THE REVISED GAAR GUIDANCE or THE BLIND LEADING THE BLIND?[1]

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1 The Lull before the Storm

The GAAR was introduced by Finance Act 2013 and applied only with effect from July 17th 2013. It is no doubt for that reason that we have not heard much of it recently, as personal and trust tax returns and even some corporate tax returns for periods covered by the GAAR will not as yet have needed to be made and, even where they have been, the generous transitional provisions meant that a fair amount of GAAR forestalling was possible.

2 The GAAR and Accelerated Payment Notices

Part of the GAAR legislation was high-jacked by the Finance Act 2014 provisions allowing the service of an Accelerated Payment Notice. Craftily, and thoroughly reprehensively, HMRC hoodwinked Parliament into *apparently* enacting that an Accelerated Payment Notice could be served simply because a GAAR counteraction notice has been given and at least two of the members of a sub-panel of the HMRC-packed GAAR Advisory Panel was that the tax arrangements were not a reasonable course of action, even though for the GAAR to apply other conditions would need to be satisfied. Worse still, this trigger condition for the service of an Accelerated Payment Notice is not in terms, in contrast with the

1 "Can the blind guide the blind? Shall they not both fall into a pit?" - Luke 6:39.

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question whether the GAAR in fact applies is not (or so it would seem), one in which the judgment of any independent court or tribunal is involved.[3]

I say "apparently" because, in my view, it may well be possible to argue before the Courts, possibly depending on the precise circumstances, that HMRC have not, in fact, validly served an Accelerated Payment Notice.

3 The Guidance Approved 30th January 2015

3.1 General Comment

I shall refer to the Guidance Approved by the GAAR Advisory Panel on 30th January 2015 as "the New GAAR Guidance".[4] Some of the New GAAR Guidance involves simple updating, such as substituting up to date statutory references. Much of it involves pernickety changes of style and format, such as the substitution of upper-case for lower-case letters and *vice versa*, which suggests the authors are far more concerned with form than substance. For all that, it appears that HMRC either cannot spell or cannot type and do not have a budget which runs to a spell-checker. Obvious typographical errors such as "National Insurance contibutions" at B9.2 have not been picked up. I cannot help feeling that that is perhaps symbolic of the varying quality of the substantive content.

The most important part of this article is section 5, which discusses a wholly new Example in the New GAAR Guidance. In my view, its inclusion shows how completely unfit for purpose are both those employed by HMRC who are responsible for the GAAR Guidance and the GAAR Advisory Panel which has approved it.

3.2 Significance of New GAAR Guidance

The significance of the New GAAR Guidance is accurately set out at the beginning:

"Part A – Purpose and status of this guidance

> A1 This guidance is published with two main objectives.

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3 It is explicitly recognised in the New GAAR Guidance at C6.5.11: "… it is important to recognise that the Advisory Panel (and the relevant sub-panel) is not exercising any sort of judicial role".

4 It is called "HM Revenue and Customs (HMRC) General Anti Abuse Rule (GAAR) guidance, approved by the Advisory Panel with effect from 30 January 2015) updated to January 30th 2015."

> A2 The first is to give, in layperson's language, a broad summary of what the General Anti-Abuse Rule ('the GAAR') is designed to achieve, and how the GAAR operates so as to achieve it.
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> A3 The second is to be an aid to the interpretation and application of the GAAR, by discussing its purpose, considering particular features of the GAAR and, where appropriate, illustrating that discussion by means of examples.
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> A4 In this context it is important to note that this guidance's function as an aid to the interpretation and application is explicitly recognised by the GAAR legislation. S211(2) of Finance Act ('FA') 2013 requires any court or tribunal which is considering the application of the GAAR to take into account those parts of the Guidance which have been approved by the GAAR Advisory Panel. Parts A, B, C and D of the current guidance have been approved by the Advisory Panel (which is a panel of individuals chosen for their relevant knowledge and experience all of whom are completely independent of HMRC)."

4 Need the GAAR be Self-Assessed?

4.1 The Old Guidance

The original Guidance (of April 2013) was inconsistent on the need for a taxpayer to take the GAAR into account in self-assessing.

It stated:

> "B14 Management of the GAAR by HMRC officials
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> B14.1 To ensure that HMRC invokes and applies the GAAR responsibly and consistently, the GAAR legislation requires counteraction of the abusive tax arrangement to be initiated by an official who has been specifically designated for this purpose by HMRC. HMRC officials may not in any circumstances commence counteraction under the GAAR without such prior consent, and a taxpayer is entitled to require evidence that such consent has been obtained. (Part E of this guidance contains more detail). The procedure for applying the GAAR to any arrangement requires that the proposed application of the GAAR should be put before an advisory panel of experts, independent of HMRC, who will give their opinion (or opinions if they are not unanimous) as to whether the arrangements in question constitute a reasonable course of action.

> B15 The GAAR and Self-Assessment
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> B15.1 The GAAR forms part of the tax laws of each of the taxes to which it applies. Where those taxes operate on a basis of Self Assessment, then taxpayers are required to take the provisions of the GAAR into account when completing their Self-Assessment tax returns."

It does not take a logician to work out that B15 is quite inconsistent with B14. If indeed counteraction can be initiated only by a specifically designated official, after consideration by a panel of "experts", then, unless and until such an official duly counteracts, the GAAR has failed to come into operation. It follows that the taxpayer's self-assessment return cannot be incorrect simply because it does not take into account the possible application of the GAAR. For, until that self-assessment return has been received, the official cannot even have initiated the GAAR counteraction procedure.

So which was correct? While I have a view, I leave the reader to consider the, arguably ambiguous, meaning of Finance Act 209 section 213 (Counteracting the tax advantages).

4.2 The New GAAR Guidance

HMRC might have been forgiven for having prepared the original GAAR Guidance and the GAAR Advisory Panel might have been forgiven for approving it in a hurry. In any event, one would expect the New GAAR Guidance to plump for one view or the other. B14 and B15 are in fact completely unchanged.[5] One has to ask whether any one in HMRC has in fact read the document as a whole! Worse still, one has to ask how conscientiously the GAAR Advisory Panel has discharged its duty to understand it before approving it!

5. New Example D25A

5.1 The Example

I set out the full text of the new Example D25A. However, the reader may not wish to read beyond the point I have marked with a row of asterisks, at the end of D25A.2, as my comment is principally limited to the text before that.

"D25A RSP Limited – Disguised remuneration

This example illustrates an arrangement with contrived steps designed to avoid the Part 7A ITEPA 2003 disguised remuneration rules, and is contrary to the policy and principles of the relevant provisions.

D25A.1 Background

D25A.1.1 This scheme is intended to extract value from an EBT where money or assets are "trapped" within an employee benefit trust (EBT) without Part 7A of ITEPA and regulation 22B of the SSCR applying.

D25A.2 The arrangements

D25A.2.1 In April 2010 RSP Ltd established a discretionary trust for the benefit of one director. In November 2010 RSP Ltd made a £1m further contribution to the trust. The anti-forestalling provisions for Part 7A took effect from 9 December 2010, before the director could access the funds.

The following steps are taken –

- the EBT trustees subscribe £1m for fully paid up shares in a new wholly owned company resident in Jersey
- the director borrows £1m cash from RSP Finance Ltd (a group co) at a commercial rate (Loan 1)
- the director purchases the Newco shares from the EBT for £1m, financed by the loan funding
- RSP Finance Ltd sells a loan note instrument for £1m to the EBT at full value (Loan 2) [5A]

At this point the EBT is owed £1m by RSP Finance Ltd. The director has a "money-box" Jersey company with £1m but also owes £1m to RSP Finance Ltd.

Under a tri-partite agreement between the EBT Trustees, the director and RSP Finance Ltd –

- the director agrees to procure that the EBT trustees will release the debt owed by RSP Finance Ltd (Loan 2)[6]
- in return RSP Finance Ltd agree to treat the debt owed by the director as satisfied (Loan 1)

Following this final step

- no loans remain in place

5A RV Note: I am sure that what HMRC mean is that RSP Finance Limited itself *issues* a loan note for a consideration equal to its its par value, rather than sells an existing note issued by a third party.

6 See the next footnote.

- no funds remain in the EBT[7]
- the director wholly owns a Jersey company with £1m cash

[*** RV is not commenting on the text of the Example beyond this point]

D25A.3 The relevant tax provisions

D25A.3.1 Income tax provisions

Section 62 of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA')

Part 7A of ITEPA

Section 188 of ITEPA

Section 415 of the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA')

D25A.3.2 NICs provisions

Sections 3 and 6 of the Social Security Contributions and Benefits Act 1992 ('SSCBA').

Regulation 22B of the Social Security (Contributions) Regulations 2001 (SI 2001 No 1004) ('SSCR').

D25A.4 The taxpayer's tax analysis

The loan made by RSP Finance Ltd is not made by a relevant third person [s.554A(7)(c)/(8)] so does not result in a charge under Part 7A.

The transfer of shares by the EBT trustee to the director is a relevant step within s554C(1)(b), but the value of the relevant step is reduced to nil [s.554Z8(5)/(6)].

The loan from RSP Finance Ltd is an employment-related loan within s174(1)/(2), but is not a taxable cheap loan [s176]. As it is released for consideration, no charge to tax arises.

Loans are not earnings so no Class 1 NICs are due.

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7 It is thus implicit, as one would expect, that the director has actually procured the trustees to release the debt owed by RSP Finance Ltd. Otherwise, there would indeed still be "funds" in the EBTs in the form of money owed by RSP Finance Ltd to it.

D25A.5 What is the GAAR analysis under Section 207(2) FA 2013?

HMRC accept that loans are not earnings as defined in section 3 of the SSCBA nor general earnings as defined in section 62 of ITEPA. The arrangements are intended to exploit this and the fact that Part 7A of ITEPA does not apply to payments which are not made by a third party.

It was the intention of Part 7A of ITEPA to regularise the taxation treatment of arrangements which involved the provision of reward, recognition, earnings/employment income or loans through third parties (including trusts or other vehicles used to reward employees), and sought to avoid or defer the payment of income tax and or Class 1 NICs.

These arrangements are clearly designed, successfully or otherwise, to avoid Part 7A by the use of a number of contrived or abnormal steps. They would therefore be considered abusive for the purposes of the GAAR.

D25A.5.1 Are the substantive results of the arrangements consistent with any principles on which the relevant tax and NIC provisions are based (whether express or implied) and the policy objectives of those provisions?

The purported end result of these arrangements is that the employee has received what appears to be an amount of earnings from a third party with no tax and no Class 1 NIC. This is not the intention of the main charging provisions for earnings for tax or NIC and neither is it within the policy objectives for Part 7A. The substantive result of the arrangements cannot reasonably be considered as being consistent with the relevant tax and NIC provisions or their policy objectives.

D25A.5.2 Do the means of achieving the substantive tax and NICs result involve one or more contrived or abnormal steps?

The Employment Income treatment of this arrangement involves consideration of each step. The arrangements entered into are highly artificial and contrived.

Loan 1 is not genuinely repaid.

Loan 2 is effectively written off or released following the action of the Trustees.

D25A.5.3 Were the arrangements intended to exploit any shortcomings in the relevant NICs provisions?

The scheme sought to exploit a shortcoming in Part 7A of ITEPA or to avoid Part 7A by contriving loans between a number of parties to avoid a direct payment from a third party. If an amount is treated as employment income under Part 7A it is treated as earnings for Class 1 NICs purposes.

D25A.5.4 Does the arrangement include any of the indicators of abusiveness within Section 207(4) FA13?

If the arrangements work, they result in no earnings or general earnings subject to Class 1 NICs/chargeable to income tax. This is clearly much less than the value the director actually received.

D25A.5.5 Do the tax and NICs arrangements accord with established practice and has HMRC indicated that it accepts that practice?

The established practice for the taxation of normal earnings such as wages, salary or bonuses is the operation of PAYE and the application of NIC. Arrangements which involve placing funds in an off-shore trust and then entering into a series of highly contrived steps to extract those funds do not accord with established practice.

HMRC has never indicated acceptance of such practices.

D25A.6 Conclusion

On the facts given the arrangement is an abusive one to which HMRC would seek to apply the GAAR. Additionally HMRC would run as an alternative a technical challenge under provisions of Part 7A."

5.2 Commentary

It beggars belief that HMRC should consider - and that the GAAR Advisory Panel should agree - that this hopeless scheme should be a worthy candidate for GAAR counteraction. It gets nowhere near the GAAR because it fails at the outset for the simplest of reasons - and would have failed 100 years ago! While I appreciate that HMRC state, at D3.1 of the New GAAR Guidance, "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", yet the reason this scheme does not work is elementary and Deed of Settlement not involve either "other anti-avoidance legislation" or "specific 'technical' tax rules".

The real transfer of value - and any supposed tax advantage - occurs only under the so called "tri-partite agreement".[8] While the effect of this is not explained as clearly as it could have been, it must be the case that the EBT Trustees release the loan due to them from RSP Finance Ltd, in consideration of RSP Finance Ltd agreeing to treat the debt owed by the director as satisfied.

Now it is clear that, as a matter of trust law, the trustees of the employee benefit trust can release the debt only if, as a minimum, that would be for the benefit of the director. The trustees are in effect satisfying the debt of the director to RSP Finance Ltd. They are not doing so in cash, but they are doing so in money's worth.

It is equally clear that if the trustees of the employee benefit trust had simply appointed the debt owed them by RSP Finance Limited to the director, that would have constituted earnings of his.[9]

Does it make any difference that they have instead incurred expense in order to discharge his debt to RSP Finance Limited and thus conferred a pecuniary benefit on him?

Although I have been in practice at the Bar 35 years, 25 years as a Silk, I had never supposed that it could conceivably make a difference. Given this example, however, I looked again at the authorities. I can only assume that both HMRC and the members of the GAAR Advisory Panel have overlooked a recent decision of the House of Lords and all the comments made in tax text books since it was decided.

The recent decision is *Hartland v Diggines (H M Inspector of Taxes)* (1926) 10 TC 247. In that case the employer of the employee, without being under any contractual obligation to do so, discharged the debt of the employee to a third party. In what must be a record for the shortest set of speeches or judgments in an income tax case, the House of Lords unanimously held that the employee had

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8 This use of "tri-partite" or "tripartite" is an unusual one. It was in fact coined by me in relation to an element in certain strategies of my invention which were designed, not to enable an employee to receive a benefit from his employment without being taxed on it as "earnings" but to avoid a "bear trap" under which the employee would otherwise be taxed on a non-existent benefit. As I had had enough of being ripped off, I deliberately used an existing word in a new, inconventional, sense to help me detect any plagiarism. It seems that the inventor of this scheme must have known of one of mine and been, let us say, "inspired" by it. In fact, he seems to have been so hopeless in adapting my work, that I can can hardly feel resentful.

9 If authority were needed for that proposition, one need look no further than the decision of the House of Lords in *Brumby (H M Inspector of Taxes) v Milner* (1976) 51 TC 577.

received an "emolument"[10] equal to the amount paid to discharge the debt. The main argument for the employee was that the sum was not an emolument "because it was not paid to the Appellant or at his request". That argument was soundly rejected. As Viscount Cave LC said:

> "It is true that the Appellant did net receive cash in his hands, but he received money's worth … This being so, I cannot resist the conclusion that the payment was in fact a part of his profits and emoluments as an, officer of the Company for which he has been properly assessed to tax."

So the scheme founders because the director has received an emolument.[11] Moreover, he cannot even claim, as could Mr Hartland, albeit to no avail, that the release of RSP Limited's indebtedness was not at his request - he was a party to the tri-partite agreement.

Even if that were wrong, which I do not think for one moment it was, the director would be assessable under the benefit in kind provisions, in particular Income Tax (Earnings and Pensions) Act 2003 Part 3 Chapter 10 on the cost to the trustees of procuring for him the benefit of having his indebtedness to RSP Limited satisfied.

If indeed the scheme had worked, absent the GAAR, I can totally understand why HMRC would consider it would be a prime candidate for the GAAR. By means of a complicated series of transactions, with tax planning at their heart, value passes out of the employee benefit trust and into the estate of the director. If that had been done by a simple cash payment from the employee benefit trust to him, that would clearly have constituted "earnings".

Astonishing as it is that (a) the inventor and promoters of the scheme and (b) the tax and legal advisers of uses of the scheme should not have perceived this, it is verging on the incomprehensible that neither of:

> (c) HMRC nor
>
> (d) the GAAR Advisory Panel

should have appreciated the simple, obvious analysis of the tax effects of the scheme.

5.3 The Moral

Under Finance Act 2013 section 211(2)

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10 and thus, under Income Tax (Earnings and Pensions) Act 2003 "earnings".

11 and thus "earnings" within Income Tax (Earnings and Pensions) Act 2003 section 62

> "(2) In determining any issue in connection with the general anti-abuse rule, a court or tribunal must take into account-
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> (a) HMRC's guidance about the general anti-abuse rule that was approved by the GAAR Advisory Panel at the time the tax arrangements were entered into, and
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> (b) any opinion of the GAAR Advisory Panel about the arrangements (see paragraph 11 of Schedule 43)."

The Court must take these matters into account. It is entirely up to the Court what weight it attached to them. If the GAAR Advisory Panel can approve such hopeless guidance as is found in Example D25A, that provides taxpayers with considerable ammunition in support of an argument that the GAAR Advisory Panel is so unfit for purpose that its views should be given no weight at all. I asked in the alternative title to this article THE BLIND LEADING THE BLIND? Is it perhaps rather a case of the blind leading the blind by the nose?