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# **Simplifying anti-avoidance legislation**

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A progress report on the anti-avoidance simplification  
review

12 March 2008

# Contents

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Chapter		Page
1	Introduction	3
2	Engagement and summary of views	5
3	The way forward	7
Annex	Different approaches to anti-avoidance legislation	10

# Chapter I: Introduction

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**1.1** The Government is committed to ensuring the UK provides a world-class environment for business. As part of the Government's commitment to tax simplification, the Pre-Budget Report and Comprehensive Spending Review (PBR) launched three reviews, including the Anti-avoidance Simplification Review which is the focus of this document. The objective of the review is to consider how anti-avoidance legislation can best meet the twin aims of simplicity and revenue protection.

**1.2** The Government has identified three principles of tax simplification, which underpin this work:

- simplification will be a priority when designing and reviewing tax policy alongside sound public finances and fairness;
- the Government will work in partnership with business to identify further opportunities to simplify the tax system; and
- the Government will share its findings on the viability of tax simplifications with business.

**1.3** The PBR identified the priority areas that HM Treasury (HMT) and HM Revenue & Customs (HMRC) believe will best achieve simplification in anti-avoidance legislation:

- ensuring new anti-avoidance legislation is clear, effective and well targeted; and
- simplifying areas of existing anti-avoidance legislation.

## Combining revenue protection with simplicity

**1.4** The role of HMRC is to administer the UK's tax and customs systems so that society's financial well-being is ensured. In doing this, HMRC is committed to making it as easy as possible for taxpayers to get it right, while protecting society by dealing firmly with anyone who intentionally avoids their responsibilities. This provides the over-arching context both for HMRC's anti-avoidance strategy and for this Simplification Review.

**1.5** HMRC's strategic aims for countering avoidance are to:

- make tax law robust against avoidance;
- engage with our customers about our approach to avoidance (as set out, for example, in *The framework for a better relationship – Making a difference: Review of Links with Large Business*, also published today);
- optimise our operational approach to avoidance; and
- change the economics of avoidance to make it less attractive, so that the expected costs of avoidance exceed the perceived benefits.

**1.6** The objectives of the Simplification Review build on these strategic aims. Areas will be selected for further scrutiny on the extent to which legislation might be repealed or redrafted in less complex ways with the aim of producing improved legislation that is as straightforward as possible, well targeted and with a clearly discernible purpose. At the same time, the aim will be to ensure that the new legislation provides a similar - or more effective – level of protection to the Exchequer.

## **Structure of this document**

**1.7** Chapter 2 reports progress on the Anti-Avoidance Simplification Review announced at PBR, summarising the views of participants in the Review.

**1.8** Chapter 3 sets out the proposed way forward: outlining the measures identified for repeal, the specific areas identified for further review as a result of the work done so far, and the intended timetable for taking the work forward.

**1.9** The Annex to this document describes and compares a number of different approaches to counter avoidance and considers how the measures announced at Budget for enactment in the 2008 Finance Bill reflect these different approaches.

**1.10** HMRC is grateful to everyone who gave time to attend meetings or submit responses.

## Chapter 2: Engagement and summary of views

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**2.1** An online survey was announced at PBR 2007 giving the opportunity to comment on the priority areas for the Review. Written submissions were also received which, taken with the results of the survey, show that there is strong backing for the Review and the priority areas suggested at PBR.

**2.2** In addition, to further inform the review so that it could begin to focus on delivering results, HMRC and HMT have been engaging with business and professional stakeholders – for example, through a workshop and other informal discussions.

**2.3** Stakeholders were asked for views on how the Review’s aims of combining simplicity with revenue protection could best be put in to practice, and on the priorities for simplification.

### External engagement – summary of views

**2.4** Businesses and their advisers accept the need for more effective anti-avoidance rules. However, they want legislation that is clear, well targeted and easier to use. They also want to be able to understand the tax consequences of complex commercial transactions with reasonable certainty.

**2.5** The following points were also identified as important:

- anti-avoidance legislation should be used only for the purpose intended and should not be used out of context;
- anti-avoidance legislation can be particularly burdensome for non-avoiders where there are overlapping provisions to consider for the same commercial transaction;
- in targeting legislation, HMRC should recognise that while deals may be structured in a tax efficient manner, this does not always involve avoidance.

**2.6** It was recognised that a variety of approaches to anti-avoidance legislation are available and all are capable of being well targeted and proportionate. But all were felt to work best with full consultation and scrutiny.

**2.7** In desiring well-targeted legislation, external stakeholders did not necessarily want to restrict future legislation to ‘black-letter’, prescriptive rules. The essence of effective targeting was that the purpose of the law should be clearly stated and users of the legislation should be able to understand clearly what their obligations were.

**2.8** There was considerable interest in the ‘principles based’ approach, which was seen as a way of improving clarity of purpose. Mixed views were expressed on Targeted Anti-Avoidance Rules (TAARs): some were seen as clear and well-targeted, while others were seen as very broad and less clearly focused. Both of these approaches are discussed in more detail in the Annex.

**2.9** Finally, external stakeholders prefer laws to be fully scrutinised by Parliament, with a firm preference for primary over secondary legislation.

## **Consultation on financial products avoidance**

**2.10** Alongside the Simplification Review, a consultation document was launched on 6 December 2007 (*Principles-based approach to financial products avoidance: a consultation document*) with the aim of using a principles-based approach to simplify two specific areas of anti-avoidance legislation: disguised interest and transfers of income streams. The responses to this consultation were generally supportive of its aims and of the potential of the principles-based approach. However, the responses showed that there was a strong desire for more time to get the new legislation right and the Government has therefore deferred the introduction of the principles-based legislation to Finance Bill 2009 to allow for further consultation. In the meantime, targeted legislation will be introduced in Finance Bill 2008 to counter known avoidance schemes in the two areas.

# Chapter 3: The way forward

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## Approaches to anti-avoidance legislation

**3.1** The different approaches to anti-avoidance legislation – from ‘black-letter’ rules to recent, more generic approaches – are described in more detail in the Annex. It is likely that the Government will need to retain this range of approaches at its disposal to provide effective protection against emerging threats to the Exchequer.

**3.2** Nevertheless, the more generic approaches – including the principles-based approach and TAARs – do appear to provide scope for simplifying existing legislation while protecting revenues. The Government will also consider using such approaches, where appropriate, when introducing new legislation.

## Repeals

**3.3** Building on the engagements with stakeholders, HMRC has been reviewing anti-avoidance legislation to identify any provisions which are outdated and complex, and can be repealed without sacrificing revenue protection.

**3.4** As a result, the following provisions will be repealed in Finance Bill 2008:

- Sections 731 to 736 Income & Corporation Taxes Act 1988 (ICTA) on ‘bond-washing’ and ‘dividend buying’;
- Sections 704 paragraph B and 704 paragraph C(1)(b) of ICTA and the Income Tax Act 2007 (ITA) equivalents on transactions in securities; and
- Sections 138 and 139 of ICTA on employment-related securities.

**3.5** The further specific reviews outlined below may also identify additional redundant provisions which can be repealed.

## Specific areas identified for review

**3.6** Participants in the engagement events were asked to consider priorities for areas of legislation most in need of simplification – either because existing law is confusing, in terms of meaning or scope, or because compliance with the law is burdensome.

**3.7** Based on the priorities identified, and having regard to what is likely to be achievable within the twin objectives of the review, HMRC will conduct reviews on the scope for simplification in the following areas of anti-avoidance legislation:

- the ‘Transactions in Securities’ legislation (sections 703 to 709 ICTA and Chapter I Part 13 ITA);
- certain rules relating to shares acquired by employees (Part 7 of the Income Tax (Earnings and Pensions) Act 2003);

- the rules to prevent losses (both capital and income) being transferred from one group of companies to another (Schedule 7A Taxation of Chargeable Gains Act 1992 (TCGA) and sections 768 to 769 ICTA);
- the rules to prevent value being shifted from one asset to another for capital gains purposes (value-shifting and depreciatory transactions rules) (sections 30 to 34 and 176 and 177 TCGA); and
- the tax treatment of property lease premiums (sections 34 to 39 and sections 87 and 87A ICTA and sections 60 to 67 and sections 276 to 306 Income Tax (Trading and Other Income) Act 2005).

**3.8** Another area raised by participants at the external engagements was the various rules preventing relief for transactions carried out for ‘unallowable purposes’. This basic concept appears frequently throughout the Taxes Acts, with a number of different approaches taken in different contexts, and we are considering whether there might be scope for greater alignment of the provisions.

**3.9** In line with the Government’s principles for simplification, all of this work will continue to be carried out in partnership with external stakeholders. The proposed timetable is set out below.

**3.10** The areas identified above all relate to direct taxes. The area of indirect tax identified by stakeholders for potential simplification was the anti-avoidance legislation relating to the ‘option to tax’ supplies of land and property. This issue is being taken forward in the context of the VAT Simplification Review announced at PBR and published on the H M Treasury website:

[http://www.hm-treasury.gov.uk/pbr\\_csr/documents/pbr\\_csr07\\_tax.cfm](http://www.hm-treasury.gov.uk/pbr_csr/documents/pbr_csr07_tax.cfm).

The VAT review also publishes regular updates on the H M Treasury website:

[http://www.hmtreasury.gov.uk/media/C/6/simplification\\_update\\_vat\\_dec07.pdf](http://www.hmtreasury.gov.uk/media/C/6/simplification_update_vat_dec07.pdf).

## Linked Reviews

**3.11** There may be further reviews of the effectiveness of anti-avoidance legislation over the coming months (for example, on leasing of plant and machinery, which has been subject to continuing attempts to circumvent it). These reviews may have objectives beyond simplification but their output will have regard to the scope to simplify existing legislation where possible.

## Timetable

**3.12** The speed and sequencing of the reviews will take into account the need to obtain considered input from business, their advisers and representative bodies, alongside the range of other consultations.

**3.13** Informal dialogue will commence over the summer on the reviews of Transactions in Securities, certain rules relating to shares acquired by employees, and the various ‘unallowable purposes’ tests, with a view to possible formal consultation in the autumn.

**3.14** The reviews of value shifting and capital loss buying will be closely linked with the review of corporate capital gains which has resulted from the CT Related Companies Simplification Review, and again dialogue will commence over the summer.

**3.15** The review of the lease premium rules will be linked to the continuing consultation on the principles-based approach to transfers of income streams.

**3.16** The reviews of the income loss-buying rules and the lease premium rules will be on a longer timescale.

**3.17** An update on the progress of the Simplification Review will be provided at PBR 2008.

## Annex: Different approaches to anti-avoidance legislation

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**A.1** To be effective, anti-avoidance legislation needs to counter what are often complex and highly artificial avoidance schemes. Over recent years the Government has developed approaches to make anti-avoidance legislation clearer and better targeted, and believes that these approaches can support moves to simplify the tax system.

**A.2** Recent approaches tend to be more generic and generally try to include the principles and purposes behind new legislation so as to make it clear and certain what the legislation is designed to achieve.

**A.3** This Annex briefly describes the ‘black-letter’ approach to anti-avoidance legislation and goes on to compare it with the more recent, generic, methods. It also gives examples of the different approaches from measures included in this Budget.

### ‘Black-letter’ approach to anti-avoidance legislation

**A.4** The conventional approach is to spell out in detail either the circumstances in which measures apply or the qualifying conditions to be met. This approach - variously termed ‘black-letter’ or rules-based law - can be extremely useful. For example, threats to revenue can appear overnight and quite often legislation only needs to be slightly amended to counter a threat before revenues are compromised. The disclosure rules have enabled this ‘fine tuning’ to be employed with great effect.

**A.5** The measures on plant and machinery leasing announced at PBR 2007 and on 31 December 2007, and to be introduced in Finance Bill 2008, are examples of such ‘fixes’.

#### **Plant or machinery leasing avoidance.**

Four distinct types of avoidance involving the leasing of plant and machinery have been disclosed to HMRC. These schemes involve:

- the use of section 222 Capital Allowances Act 2001;
- attempts to create tax losses in circumstances where the lessor is said to deal in the leased asset;
- the use of head lease / sub-lease structures to create tax free receipts matched by allowable deductions;
- the use of premiums and similar arrangements to create tax-free receipts.

Measures to counter the first two types of scheme were announced at PBR 2007 and further measures to counter the third and fourth categories were announced on 13 December 2007.

**A.6** There are sometimes difficulties with the ‘black-letter’ approach in that legislation can be long and complex and avoidance schemes can sometimes be constructed to take advantage of the detailed rules. Nevertheless, it is a quick, flexible and targeted approach and is therefore likely to remain a necessary approach

to avoidance legislation.

**A.7** The ‘black-letter’ approach may sometimes be supplemented by Ministerial statement. For example, legislation may be announced with immediate effect to counter new and urgent threats to the Exchequer, usually accompanied by draft clauses.

**A.8** On one recent occasion, a Minister announced that future measures would be contemplated in a particular area, with effect from the date of the Ministerial statement, without providing detailed draft legislation. This was the statement made by the Paymaster General on 2 December 2004 which dealt with persistent avoidance involving tax and National Insurance Contributions arising from employment income. Legislation linked to this announcement was enacted in section 92 FA 2006, with effect from 2 December 2004.

### **Recent approaches: Targeted Anti-Avoidance Rules (TAARs)**

**A.9** A TAAR is a piece of anti-avoidance legislation designed to stop avoidance in a particular area of tax law. Typically a TAAR may be introduced to counter a wide spectrum of repeated avoidance in a particular area, where it is clear that existing legislative methods are not solving the problem. Alternatively a TAAR may feature in a new area of law at the outset as a defence against potential exploitation.

**A.10** TAARs aim to strike a balance between generality and specificity. They are targeted against arrangements designed to achieve a tax advantage in certain circumstances set out within the TAAR, but without the detailed prescriptive rules typical of ‘black-letter’ law.

**A.11** TAARs are not intended to apply to normal commercial transactions or investment decisions. This is generally achieved by a ‘purpose’ rule within the TAAR, so that it operates only when a person enters into arrangements which have a main purpose of securing a tax advantage. TAARs are frequently accompanied by detailed guidance which also can also set out their underlying principles which they embody.

**A.12** Examples of recent TAARs include the three corporate capital loss TAARs enacted in Finance Act 2006 and aimed at contrived loss creation, loss and gain buying and capital loss conversion schemes. The 2007 Finance Act extended one of them to individuals, trusts and personal representatives of deceased persons.

**A.13** This approach can also enable HMRC to achieve the repeal of older, complex legislation (such as the ‘gain buying’ rules in Schedule 7AA TCGA, repealed with the introduction of the corporate capital loss TAARs).

**A.14** An example of a TAAR to be introduced in Finance Bill 2008 is the measure to prevent avoidance of income tax using manufactured payments, announced on 31 January.

### **Avoidance of Income Tax: Manufactured payments.**

Manufactured payments are payments representative of interest or dividends payable on securities arising in the course of repo or stock-lending arrangements. Individuals who pay Manufactured Payments are generally able to obtain relief for the payments against their general income. This has given rise to a range of avoidance schemes whose object is to secure relief for payments whilst ensuring that the individual is economically flat overall (and in profit after tax). A proposed TAAR will prevent relief for Manufactured Payments that are paid, on or after 31 January 2008, under arrangements having a tax avoidance purpose.

### **Recent approaches: principles-based approach**

**A.15** The principles-based approach to legislation seeks to include an expression of the policy intent behind the statute. Sometimes it is manifest in the form of ‘purposive drafting’ and is an approach which explicitly sets out the result the legislation is intended to achieve.

**A.16** A principles-based approach can be used either in anti-avoidance legislation to counter emerging threats, or in crafting new legislation to replace entire areas of the tax code that have become overly complex, or indeed in formulating completely new tax laws.

**A.17** The Courts have frequently had to deal with litigation where they felt that Parliament’s intention, when it passed the legislation, was difficult to discern. For over 20 years since *W T Ramsay Ltd v CIR* (54TC 101) the courts have considered literal and purposive interpretations of tax statute. With the recent cases of *BMBF v Mawson* (76 TC 446) and *CIR v The Scottish Provident Institution* (76 TC 538) the House of Lords confirmed that the modern approach to all statutory construction is to apply a purposive construction. They explained that the essence of the ‘Ramsay’ approach was to apply a purposive construction, to determine the nature of the transaction to which the statutory provision in question was intended to apply, and then to decide whether the actual transaction, viewed realistically, falls within the statutory description.

**A.18** A current example of a principles-based approach is the subject of the recent HMRC consultation, *Principles-based approach to financial products avoidance*. This document set out draft legislation in two areas – disguised interest and income transfers. The document described how the legislation would embody a principle of UK taxation and how the legislation would operate by reference to the principle. The aim is to provide clarity of purpose so that taxpayers will understand the principle and how it applies to their circumstances. In addition the new legislation would allow simplification in that existing complex provisions can be repealed (including the ‘shares as debt’ rules at sections 91A to 91G Finance Act 1996).

**A.19** Following consultation, introduction of the principles-based measures will be deferred until Finance Bill 2009 (with specific ‘fixes’ to the existing legislation in the meantime) to allow time for further consultation.