rule could create serious uncertainty in normal commercial transactions. It was suggested that the approach to the application of s441 has changed direction since it was originally enacted. HMRC noted that generally, purpose-based anti-avoidance rules look for "only or main purposes" of obtaining a tax benefit, not for any purpose. The existence of a main purpose is a question of fact and degree, and will depend on the context of the overall arrangements, but a transaction clearly undertaken for commercial reasons is unlikely to be caught simply because a more tax-beneficial option is selected in the implementation. Notwithstanding the potential breadth of s441, it has not inhibited commercial transactions.

HMRC said that the debate on where and how to draw the limits of anti-avoidance rules is not new. Generally, an appropriate balance is struck through detailed consideration of statutory wording, combined in some cases with guidance. Ultimately, however, this is similar to the discussions on s441 – it is not possible to give definite answers as to where the line falls as it is very much fact dependent; examples expressed at a generic level often simply serve to shift debate from the application of statutory words to a particular set of detailed facts to the application of one or more examples. It is necessary to depend on the legislative wording (which is up for discussion) and all guidance supporting material. There will always be difficult borderline cases.

Group members suggested that it would be helpful if there could be some additional filters as otherwise we will end up in the same place as the ongoing discussions between HMRC and taxpayers on the scope of s441 and this soaks up a lot of resource. As an example of additional filters, the derecognition anti-avoidance only applies where there is derecognition and there is then a purpose test. If there is no other filter and the rule is relying solely on purpose, it becomes very difficult to agree where the line falls. HMRC said that it was not clear what such filters would be, or that they would remove uncertainty. They might reduce the number of cases where any uncertainty arose, but at the expense of less comprehensive anti-avoidance cover. Application of the TAAR would depend on the existence of evidence of purpose – a purely commercial transaction could not be caught and there should be no significant uncertainty.

It was suggested that one option might be a non-exhaustive list of counteractions to be applied in particular scenarios. Although this would not affect the trigger mechanism, it might give some more certainty. HMRC said they were open to suggestions here. However, while there was no desire to impose unnecessary commercial uncertainty, where a case had triggered the TAAR, so that tax avoidance had been identified, it did not see any need to provide comfort or certainty about the counteraction. In such circumstances, uncertainty was desirable and may act as an effective deterrent.

The intention is not to derail purely commercial transactions but some uncertainty is inevitable. There is precedent for wide anti-avoidance rules, and this has not derailed commerce and has largely achieved its aims. Group members said that the difficulty with this is that financing is core to all business and the uncertainty when structuring transactions involving LR/DC matters in the presence of a regime TAAR could be significant. Section 363A CTA2009 is a good example - this has in fact inhibited transactions as it is so widely drawn; hence the significant number of clearance applications on this. There is a risk of ending up in a similar place with a regime TAAR. Also, with s441, there was a perception that goalposts moved post-enactment and there is a fear that the same could happen here. HMRC noted that it was not that the goalposts moved but rather HMRC did not apply the rule as often as they could have. The group disagreed with this, suggesting that the rule is being applied in a much wider sense than originally anticipated. It is essential to avoid having a rule which is so wide that it does hamper commercial transactions. This is accepted but equally the rule needs to serve its function.

It was noted that it not clear how the wording of the regime TAAR might differ depending on whether or not there is also a general override to accounts ("fairly represents" or looking behind accounts). It was agreed that a decision needs to be made as to what the rule is supposed to do in order to know what it will look like. If the decision is for no general override then this is something that regime TAAR will need to cover as regards avoidance cases.

Next steps

The discussion on the regime TAAR will continue at the next meeting. The discussion needs to become more granular around what the rule will and should cover and, what rules it might supplant and what could be repealed.

It was suggested that some kind of skeleton would be helpful in order to focus discussion. HMRC agreed to produce something but on the understanding that it will be very much a discussion piece. It was noted that it would be helpful if this could address counteractions as well as triggers - will it just be just and reasonable? HMRC agreed to include this.

It was agreed that a skeleton would be reviewed and discussed at the next meeting.