TAX

Tackling tax affairs

The proposed General Anti-Abuse Rule is dividing opinion among tax practitioners

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Opinions are divided as to the likely impact of the proposed General Anti-Abuse Rule (GAAR) to be introduced next year. Some tax practitioners believe the GAAR will transform the tax-planning landscape by significantly reducing the scope for tax mitigation, while others perceive the proposed GAAR to be little more than a cosmetic exercise. Perhaps the reality lies somewhere between the two extremes.

The report by Graham Aaronson QC, prepared at the Government's request, explained that the GAAR would be targeted at 'abusive' arrangements and not more general forms of tax avoidance. In this way, the GAAR would operate to deter contrived and artificial schemes regarded as an intolerable attack on the integrity of the UK's tax system, without compromising sensible and responsible tax-planning which negotiates the most favourable route through the niceties of complicated tax law.

There is an argument that the introduction of a GAAR might even encourage rather than discourage tax mitigation planning. As Aaronson explains, at the present time tax tribunals and the courts are faced with the temptation to stretch statutory interpretation when striking down abusive schemes in order to achieve a sensible result. "This is widely considered as producing considerable uncertainty in predicting the outcome of such disputes," he says. "In practice, this uncertainty spreads from the highly abusive cases into the centre ground of responsible tax planning. A GAAR specifically targeted at abusive schemes would help reduce the risk of stretched interpretation and the uncertainty which this entails."

Opponents of a GAAR articulate a different narrative. At the present time, tax tribunals and the courts apply a recognisable set of principles in a consistent and rationally defensible way. If a GAAR is introduced, inevitably there will be mission creep, and the result will be far greater uncertainty in cases where legitimate tax-planning arrangements are involved.

Some insight can be gained from a consideration of experiences in other common law jurisdictions where a GAAR has been introduced.

In Australia, a GAAR has operated for many years, and schemes which constitute a sham are the focus of attack. However, there is a strong academic perception that the GAAR has introduced uncertainty into Australian tax-planning and there have been unforeseen consequences from its application.

The operation of a GAAR in New Zealand has been characterised by differing commentaries. The New Zealand provision is widely couched, striking at arrangements which have tax avoidance as one of their purposes or effects, irrespective of whether or not any other purpose or effect is attributable to ordinary business or family dealing. The application of the GAAR divided members of the Privy Council in 2005 (*Peterson v Commissioners of Inland Revenue*) when, in a minority judgment, Lords Bingham and Scott concluded that the majority decision in the case would emasculate the operation of the GAAR.

By focusing on the notion of an abusive arrangement, the UK Government hopes to avoid some of these difficulties. In this regard, the experience of an abuse-based GAAR in Canada is most apposite. Canada introduced a GAAR in 1998 to negate the effect of transactions which resulted in a reduction of tax, subject to evidence that the transaction was not an abuse of the legislation in question. The first case decided by the Canadian Supreme Court in 2005 (*Re Canada Trustco*) concluded that the GAAR was not engaged where there was a purchase and leaseback arrangement which enabled a company to deduct capital costs when computing its profits. Meanwhile, in a second case heard at the same time (*Re Mathew*), the Supreme Court determined that an arrangement enabling an insolvent company to transfer its losses into a partnership which subsequently offset the losses against partnership income circumvented the intention of the Canadian legislature and therefore was caught by the GAAR. Whether the operation of the GAAR was truly determinative in this case is debatable. There is certainly an argument that the Canadian Supreme Court would have reached the same decision by way of statutory construction in the absence of a GAAR.

There is general agreement among tax practitioners that a small number of cases will be affected when the GAAR is introduced next year. On any view, the GAAR will provide tax tribunals and the courts with a weapon to deal with abusive schemes which cannot be struck down by applying normal principles of statutory interpretation to the tax provisions concerned. Accordingly, the deficiency relief/capital gains tax loss scheme in Ships 2, which came before the court last year (*HMRC v Mayes*), will almost certainly be caught, whereas other cases such as those involving film scheme arrangements (*Icebreaker, Eclipse 35*) will continue to be decided by reference to established principles of statutory construction. This being so, the introduction of the GAAR is unlikely to have the widespread impact that some tax practitioners fear.