GAAR ADVISORY PANEL

Redacted and sub-panel approved version of the Opinion Notice issued on 12 February 2020

Subject Matter: Miscellaneous income loss. Creation of loss, via use of mirroring forward contracts - matching gain said not to be taxable.

Taxes: Income Tax

Relevant Tax Provisions: Chapter 11 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 and section 152 Income Tax Act 2007; section 115 (1) (a) Taxation of Chargeable Gains Act 1992.

Opinion: the entering into of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions; and the carrying out of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions.

Opinion Notice

This opinion notice is given pursuant to paragraph 11 of Schedule 43 to the Finance Act 2013 ("FA 2013") by a sub-panel consisting of three members of the GAAR Advisory Panel (the "**Panel**") in response to the referral by HMRC dated 12 November 2019 (the "**Referral**") relating to an individual taxpayer.

The sub-panel received written material from HMRC under paragraph 7 Schedule 43 FA 2013 and written representations under paragraphs 4 and 9 Schedule 43 FA 2013 on behalf of the individual taxpayer (the "**Responses**").

1 Reminder of what the sub-Panel's opinion notice is to cover

"An opinion notice is a notice which states that in the opinion of the members of the sub-panel, or one or more of those members—

(a) the entering into and carrying out of the tax arrangements is a reasonable course of action in relation to the relevant tax provisions—

(i) having regard to all the circumstances (including the matters mentioned in subsections (2)(a) to (c) and (3) of section 207), and

(ii) taking account of subsections (4) to (6) of that section, or

(b) the entering into or carrying out of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions having regard to those circumstances and taking account of those subsections, or

(c) it is not possible, on the information available, to reach a view on that matter, and the reasons for that opinion." (Paragraph 11(3) Schedule 43 FA 2013)

"For the purposes of the giving of an opinion under this paragraph, the arrangements are to be assumed to be tax arrangements." (Paragraph 11(4) Schedule 43 FA 2013)

2 Terms used in this opinion and parties to the arrangements

2.1 This case relates to an individual taxpayer: (the "**Individual**").

2.2 In addition to the Individual this case also involves:

2.2.1 a financial trader (the "**Counterparty**")

2.2.2 A firm which made the individual aware of the tax planning (the "**Introducer**") and

2.2.3 Another firm which assisted in finding the Counterparty (the "**Intermediary**").

2.3 When we refer to "**Guidance**" we mean the GAAR Guidance approved by the Panel with effect from 15 April 2013.

3 Background

3.1 The facts in this Opinion are taken from the Referral. There was no challenge to these facts in the Responses.

3.2 On 20 March 2014, the Individual wrote to the Intermediary concerning arrangements of a kind described in Section 4 below, that is: involving a pair of mirror-image barrier contracts relating to the sterling/US dollar exchange rate.

3.3 In the letter the Individual requested the Intermediary to find a counterparty which would enter into both contracts so that the exposure on one contract would be secured by the profit on the other.

3.4 The letter also stated that the Individual had received tax advice on the tax implications of entering into the proposed contracts.

4 Outline of the arrangements

4.1 On 21 March 2014, the Individual opened an execution only account with the Counterparty. The form used for opening the account made it clear that the protections for retail clients would not apply to transactions undertaken on an execution only basis.

4.2 Also on 21 March 2014, the Individual entered into an ISDA Master Agreement with the Counterparty.

4.3 On 22 March 2014 the Individual paid £10,000 to a firm of solicitors. On 23 March 2014 the Individual paid a further £6,250 to those solicitors.

4.4 Part of the £16,250 was used to provide a payment of £5,500 to the Counterparty to be used as collateral for the two contracts described below and to cover dealing fees.

4.5 The balance of the monies paid to the solicitors (£10,750) was used to pay a commission or fee to the Introducer. The amount paid was said to be "*in* *respect of the notional amount …of the first in the series of Financial Instruments"* but was intended to cover up to four sets of scheme transactions entered into within a period of 180 days. There was to be no rebate if fewer than four iterations of the scheme transactions took place.

4.6 On 24 March 2014 the Individual and the Counterparty entered into two currency forward purchase contracts both based on the GBP/USD Spot FX rate and which substantially mirrored each other.

4.7 Under the first contract:

4.7.1 The Individual was required to pay £255,000 to the Counterparty on the settlement date, 3 April 2014;

4.7.2 The Individual became entitled to receive:

(a) If the underlying index on the valuation date (28 March 2014) was at or below the lower barrier, Certificates of Deposit to the value of £5,000;

(b) If the underlying index on the valuation date was above the upper barrier, Gilts to the value of £500,000;

(c) If the underlying index on the valuation date was above the lower barrier but below or at the upper barrier, Gilts to the value of £256,250.

4.8 Under the second contract:

4.8.1 The Individual was required to pay £255,000 to the Counterparty on the settlement date, 3 April 2014;

4.8.2 The Individual became entitled to receive:

(a) If the underlying index on the valuation date (28 March 2014) was at or below the lower barrier, Gilts to the value of £500,000;

(b) If the underlying index on the valuation date was above the upper barrier, Certificates of Deposit to the value of £5,000;

(c) If the underlying index on the valuation date was above the lower barrier but below or at the upper barrier, Gilts to the value of £256,250.

4.9 The lower barrier and the upper barrier were the same for both contracts. Thus, unless at 28 March 2014, the market was within approximately 0.3% of its value on 24 March 2014, the index would be outside the contract barriers in one direction or other. The index on 28 March 2014 must have been outside the contract barriers as the Individual became entitled to receive Gilts of £500,000 and Certificates of Deposit of £5,000 on the settlement date of 3 April 2014. (We were not told which contract produced which outcome.)

4.10 On 31 March 2014, the Individual and the Counterparty agreed that the Counterparty would purchase for market value the Gilts and Certificates of Deposit that the Individual would receive under the two contracts.

4.11 The contracts were settled on 3 April 2014 and on 4 April 2014, and the Counterparty informed the Individual that he would receive the net balance of £71.

4.12 In his tax return for the year ended 5 April 2014, the Individual claimed a loss for income tax purposes from a miscellaneous transaction of £250,000 in respect of the Certificates of Deposit. The Individual claimed that the corresponding gain on the Gilts was exempt from Capital Gains Tax and Income Tax.

5 Summary of substantive result of the arrangements

5.1 Although various outcomes were possible under the contracts, there was no possible outcome where the Individual would make a pre-tax profit after fees and expenses.

5.2 If the underlying index was either above the specified upper barrier on the valuation date (28 March 2014) or at or below the specified lower barrier, the outcome of the two contracts would be the same:

5.2.1 The Individual would pay to the Counterparty 2 x £255,000 i.e. £510,000;

5.2.2 The Individual would receive £500,000 in Gilts (under the first contract if the Index was above the upper barrier, under the second contract if the Index was at or below the lower barrier);

5.2.3 The Individual would receive £5,000 in Certificates of Deposit (under the first contract if the Index was at or below the lower barrier, under the second contract if the Index was above the upper barrier);

5.2.4 The value due from the Individual (£510,000) and the value due to the individual (£500,000 + £5,000) was balanced by the £5,000 of collateral deposited by the Individual;

5.2.5 The Individual would also have paid £10,750 to the Introducer (see paragraph 4.5 above);

5.2.6 After payment of the fees to the Introducer and other transaction expenses, the Individual would inevitably make a pre-tax loss.

5.3 If the index on the valuation date was between the upper and lower barriers:

5.3.1 The Individual would pay to the Counterparty 2 x £255,000 i.e. £510,000;

5.3.2 The Individual would receive Gilts worth 2 x £256,250 i.e. £512,500.

5.3.3 We have not been told what would have happened to the £5,000 collateral in that point so, for the purposes of this Opinion, we have assumed that it would have been returned to the Individual if the underlying index had remained within the upper and lower barriers (which was not in fact the case);

5.3.4 The Individual would thus have had a small profit (£2,500) from the two contracts but would have paid £500 in transaction costs and £10,750 to the Introducer;

5.3.5 Even in this scenario, after payment of the fees to the Introducer and other transaction expenses, the Individual would inevitably make a pre-tax loss.

5.4 In the Referral, HMRC drew attention to the narrow spread between the upper and lower barriers and drew the inference that the contracts were designed so that there was a very high probability that the index would be outside the barriers when the contracts expired. The Responses did not deny that this was the case, although it pointed out that it was factually possible that the contracts could have expired with the index within the barriers.

6 The likely alternative transaction

6.1 Given that, even in the case where the contracts expired with the index within the upper and lower barrier, the Individual could not make a pre-tax profit after taking into account the fees and costs involved in the transactions, in our view the most likely alternative is that the Individual would not have entered into any of the transactions described in Section 4.

7 The tax advantage

7.1 As explained in paragraph 4.12 above, the Individual has claimed a loss in respect of the sales of the Certificates of Deposit on the basis that he had paid £255,000 under the relevant contract (we have not been told which contract it was) and had sold the Certificates of Deposit for £5,000. A loss of this nature would *prima facie* be able to be offset against certain types of income under section 152 Income Tax Act 2007.

7.2 The Individual has also claimed that the gain on the Gilts of £244,571 (sale price £499,571 less cost £255,000) was exempt from Capital Gains Tax and Income Tax.

7.3 HMRC's position is that the Individual is seeking to claim a tax deduction where no economic loss has been suffered and in particular that the two contracts were set up with the intention that:

7.3.1 The underlying index would be outside the range defined by the upper and lower barriers on the valuation date (as a result of making that range very narrow so that the risk that the index might stay within the range was acceptably low);

7.3.2 The outcomes under the two contracts would put the Individual into a position where he would be able to assert the tax outcomes described in paragraphs 7.1 and 7.2 above;

7.3.3 But where the overall outcome would mean that the Individual could only ever make a small loss after payment of fees and transaction costs.

8 Tax Results argued for by the Taxpayer

8.1 The Individual argued that the tax outcomes set out in paragraphs 7.1 and 7.2 were correct.

8.2 The Responses argued that the tax consequences of the two contacts (and subsequent sales) should be analysed separately; that HMRC was seeking to treat the two contracts as a single composite transaction, and that this was not a permissible approach for a number of reasons. To the extent that the argument raised questions about the policy of the legislation we have considered them at Sections 9 and 11 below.

8.3 However, the Responses did not argue that the contracts should not be considered together as an "arrangement". Instead, the Responses themselves compared the transactions to a "short straddle" involving a combination of various derivatives to produce a particular result.

8.4 The economic interaction between the transactions and the insistence on the use of the same counterparty (see paragraph 3.3 above) makes it clear that the contracts and the sales were part of an overall arrangement. Under section 207(3) FA 2013 we are anyway required to have regard to other arrangements if the tax arrangements form part of them.

8.5 The Responses stressed that there was a chance of a profit if the underlying index was between the two barriers on the valuation date and drew a parallel with other transactions in derivative contracts: "The commercial merit of the transactions in question corresponds to long-established derivatives strategies undertaken by market participants subject to different tax regimes". However, no explanation was given of how the transactions could be considered commercial once fees and expenses were taken into account. This point is considered further at Section 10 below in relation to the question of whether the arrangements were contrived or abnormal.

8.6 The Responses suggested that the GAAR should not be engaged because there is a case on similar facts before the Tribunal. It was not made clear why this should prevent the GAAR applying to this case.

8.7 The Responses also argued that, as the Individual has not so far tried to make use of the loss, there is as a matter of fact no tax advantage.

8.8 Schedule 43 paragraph 11 (4) FA 2013 provides:

"*for the purposes of giving an opinion [of the GAAR Panel], the arrangements are to be assumed to be tax arrangements"*

that is: arrangements within section 207 (1) FA 2013.

Section 207 says:

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

8.9 Thus, for the purposes of this Opinion, we are required to assume that there is a tax arrangement and hence a potential tax advantage. We are not required to consider whether there are provisions other than the GAAR which may prevent a tax advantage arising.

8.10 The Responses also drew our attention to recent case law emphasising that that the intention of legislation should be ascertained from the legislation and not from wishful thinking about what Parliament might have intended. We note that section 207 (2) (a) FA 2013 requires consideration of the principles on which the relevant legislation is based, whether these principles are express or implied, and also the policy objectives of that legislation and we refer to paragraphs C5.7.2 to 5.7.8 of the Guidance.

9 What are the principles of the relevant legislation and its policy objectives?

9.1 The relevant legislation is:

9.1.1 In relation to the Certificates of Deposit, Chapter 11 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 and section 152 Income Tax Act 2007 (the "**CD provisions**");

9.1.2 In relation to the Gilts, section 115 (1) (a) Taxation of Chargeable Gains Act 1992 (the "**Gilts provision**").

9.2 We consider that the CD provisions are based on the principle that profits from transactions in certificates of deposit should be subject to income tax and losses from such transactions relieved from income tax and reflect an underlying policy that, where the return on an instrument is, or is mainly, driven by interest rates, should be within the income tax regime. We note that Chapter 11 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 applies not only to certificates of deposit but also to rights to other short term money market instruments which trade wholly in electronic form and to other uncertificated rights in relation to deposits of money.

9.3 We consider that the Gilts provision is intended to take profits on transactions in gilts outside the capital gains tax regime representing an underlying policy assumption that such profits would arise from the accrual of interest or from market pricing reflecting actual or predicted changes in interest rates. Profits deriving from the accrual of interest would be expected to fall within the accrued income scheme (Chapter 2 Part 12 Income Tax Act 2007), and profits deriving from market movements would either be subject to income taxation as a profit from a dealing activity, an adventure in the nature of trade or miscellaneous income from speculation; or under Chapter 11 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 itself if they represented a profit on Treasury Bills; but would be exempt if they arose on genuine long-term investments.

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

10.1 The transactions appear to be without any purpose other than to enable the Individual to attempt to claim a tax-relievable loss on the sale of the Certificates of Deposit and an exempt gain on the sale of the Gilts.

10.2 We appreciate that, if the underlying index had remained within the upper and lower boundaries, the two contracts would have produced a profit. However, once the fees payable by the Individual were taken into account, it was not possible for the Individual to make an overall pre-tax profit from the arrangements no matter what the position of the index was on the valuation date.

10.3 We agree that single or multiple derivative contracts can be entered into for commercial purposes, but the absence of any possibility of an overall pre-tax profit and the circumstances in which the transactions were entered into (in particular the insistence on a common counterparty and the contemplated repetition of the arrangements) indicate to us that the transactions are artificial and, in the light of the narrow spread between the upper and lower boundaries, contrived to maximise the likelihood of an apparent loss on the Certificates of Deposits deliverable under the contracts.

10.4 We also think that it would be unusual in a commercial context for the two contracts to be settled gross (i.e. with the full amount being paid under both contracts) and in kind with sale arrangements to monetise the instruments delivered under the contracts, as opposed to being settled for a net cash difference. In substance, the arrangements amounted to net settlement, but net settlement would not have allowed the Individual to claim the asserted tax outcomes. We think this also indicates that the transactions were contrived and artificial.

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

11.1 We agree with the Responses that, in general, the CD provisions are intended to allow losses made on transactions in certificates of deposit to be used to relieve other relevant taxable income and that the Gilts provision is intended to provide exemption for capital gains on transactions in Gilts.

11.2 However, we consider that the loss contemplated by the CD provisions is a real economic loss and not a loss which arises as part of arrangements designed to ensure that although when looked at in isolation, the Individual may make a loss on whichever contract may deliver the Certificates of

Deposit, the Individual will be economically insulated from the impact of that loss by the profit they will make from the other contract delivering the Gilts. We find it hard to see why Parliament would wish to allow relief in those circumstances. As explained in paragraph C5.7.4 of the Guidance, the subsequent enactment of anti-avoidance legislation can indicate the principles and policy underlying the original legislation. and we note that in Finance Act 2015, Parliament enacted an anti-avoidance rule (section 154A Income Tax Act 2007) intended to prevent losses being used where they arose as part of arrangements which have the purpose or a main purpose of reducing tax liability under section 152 Income Tax Act 2007.

11.3 We agree with the Responses that in general the Gilts provision is intended to take gains and losses on Gilts outside the scope of capital gains taxation. If the Gilts provision would treat a real economic gain as a non-taxable item, we do not find it surprising that the Gilts provision would also treat a gain which is made as part of arrangements which take away from the Individual the benefit of the gain as a tax nothing.

12 Is there a shortcoming in the relevant legislation that was being exploited (section 207(2)(c) FA 2013)?

12.1 We do not consider that the arrangements described in Section 4 sought to exploit a specific shortcoming in any particular piece of legislation. As noted in Section 11.2 above, the shortcoming was of a more general or structural nature. The CD provisions and the Gilts provision were separate regimes within the tax code and simply did not envisage the contrived interaction of the transactions brought together in these arrangements.

13 Does the planning result in:-

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

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

(iii) a claim for the repayment or crediting of tax which has not been and is unlikely to be paid

and, if so, is it reasonable to assume that such a result was not the intended result when the relevant tax provisions were enacted (section 207(4) FA 2013)?

13.1 The planning, if successful, would result in the Individual being able to claim a loss for income tax purposes of £250,000 although the overall effect of the arrangements was to insulate him from the economic impact of that loss. That is a result within item (ii) above. It is reasonable to assume that a tax loss in these contrived circumstances was not the intended result when the relevant tax provisions were enacted.

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

14.1 HMRC has said there is no relevant established practice and that it has not indicated its acceptance of the tax planning represented by the transactions.

14.2 The Responses did not challenge this.

15 Discussion

15.1 The Individual entered into co-ordinated transactions with the Counterparty from which the Individual had no prospect of making an overall pre-tax profit. Even if the index had remained within the upper and lower barriers any profit from the transactions themselves would have been lower than the fees payable by the Individual.

15.2 HMRC has suggested and the Responses have not denied that the upper and lower barriers were chosen so that it was highly probable that the index would be outside the barriers on the valuation date and the Individual would be in a position to argue that he had obtained a tax-relievable loss and a tax exempt gain even though in economic terms he would be in a substantially neutral position (apart from fees).

15.3 It was argued in the Responses that the transactions were comparable to commercial transactions. We do not agree. Commercial parties do not enter into transactions where there is no prospect of profit or some other benefit. There was no prospect of an overall pre-tax profit here and no other benefit has been suggested apart from the possibility of claiming a tax relief.

15.4 We have considered whether the fact that the "shortcoming" in the legislation is of a general nature, that is that the legislation at the time simply did not have specific provisions designed to apply to the arrangements described in Section 4, as opposed to there being a defect or omission in a specific statutory provision, should affect our conclusion and we consider that it should not.

15.5 The other aspects of the statutory test, in particular the question of whether the arrangements are contrived and abnormal and the question of whether the arrangements are inconsistent with principles and policy objectives of the legislation, are so clearly met that we consider it clear that neither the entering into nor the carrying out of the steps in this case amounts to a reasonable course of action in relation to the relevant statutory provisions.

15.6 We have considered all the circumstances and the statutory tests set out in section 207 (2) (a), (b) and (c) FA 2013 and section 207 (4) (b) FA 2013 and they each indicate that neither the entering into nor the carrying out of the transactions described in Section 4 amounts to a reasonable course of action in relation to the relevant statutory provisions.

16 Conclusion

Each of the sub-Panel members is of the view, having regard to all the circumstances (including the matters mentioned in subsections 207(2)(a), 207(2)(b), 207(2)(c) and 207(3) FA 2013) and taking account of subsections 207(4), 207(5) and 207(6) FA 2013, that:

a) the entering into of the tax arrangements is **not** a reasonable course of action in relation to the relevant tax provisions; and

b) the carrying out of the tax arrangements is **not** a reasonable course of action in relation to the relevant tax provisions.