The House of Lords Economic Affairs Committee Sub Committee to inquire into the draft Finance Bill 2013

Evidence submitted by Richard Murphy FCA in anticipation of a hearing on January 21 2013

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1. Tax Research LLP

1.1. Richard Murphy is a UK chartered accountant. He was senior partner of a practicing firm and director of a number of entrepreneurial companies before becoming one of the founders of the Tax Justice Network in 2002. He now directs Tax Research LLP, a research and advisory body dedicated to investigating the impacts of tax avoidance and tax evasion with a particular emphasis on their impact on the poorest in the UK and worldwide. Richard writes, broadcasts and blogs extensively, the latter at http://www.taxresearch.org.uk/Blog/.

1.2. Richard created the country-by-country reporting concept that is designed to disclose corporate tax avoidance and has been credited with creating much of the debate on tax gaps in the UK and Europe. He also defined the term 'secrecy jurisdictions', now widely used in debates on offshore.

1.3. Richard has been a visiting or research fellow at a number of UK universities and is joint author of 'Tax Havens, The True Story of Globalisation', Cornell University Press 2010 and sole author of 'The Courageous State', Searching Finance, 2011. His latest book, "Over here and under-taxed' will be published in February 2013 by Random House. He is now working on a book entitled 'The Joy of Tax'.

2. This submission

2.1. This submission concentrates on the measures intended to tackle tax avoidance in the draft clauses of the Finance Bill 2013[i]. It concentrates on the General Anti-Abuse Rule but also addresses, as requested, the cap on allowances and the rules relating to annual residential property charge.

2.2. The issues are not discussed in detail: the review looks at the motivation for each measure, its likely effectiveness and the means by which the apparent goals could have been better achieved.

3. The General Anti-Abuse Rule, an overview of this submission

3.1. The General Anti-Abuse Rule as proposed for inclusion in the Finance Bill 2013 suffers from three fundamental problems:

3.1.1. It is not general in nature;
3.1.2. It does not tackle tax avoidance as that term is now widely understood, including by the Prime Minister[ii];
3.1.3. Its construction makes it unlikely to succeed in its objectives.

3.2. Given the weaknesses of the General Anti-Abuse Rule it needs to be withdrawn and replaced by a measure akin to the General Anti-Tax Avoidance Principle Bill proposed by Michael Meacher MP and currently awaiting its second reading in the House of Commons[iii].

3.3. In the interests of full disclosure I put it on record that I wrote Michael Meacher's Bill and am now serving on the Interim GAAR Advisory Panel established by H M Revenue & Customs to advise on issues relate to the introduction of the General Anti-Abuse Rule.

4. Why the General Anti-Abuse Rule is not general in its scope

4.1. When proposing the General Anti-Abuse Rule the government accepted the advice of Graham Aaranson QC, who I understand is to give advice to the Committee. He said in his reported dated 11 November 2011[iv]:

4.2. I have concluded that introducing a broad spectrum general anti-avoidance rule would not be beneficial for the UK tax system. This would carry a real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning. Such tax planning is an entirely appropriate response to the complexities of a tax system such as the UK's.

4.3. That opinion is reflected in the draft GAAR guidance published in December 2012, which says:

4.3.1. The GAAR is intended to have a narrower application than the general anti-avoidance rules found in several other jurisdictions, which usually have potential application to a broader spectrum of tax avoidance[v].

And

4.3.2. TAARs may apply to a wide range of tax avoidance, including tax avoidance that would not be considered to be at the "abusive" end of the spectrum of tax avoidance that is the target of the GAAR[vi].

And

4.3.3. The legislation *sets out that a court or tribunal may take into account any guidance, statements or other material that was in the public domain at the time the arrangements were entered into. Examples of matters that may be taken into account include: Hansard, Explanatory Notes, Written Ministerial Statements, academic literature, external practice, HMRC guidance* ***and evidence as to how particular arrangements are normally structured in the market place*** *(so as to compare or contrast such practice with the arrangement under consideration)*[vii]

NB: My emphasis added

4.4. These quotations (and many others could support the view) suggest that:

4.4.1. The General Anti-Abuse Rule is intended to have limited scope;
4.4.2. The GAAR is intended to only target the most abusive tax avoidance and not tax avoidance in general;
4.4.3. The GAAR is not intended to address arrangements commonplace in commercial activities even if they are otherwise abusive tax avoidance.

4.5. The result of these limitations in scope are that:

4.5.1. The GAAR will only tackle highly contrived, pre-conceived tax avoidance;
4.5.2. The GAAR will be little used;
4.5.3. The GAAR cannot be applied to normal commercial arrangements, however abusive they might be and whatever they might cost the UK Exchequer.

5. Why the General Anti-Abuse Rule does not tackle tax avoidance

5.1. For the reasons noted above the GAAR will not tackle any of the arrangements that have caused considerable concern to the Prime Minister, the House of Commons Public Accounts Committee, the press and general public since the beginning of 2012.

5.2. To put it plainly: because the tax avoidance of Google, Starbucks, Amazon and many similar companies is considered to be normal commercial practice the GAAR that the government is proposing cannot be applied to those arrangements and as such it will have no impact on the mattes causing greatest concern to the public and politicians of all parties.

5.3. In this case it is very hard to describe this as a General Anti-Abuse Rule, or anything akin to it.

5.4. Nor does this General Anti-Abuse Rule tackle tax avoidance is it now widely understood.

5.5. This is not because it is not technically possible to challenge the arrangements that have been used by Google, Amazon and Starbucks: as the GAAR Guidance notes, it can be applied to abuse of OECD double tax agreements[viii], much of which is at the heart of what has been happening in these three cases. What precludes action is that this abuse is now commercially commonplace and as such has been ruled out of consideration for the purposes of the GAAR.

6. Why the General Anti-Abuse Rule's construction means it is unlikely to achieve its own limited goals

6.1. The GAAR presumes an arrangement is abusive if[ix]:

6.1.1. Tax arrangements are abusive if entering into those arrangements, or carrying them out, cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances.

6.2. As the GAAR makes clear "the circumstances" must include consideration of whether:

6.2.1. • the substantive results of the arrangements are consistent with any principles on which those tax provisions are based (whether express or implied) and the policy objectives of those provisions;
• the means of achieving those results involves one or more contrived or abnormal steps; and
• the arrangements are intended to exploit shortcomings in the relevant tax provisions.

6.2.2. These tests are fair. The problem is with the "double reasonableness test".

6.3. As the GAAR notes suggest the double reasonableness test[x]:

6.3.1. does not require the judge to give his or her view on whether tax arrangements are a reasonable course of action, but instead requires the judge to consider what the range of reasonably held views is. And it means that the GAAR will not apply if, even though the judge does not himself regard an arrangement as a reasonable course of action, he nonetheless considers, in all the circumstances, that such a view may reasonably be held.

6.4. The test is not then one of fact as to whether the abuse being considered abuse the principles noted in 6.2.1.; the test is whether it is reasonable to think in the light of current prevailing thinking that they do. The question to then ask is who might hold reasonable opinion on this matter. The opinion of the person on the Clapham omnibus will no doubt not be considered reasonable: they will not be considered to have made an informed decision. In that case the prevailing sentiment will have to be that of the tax profession and the companies likely to enter into such arrangements: outside HMRC they are the only people likely to have an informed opinion. Since tax avoidance of the sort the GAAR tackles only happens because the prevailing sentiment of many in the tax profession and in commercial enterprises both encourages and permits it this test is inherently biased in favour of tax abuse. That is assisted by the clear guidance given that if there are conflicting views an arrangement cannot be abusive[xi]. This sets an almost insurmountable obstacle for the GAAR to jump over before it can be applied.

6.5. There is a second near insurmountable obstacle that comes from this guidance[xii]:

6.5.1. In proceedings before a court or tribunal in connection with the GAAR, the burden of proof is on HMRC to show that:
• there are tax arrangements that are abusive; and
• the counteraction of the tax advantages arising from the arrangements is just and reasonable.
This is different to most tax appeals (apart from some penalty appeals) where the burden of proof in an appeal is on the appellant and in an application is on the applicant.

6.5.2. In other words, not only is the prevailing sentiment of the tax profession the guideline for what is reasonable in the double reasonableness test that the General Anti-Abuse Rule will use, the reality is that HMRC will have to prove that their opinion that an arrangement is reasonable is both wrong and not held. There appears little prospect of HMRC being able to do that.

6.6. The final obstacle to the General Anti-Abuse Rule working is the requirement that before HMRC can bring any action under it the approval of the GAAR Advisory Panel is required. As the guidance notes:

6.6.1. The Advisory Panel represents a spread of interests including business, tax advisers and wider taxpayer interests. The panel provides a view which is independent from HMRC, and no HMRC officer is a member of the panel.

6.6.2. It should be recalled that if the panel is split the arrangement is not abusive. The absence of a judge and the fact that the vast majority of those appointed to the panels that will review GAAR cases will come from the tax profession and given that the burden of proof is on HMRC builds in an inherent disadvantage to HMRC when seeking to use the GAAR. Decision making on the upholding of tax law, and even the ability to challenge arrangements considered abusive under tax law, has been outsourced in the case of the GAAR to a panel inevitably drawn from the tax profession. The incentive for HMRC to take on such challenges will be very low indeed.

7. Alternatives to the General Anti-Abuse Rule

7.1. Whatever the rights or wrongs of the judgement made in November 2011 on the General Anti-Abuse Rule it is now apparent that in the light of events in 2012 they were wrong: the GAAR is already outmoded and ineffective legislation that cannot achieve the aim set of it by the government of effectively constraining tax avoidance.

7.2. There is not space here to discuss all alternatives. Suffice to say a General Anti-Tax Avoidance Principle would:

7.2.1. Let HMRC commence action on its own initiative;
7.2.2. Replace the deeply subjective double reasonableness test with an objective economic substance test which would assess whether tax was paid in the right place at the right rate under the right tax code at the right time given the economic impact of the transactions that actually occurred;
7.2.3. Place the burden of proof on the taxpayer to show that this had happened;
7.2.4. Impose penalties on those who sought to avoid tax in a way that fell foul of this test to deter those seeking to do so;
7.2.5. Provide a clearance system so that any taxpayer could obtain a prior agreement to their proposed arrangements from HMRC, albeit at a price for the certainty that could supply them with.

8. The cap on allowances

8.1. The government claims that the logic of the proposal is to create a cap on unlimited income tax reliefs that will be "set at £50,000 or 25 per cent of an individual's income, whichever is greater." It adds "This measure is about fairness: a tax system should provide relief to support those who take risks by investing in their business or in certain types of shares – but that support should not be without limit."[xiii] I struggle to relate these sentiments to the proposals made for a number of reasons.

8.2. Firstly, the cap appears entirely arbitrary. The Enterprise Investment Scheme (EIS), which provides income tax relief at 30% on up to £1 million of investment per annum, and the Venture Capital Trust (VCT) scheme that provides for income tax relief, also at 30%, on investments of up to £200,000 per annum, are excluded from the cap. Their exclusion very obviously makes it possible for total tax relief of well over £50,000 or 25% of an individual's income to be granted in a year.

8.3. Secondly, the first three 'reliefs' to which the cap is to be applied are:

8.3.1. Trade Loss Relief against general income, which is available for losses made by an individual carrying on a trade, profession or vocation;
8.3.2. Early Trade Losses Relief, which is available to an individual in the first four years of the trade, profession or vocation;
8.3.3. Post-cessation Trade Relief which is available for qualifying payments or qualifying events within seven years of the permanent cessation of the trade;

In general a loss is considered to be negative income for tax purposes. These provisions are therefore not reliefs as such, but are instead offsets against other income to be made when calculating what a person's income for tax purposes might be. I have real difficulty seeing how such a cap can encourage entrepreneurship. It would be better to have enhanced provisions restricting the use of losses not incurred in the ordinary course of trade.

8.4. Thirdly, whilst the remaining seven reliefs identified by the government for the purposes of being capped may be appropriate their inclusion and the resulting measures make no sense unless there is added to that list other reliefs already capped, which then need to be included in the calculation of an overall limit on tax relief. I would argue, therefore, that pension tax reliefs of all sorts, and reliefs for EIS and VCT schemes need to be added to the list of reliefs included in the cap, even if separately limited in their own right. Only then does a cap make sense. As it stands the new arrangements will present a nightmare to calculate and will result in arbitrary taxation.

8.5. In general terms this cap raises more questions than it answers:

8.5.1. It remains unclear why a higher rate tax payer should have their savings subsidised to greater degree than those paying basic rate tax;
8.5.2. Higher rate tax relief on charitable giving that saves the taxpayer money but provides no matching benefit to the charity appears to be illogical;
8.5.3. The advantage of the use of tax reliefs to encourage investment without the overall direction of an industrial policy remains unclear;
8.5.4. Adjustment to tax rates would achieve the desired effect of revenue raising better than these arrangements can ever possibly do: keeping the 50% tax rate would have been the obvious way of doing this.

9. Annual residential property charge

9.1. According to the Treasury "This consultation is part of a package of measures that the Government announced at Budget 2012 to ensure that individuals and companies pay a fair

share of tax on residential property transactions and to tackle avoidance, including the wrapping of property in corporate and other "envelopes"[xiv].

9.2. In summary, there is little evidence that the proposed annual tax charge or the charging of capital gains on the entities holding such properties will achieve the government's objectives of ending tax abuse. This is because:

9.2.1. It may not be easy to properly identify the properties to which the charge should be applied: the property owner is required to self assess their property and submit a valuation with their tax return. Apart from obvious valuation issues many who have such properties will not submit tax returns and companies only owning property in the UK need not necessarily do so. The chance of data being captured is, therefore, very low;

9.2.2. If valuation data can be captured seeking to impose the charge will be difficult: establishing who will be liable given the complex ownership, residence and tenancy arrangements that can be constructed will prove insurmountable objects to collecting tax in many cases;

9.2.3. Given the opacity of property ownership arrangements imposing penalties on companies that own properties that do not comply with the charge will be almost impossible to achieve. The government has optimistically said it will pursue all beneficial owns of such properties: the truth is it has no way of finding out who they are.

9.3. There is a much better way to tackle these arrangements: all companies and other entities owning property in the UK must now be required to file the following annually with HMRC for publication on public record:

9.3.1. An annual declaration of beneficial ownership with proof to the standard required for anti-money laundering purposes;

9.3.2. An annual set of accounts;

9.3.3. A statement of the address of a UK agent responsible for the company's affairs and who has unlimited liability to make settlement of its debts.

9.4. In addition:

9.4.1. It must be required that any property transaction where the property is owned by a corporate entity (whether UK or foreign owned) other than for commercial purposes should be subject to tax withholding at source at the current capital gains tax rate with that sum to be retained by HMRC until evidence of any tax liability has been agreed;

9.4.2. The rules on withholding taxes on rents paid to foreign companies should be rigorously applied;

9.4.3. Beneficial owners of properties who reside in them without rent being charged should be subject to a benefit in kind charge for the use of that property and a payment equivalent to income tax on that benefit in kind should be charged;

9.4.4. If any tax liability is outstanding when a property is sold then the person handling the transaction should be liable for retaining the tax due;

9.4.5. If any tax is owing in respect of a property more than three years after the charge arose that property should be sold in the open market to realise the funds required to make settlement of the tax due.

These arrangements would be much more likely to stop tax avoidance.

10. Endnotes

[i] http://www.hmrc.gov.uk/budget-updates/march2012/finance-bill-2013-draft.htm#1
[ii] See http://www.telegraph.co.uk/news/politics/david-cameron/9779983/David-Cameron-Tax-avoiding-foreign-firms-like-Starbucks-and-Amazon-lack-moral-scruples.html
[iii] http://services.parliament.uk/bills/2012-13/generalantitaxavoidanceprinciple.html
[iv] http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf para 1.5
[v] http://www.hmrc.gov.uk/budget-updates/11dec12/gaar-guidancepart-a.pdf para 1.3
[vi] http://www.hmrc.gov.uk/budget-updates/11dec12/gaar-guidancepart-a.pdf para 1.5.1
[vii] http://www.hmrc.gov.uk/budget-updates/11dec12/gaar-guidancepart-b.pdf page 3
[viii] http://www.hmrc.gov.uk/budget-updates/11dec12/gaar-guidancepart-a.pdf page 11
[ix] http://www.hmrc.gov.uk/budget-updates/11dec12/gaar-guidancepart-a.pdf page 16
[x] http://www.hmrc.gov.uk/budget-updates/11dec12/gaar-guidancepart-a.pdf page 17
[xi] ibid
[xii] http://www.hmrc.gov.uk/budget-updates/11dec12/gaar-guidancepart-c.pdf page 20
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