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Simon Thomas AM
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Cardiff Bay
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Dear Simon

LAND TRANSACTION TAX AND ANTI-AVOIDANCE OF DEVOLVED TAXES (WALES) BILL

I have been following with interest the evidence provided by stakeholders and key areas of debate in relation to the Bill during the first stage of the scrutiny process. As you are aware, I particularly welcome discussion on the practical application of the Bill and I am keen to continue to support the Committee and stakeholders and to provide any supplementary information which would be helpful.

You will be aware that some of the areas of questioning and points raised by stakeholders have been in relation to technical and complex aspects of the Bill. In light of this, I have attached further detail on the following technical questions which I hope may be helpful to the Committee's understanding:

a) Why there is a need for both a relief targeted anti-avoidance rule (TAAR) and the general anti-avoidance rule (GAAR);
b) Why the TAAR applies to non-devolved taxes, but the GAAR only to devolved taxes;
c) Which arrangements are caught by the GAAR; including the meaning of 'tax advantage', 'tax avoidance arrangements' and 'artificial';
d) Why "artificial" is used rather than "abusive";
e) Whether the Welsh GAAR wider than the UK GAAR; and
f) How will the Welsh Revenue Authority (WRA) counteract an advantage?

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I have also attached Annex 1 which provides extracts from some relevant case law, which I hope may prove useful.

My officials would be happy to provide further technical briefings if this would be of assistance to the Committee to understand some of the more complex and challenging aspects of the Bill.

I hope your Committee finds this information useful. I am keen to assist the Committee if there is anything further.

Yours sincerely

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Ysgrifennydd y Cabinet dros Gyllid a Llywodraeth Leol
Cabinet Secretary for Finance and Local Government

Why do we need both a relief TAAR and the GAAR?

1. Targeted anti-avoidance rules will continue to play an important part in the wider framework used to tackle devolved tax avoidance. A number of targeted rules have been embedded into the Bill, and provide taxpayers with certainty that existing avoidance schemes cannot operate within the LTT system.

2. The Welsh Government does not rule out the possibility of introducing further targeted anti-avoidance rules in the future, where there are known avoidance schemes operating which need to be 'closed-down'. The GAAR complements this by providing a general rule which enables the WRA to take action where those targeted rules are not in place, or where a taxpayer contends that they have found a way to circumvent the TAAR.

3. The targeted anti-avoidance rule provided by section 31 of the Bill ("the relief TAAR") is designed to stop avoidance schemes involving the claiming of one or more reliefs. Although avoidance activity covered by the relief TAAR would also be covered by the GAAR, WRA will exercise targeted rules before exercising the GAAR.

Why does TAAR apply to non-devolved taxes, but GAAR only to devolved tax?

4. The purpose of the Welsh GAAR is to enable the WRA to counteract a tax advantage which is derived from an artificial tax avoidance arrangement. Section 81D defines "tax" in this context as "any devolved tax" (i.e. landfill disposals tax and land transaction tax)[1].

5. Therefore, in order to counteract a tax advantage under the GAAR, liability to a devolved tax must have been reduced or avoided in some way. Where liability to a non-devolved tax has been reduced or avoided in some way, the Welsh GAAR will not apply as a devolved tax will not have been avoided. In these cases, it will be for HMRC and the UK Parliament to determine whether that non-devolved tax advantage should be counteracted in some way.

6. This can be contrasted with the approach taken in relation to the relief TAAR provided by section 31 of the Bill. Subsection (3) defines "tax" to include some non-devolved taxes. In every case where the relief TAAR is engaged, liability to a devolved tax will have been reduced as a result of a relief being claimed, so there will have been a devolved tax advantage. The rule provided by section 31 ensures that relief from LTT is not available where the arrangement giving rise to the relief forms part of a wider arrangement which has a main purpose of avoiding a non-devolved tax, albeit that the claim to the LTT relief, when viewed in isolation, is legitimate.

7. This means that relief from LTT cannot be claimed where the transaction forms part of arrangements which have a main purpose of avoiding a non-devolved tax[2].

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[1] The application of the Welsh GAAR to future devolved taxes will ultimately be a decision for the Assembly when passing legislation giving effect to those devolved taxes.

[2] This approach is consistent with a number of SDLT TAARs which are being replaced by the relief TAAR. See, for example, paragraph 8(5B) of Schedule 7 FA 2003, which lists a number of UK taxes.

8. An example of where this situation might arise is in a case where a company enters into two land transactions with another group company – one in England, another in Wales, with a main purpose of avoiding corporation tax. The 'English' land transaction would not be eligible for group relief as the SDLT TAAR[3] provides that group relief cannot be claimed as the transaction forms part of arrangements to avoid tax (which is defined to include corporation tax). But the absence of a wider definition of "tax" in relation to the relief TAAR, group relief from LTT could be claimed in relation to the Welsh land transaction, assuming that that Welsh land transaction, in isolation, did not fall foul of the TAAR.

9. It is not the Welsh Government's policy to allow devolved tax legislation to be used in a manner which facilitates any tax avoidance, whether or not that tax is collected by WRA. Nor is it the Welsh Government's policy that the devolution of taxes should lead to an overall weakening of the UK tax system of which those devolved taxes form a part.

Which arrangements are caught by the GAAR?

10. The GAAR provides the WRA with a power to counteract a "**tax advantage**" deriving from an "**artificial tax avoidance arrangement**". The three elements of this ("tax advantage", "artificial" and "tax avoidance arrangements") have been individually defined in the Bill.

The meaning of "tax advantage"

11. In the GAAR, a "tax advantage" can only mean one of the things listed in section 81D. In contrast, the UK and Scottish rules define "tax advantage" by reference to a non-exhaustive list[4] of things.

12. We have opted for an exhaustive list to provide taxpayers with greater certainty and clarify that only those things listed will be caught by the GAAR.

The meaning of "tax avoidance arrangements"

13. Section 81B(1) provides that an arrangement is a "tax avoidance arrangement" if "*the obtaining of a tax advantage for any person is the main purpose, or one of the main purposes, of a taxpayer entering into the arrangement*".

14. This general test is broadly consistent with the equivalent UK and Scottish GAARs found in section 207(1) of the Finance Act 2013 ("FA 2013"), and section 63(1) of the Revenue Scotland and Tax Powers Act ("RSTPA"), except that section 81B omits the requirement to "having regard to all the circumstances". We concluded that this was superfluous: when deciding whether an arrangement is caught by the rule, WRA must always have regard to all relevant circumstances as a matter of public law.

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[3] Paragraph 2(4A) of Schedule 7 Finance Act 2003 ("FA 2003").
[4] Section 208 FA 2013 and section 65 RSTPA 2014.

Main purpose test

15. The definition of "tax avoidance arrangement" includes cases where "the main or one of the main purposes" of entering into the arrangement is to obtain a tax advantage.

16. Practitioners and the judiciary will be familiar with this type of "main purpose" test as it already exists in the UK and Scottish GAARs and is well established in a large number of TAARs. It has been considered on a number of occasions with the decisions of the courts and tribunals pointing to the application of a high threshold when deciding whether the "main purpose" test is satisfied[5].

17. Furthermore, it should be noted that the "main purpose" test does not operate in isolation. The GAAR operates as a two-stage test: the additional requirement that the arrangement must be "artificial" provides a 'filter' which limits the scope of the rule to those arrangements where one of the main purposes is the obtaining of a tax advantage, and where the entering into or carrying out of the arrangement is not a reasonable course of action in relation to the applicable legislation. Collectively, this two-stage test ensures that only those "artificial" arrangements which have a main purpose of avoiding tax are caught by the GAAR.

Arrangement

18. Because the GAAR will apply to landfill disposals tax, we have opted for a slightly wider definition of "arrangement" as compared to the UK GAAR. This ensures that avoidance arrangements involving landfill disposals tax (which might involve a particular "event" or an individual undertaking a particular "action" or "operation") are caught by the rule, and is consistent with the Scottish GAAR[6].

Meaning of artificial

19. A tax avoidance arrangement will be artificial if entering into it or carrying it out is not a reasonable course of action.

20. Section 81C(2) sets out two of the factors which might be taken into account when deciding whether an arrangement is "artificial". It is important to note that there may be other relevant factors (or even merit in disregarding those factors listed in subsection (2)), but this will depend on the nature and circumstances of the arrangement.

Does the arrangement have any "genuine economic or commercial substance"?

21. Having regard to whether the arrangement has "*any genuine economic or commercial substance*" enables WRA (and therefore the tribunal) to consider the reasons behind the structure of the transaction. A large volume of TAARs on the statute book already operate by reference to whether the arrangement has a "*genuine commercial substance*"[7], or "*bona fide commercial purpose*" and practitioners and the judiciary will

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[5] Including, *Brebner* [1967] 2 W.L.R. 1001; *Commissioners of Inland Revenue v Trustees of the Sema Group Pension Scheme* [2002] EWHC 94 (Ch) and *Versteegh Ltd and others v Commissioners for Revenue and Customs* [2013] UKFTT 642 (TC). Relevant extracts are found in Annex 1 to this letter.

[6] Section 63(2) RSTPA 2014.

[7] Sections 455 and 446A of the Income Tax (Earnings and Pensions) Act 2003 and regulation 4(2) of the Real Estate Investment Trusts (Prescribed Arrangements) Regulations 2009 (S.I. 2009/3315)

be familiar with undertaking an assessment as to whether an arrangement has "commercial substance"[8].

22. The question of whether an arrangement has any "economic" or "commercial" substance will be one of fact, and it will be for WRA (or on appeal, a tribunal) to decide whether there was any economic or commercial substance behind the arrangement. and the structure created.

23. An arrangement will have commercial substance where there is some reasonable business conduct behind the arrangement. For example, in a case where the buyer of land can purchase that land directly in a simple A-B transaction, the taxpayer will achieve their economic and commercial aim (of owning the land) and will not have entered into any arrangements that could be considered artificial or lacking in genuine economic or commercial substance. However, where the buyer enters into a more convoluted, and more costly, way to obtain the land, it is possible that the arrangement will lack genuine commercial substance. This is because, absent the tax advantage, it is reasonable to argue that the buyer would not have incurred that additional cost having regard to the economic and commercial objectives of acquiring the land.

24. Conversely, where a taxpayer is confronted with two possible options as to how the purchase of the land can be achieved, and both options deliver the same economic and commercial consequences, save that one results in a lower tax liability without any additional arrangements required, then it is reasonable for the taxpayer to choose the option which attracts less tax.

25. We have chosen to include an additional factor of "economic" substance to provide a safeguard in cases where the nature of the transaction means that there will not be any "commercial" substance behind the transaction. For example, the acquisition of a plot of land of historical importance by a charity may be motivated by that charity's desire to further its charitable objectives and protect the land in question. Furthermore, some of the reliefs relating to relief for certain transactions relating to social housing (Schedule 14) are likely to have economic substance rather than commercial substance.

26. Having regard to the "economic" substance of the transaction is not a new feature for avoidance legislation. In addition to the Scottish GAAR[9] (*which requires consideration of the "economic and commercial substance" of the arrangement*) and the UK GAAR (*which lists some examples of arrangements which might be abusive to include transactions which achieve a tax result which differs from the economic result of the arrangement*), targeted anti-avoidance rules in corporation tax legislation require consideration of the "economic purpose" of particular arrangements[10].

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[8] For example, paragraphs 2(4A) and 8(5B). Schedule 7 of the Finance Act 2003 and section 734 of the Corporation Tax Act 2010, and the Supreme Court judgment in *UBS AG v Commissioners for Revenue and Customs ([2016] UKSC 13*

[9] This was introduced by the Scottish Government as a Stage 2 amendment following concerns expressed by the Scottish Finance Committee that the Scottish GAAR might inadvertently capture gifts of land between family members.

[10] For example, section 689D of the Corporation Tax Act 2009

Why "genuine" rather than "bone fide"?

27. We think that "genuine" is more appropriate than "bone fide" As a matter of drafting policy, the Welsh Government prefers to avoid the use of Latin phrases wherever possible, except in cases where a Latin phrase conveys something more than could be conveyed in English. For the purposes of the GAAR, we do not consider that this is a case where "bona fide" conveys anything more than we need to through "genuine". The intention is that the GAAR should capture arrangements that have been created to include features that lack commercial or economic purpose so as to obtain a tax advantage.

Generally prevailing practice

28. Section 81C(3) is designed to provide taxpayers with a 'shield' against any claim that an arrangement is artificial in cases where the arrangement is consistent with generally prevailing practice, and that practice had been accepted by WRA. This has been inserted into the Welsh GAAR as a means of providing additional protection to taxpayers: it would be wrong for the WRA to attempt to recover tax that has been avoided if WRA had previously indicated that the arrangement was acceptable.

29. Although the practice generally prevailing scenario described in this provision is given as an example of something which might not constitute an "abusive" or "artificial" arrangement in the respective UK and Scottish GAARs, section 81C(3) provides an absolute bar against an arrangement being classed as "artificial" in the context of the Welsh GAAR and so constitutes a significant protection for taxpayers when compared to the UK GAAR.

Why "artificial" rather than "abusive"?

30. In the absence of any case law in relation to the UK and Scottish GAARs (*as they are yet to be exercised by HMRC and Revenue Scotland*), we consider that "artificial" and "abusive" are labels to describe a more detailed statutory test provided in the respective provisions, and those tests are broadly similar.

31. We have opted to define our test as "artificial" as we consider it more accurately describes the core of the test and the Welsh Government's intention that the GAAR will capture those arrangements that have been contrived in an artificial or abnormal manner to obtain a tax advantage. Despite the similarities in the core of the tests, the use of "abusive" in the UK GAAR suggests it is intended to capture a narrower range of arrangements that are extremely or highly contrived.

32. Importantly, tax practitioners and the judiciary will be familiar with such "artificial" tests in the context of tax avoidance. There is a reasonable and developing line of jurisprudence considering the meaning of "artificial", flowing from the well-established *Ramsay* principle which provided for the purposive interpretation of tax legislation to avoid giving effect to an "*artificial and fiscally ineffective*" scheme.

33. In contrast, an extremely limited line of jurisprudence exists as to the meaning of an "abusive" tax avoidance arrangement, and indeed in some cases, the terms "artificial" and "abusive" have been used in the courts interchangeably[11].

34. Describing the test in section 81C as "abusive" would therefore potentially add different areas of confusion as case law, as referred to earlier, has considered extensively artificial tax arrangements.

Is the Welsh GAAR wider than the UK GAAR?

35. We do not think that the Welsh GAAR is substantively wider than the UK GAAR. Apart from the different terminology "artificial" and "abusive", the key difference between the Welsh and Scottish GAARs as compared to the UK GAAR is the "double-reasonableness" test. In common with the Scottish Government, we decided not to adopt this rule as we did not consider it necessary to do so. As a public authority, WRA will be bound by normal public law principles, including the requirement to act reasonably. We do not think it necessary, therefore, to include a statutory bar on WRA counteracting an arrangement, where it *unreasonably considers* that the arrangement is caught by the GAAR.

36. In important ways, the Welsh GAAR will offer greater protection to taxpayers (see *practice prevailing* and meaning of *tax advantage*).

How will WRA counteract an advantage?

37. The UK and Scottish GAARs provide HMRC and Revenue Scotland with a wide range of powers to enable the recovery of the avoided tax[12]. These include recovering the avoided tax by making a further assessment, amending the taxpayer's return, or "*such other method*" as considered appropriate.

38. In contrast, the WRA may only recover the avoided tax through the two methods described in section 81E(3) – by amending the taxpayer's return or by means of a WRA assessment.

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[11] See the *Trustees of the Morrison 2002 Maintenance Trust and others v Commissioners for Revenue and Customs* [2016] UKFTT 0250 (TC) at paragraph 128.

[12] See section 66(4) RSTPA 2014 and section 209(6) FA 2013.

Annex 1

1. In *Inland Revenue Commissions v Brebner*[13], the Court of Appeal considered whether a tax advantage was "one of the main objects" of entering into an arrangement:

> *"... when the question of carrying out a genuine commercial transaction, as this was, is reviewed, the fact that there are two ways of carrying it out - one by paying the maximum amount of tax, the other by paying no, or much less, tax - it would be quite wrong, as a necessary consequence, to draw the inference that, in adopting the latter course, one of the main objects is, for the purposes of the section, avoidance of tax. No commercial man in his senses is going to carry out a commercial transaction except upon the footing of paying the smallest amount of tax that he can.* ***The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence.***" [at p 718-9]

2. In *Commissioners of Inland Revenue v Trustees of the Sema Group Pension Scheme*[14], the High Court was asked to consider whether "one of the main objects" of entering into an arrangement was to obtain a tax advantage:

> *"The tax advantage may not be a relevant factor in the decision to purchase or sell or in the decision to purchase or sell at a particular price. Obviously* ***if the tax advantage is mere "icing on the cake" it will not constitute a main object.*** *Nor will it necessarily do so* ***merely because it is a feature of the transaction or a relevant factor in the decision to buy or sell****. The statutory criterion is that the tax advantage* ***shall be more than relevant or indeed an object; it must be a main object.***" [at para. 53]

3. More recently, in *Versteegh Ltd and others v Commissioners for Revenue and Customs*[15] the First-tier Tribunal whether a tax advantage was a "main purpose or one of the main purposes" of the taxpayer entering into the arrangement:

> *"In the same way that the mere presence of a commercial purpose cannot rule out the existence of tax avoidance as being a main purposes,* ***the mere existence of a tax advantage, known to the taxpayer, does not on its own render the obtaining of that advantage a main purpose.*** *All the authorities point to the question being one of degree and significance to the taxpayer, and that the question is one of fact for the tribunal, having regard to all the circumstances."* [at para. 158]

4. *In UBS AG v Commissioners for Revenue and Customs*[16], the Supreme Court considered whether to interpret provisions in income tax legislation to lead to tax-free bonuses awarded by various banks in 2004 in such a way to enable them to be regarded as a means of avoiding income tax:

> *"There is nothing in the background to suggest that Parliament intended that* [the provisions allowing for the award of tax-free bonuses] *should also apply to transactions having no connection to the real world of business,* ***where a restrictive condition was deliberately contrived with no business or commercial purpose but solely in order to take advantage of the exemption.***" [para 78]

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[13] [1967] 2 W.L.R. 1001
[14] [2002] EWHC 94 (Ch). The extract was subsequently approved by the Court of Appeal in [2002] EWCA Civ. 1857 at paragraph 119.
[15] [2013] UKFTT 642 (TC)
[16] [2016] UKSC 13