14. Trusts and the GAAR

14.1 Introduction

In *Duke of Westminster v CIR*, as part of his judgement, Lord Tomlin said:

> "Every man is entitled if he can to order his affairs so that the tax attracted under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

In the summer of 2013, the General Anti-Abuse Rule (GAAR) came into effect. By implementing the GAAR, the government has rejected Lord Tomlin's approach, and has imposed an overriding statutory limit on the extent to which taxpayers can go in trying to reduce their tax bill. That limit is reached when the arrangements put in place by the taxpayer to achieve that purpose go beyond anything which could reasonably be regarded as a reasonable course of action "having regard to all the circumstances".

As will be appreciated trusts are frequently used as a means of improving tax efficiency. As such it is necessary to consider whether a trusts structure may be subject to the GAAR. In general, where HMRC are aware of a planning technique and have accepted it in the past, they will not apply the GAAR. On the other hand where an arrangement is established that is designed to exploit a loophole in legislation (that the draftsman would have dealt with had he addressed it) HMRC may well apply the GAAR.

In what follows we give a very brief overview of the GAAR – much of which is based on the *Guidance Notes* issued by HMRC in April 2013. Despite the government's continued drive to attack tax avoidance schemes, little has been said about the GAAR since its introduction, and there have been relatively few reports of it making a decision on a tax avoidance scheme.

Payments in gold

In 2017 the GAAR Committee met and ruled that a scheme introduced to avoid tax on payments in gold would be caught under the new GAAR principle.

Employee benefit trusts

In March 2020, the GAAR committee considered a scheme using an employee benefit trust. Here an elderly client bought shares in a new company especially established for the purpose. She then gifted the shares to an employee benefit trust (EBT) set up for the benefit of her family, and the company managed the investment of the cash on behalf of the trust beneficiaries.

The estate administrator claimed that the transfer into the trust was exempt from IHT under IHTA 1984, s. 28, which deals with gifts to EBTs. No periodic IHT charge would be payable because the trust qualified as an EBT under IHTA 1984.

HMRC referred the arrangement to its advisory panel dealing with the GAAR. The panel noted that the company set up by the scheme did not actually have any employees and did not need any, so it was "contrived and abnormal" to transfer shares into a trust for the benefit of employees at a time when none existed.

The panel agreed that gifting shares into the EBT might have had a legitimate aim if the company had been a long-standing family firm with an established workforce who needed an incentive to continue the business after the settlor's death. However, it was not, and accordingly the panel ruled that the transfer was actually a chargeable lifetime transfer outside the exemption in IHTA 1984 and thus liable to a 40% IHT charge, as the settlor had died within three years of the transfer. Moreover, the settlor was also a trust beneficiary, so the trust assets were potentially subject to tax on her death, as a gift with reservation of benefit.

Loans from employment trusts

Here an individual employee stablished an offshore remuneration trust and made small loans to the trust. The employer then made a large £150,000 payment to the trust, £125,000 of which was then used to make a loan to the employee. The company claimed a tax deduction on the contribution and the employee claimed that the loan was tax free.

In their opinion of 7 April 2020, the GAAR committee determined that:

- The entering into of the tax arrangement was *not* a reasonable course of action in relation to the relevant tax provisions.
- The carrying out of the tax arrangements was *not* a reasonable course of action in relation to the relevant tax provisions.

This meant that the arrangement was unacceptable tax avoidance and the £125,000 payment was taxable on the employee.

Using shares to repay a company loan

Here a scheme was devised for a director to repay an outstanding loan from a company by transferring shares in a new company established by the director.

The GAAR advisory panel concluded that the GAAR should apply as:

- Section 455 was an anti-avoidance measure designed to tax the distribution of funds from a close company by way of loan unless that loan is repaid or written off.
- Amendments made to the s. 455 legislation in March 2013 showed that Parliament's intention was to circumvent arrangements that caused a technical but not an economic repayment. As a result, if the arrangements did achieve a technical repayment and avoid the additional anti-avoidance provisions in s. 464A or 464C then there was a shortcoming in, or exploitation of, the legislation.
- The arrangements in question contained a number of contrived or abnormal steps.
- The arrangements were not consistent with standard practice accepted by HMRC.

The panel said that the taxpayers had devised a contrived way of circumventing the s. 455 rules and that the entering into or carrying out of the tax arrangements was not a reasonable course of action.

Summary

These cases demonstrate that GAAR is intended to operate as a measure designed to discourage people from entering aggressive tax avoidance schemes in the first place and so affects the culture of the taxpayer. In this respect, it is undoubtedly effective. At the end of the Chapter we consider how the GAAR might or might not apply to two classic planning routes that are very much based on trusts.

Case: *Duke of Westminster v CIR* (1935) 19 TC 490

14.2 The target of the GAAR

The primary policy objective of the GAAR is to deter taxpayers from entering into abusive arrangements, and to deter would-be promoters from promoting such arrangements. There may be tax avoidance arrangements that are challenged by HMRC using other parts of the tax code, but if they are not abusive they are not within the scope of the GAAR.

If a taxpayer implements an "abusive" tax avoidance arrangement, the GAAR may well operate so as to counteract the abusive tax advantage which he or she is trying to achieve. The counteraction under the GAAR will be an adjustment in the payment of tax which is just and reasonable in all the circumstances.

14.3 What the GAAR is not targeted at

Just as it is essential to understand what the GAAR is targeted at, so it is equally essential to understand what it is *not* targeted at.

Underlying the GAAR legislation is the recognition that, under the UK's tax code, in many circumstances there are different courses of action that a taxpayer can quite properly choose between. HMRC make a point that the GAAR will not apply to all tax-saving arrangements – any action taken based on a reasonable decision will not be attacked.

For example, the GAAR will not apply where an individual decides to carry on a trade either as a sole trader or through a limited company whose shares he or she owns and where he or she works as an employee. HMRC state that such a choice is completely outside the target area of the GAAR even though tax may be saved by taking profit as dividends.

Similarly, decisions to invest in an ISA in order to take advantage of the income tax relief which such investments carry, or to give away assets to a son or daughter without retaining a benefit in the gifted asset, with a view to reducing the amount of IHT payable on the transferor's death, fall outside the target area of the GAAR. Using statutory incentives and reliefs to support business activity and investment in a straightforward way (for example business property relief, EIS, capital allowances, patent box) are also not caught by the GAAR unless individuals abuse the use of these tax reliefs entering into contrived arrangements to obtain a relief but incurring no equivalent economic risk.

In essence, the GAAR only comes into operation when the course of action taken by the taxpayer aims to achieve a favourable tax result that Parliament did not anticipate when it introduced the tax rules in question and, critically, where that course of action cannot reasonably be regarded as reasonable.

14.4 The GAAR and the rest of the tax rules

It is important to appreciate that the GAAR is designed to counteract the tax advantage which the abusive arrangements would otherwise (i.e. in the absence of the GAAR) achieve. This means that it will usually be necessary to determine whether the arrangements would achieve their tax avoiding purpose under the rest of the tax code (i.e. the non-GAAR tax rules), before considering whether the arrangements are "abusive" within the meaning of the GAAR.

14.5 The GAAR and other statutory anti-avoidance provisions

There are many statutory provisions relating to the taxes covered by the GAAR which set out specific anti-avoidance rules. Some of these are known as targeted anti-avoidance rules ("TAARs"), while others may take the form of less explicit anti-avoidance protection.

In principle the GAAR operates independently of these other anti-avoidance rules, and it might well be used to counteract an abusive arrangement which was itself contrived to exploit a defect in the other anti-avoidance rules, whether a TAAR or otherwise.

It is important to note that in many cases the existing (non-GAAR) tax rules will be effective to defeat abusive tax arrangements, and so in such cases HMRC will not need to rely on the GAAR. However, where an abusive scheme is outside of the normal tax avoidance provisions the GAAR can apply

14.6 In what circumstances will the GAAR apply?

The GAAR can only apply if "yes" is the answer to the following four questions:

- Is there a *tax arrangement*, i.e. an arrangement which gives rise to a *tax advantag*e (see **14.7** below)?
- Does the tax advantage relate to one of the *taxes* to which the GAAR applies (see **14.8** below)?
- Is it reasonable to conclude that the obtaining of a tax advantage was *the main purpos*e, or one of the main purposes, of the arrangements (see **14.9** below)?
- Are the arrangements *abusive* (see **14.10** below)?