M45 SECTION 67 OF THE INCOME TAX (GUERNSEY) LAW 1975 – LEGAL AVOIDANCE

Introduction

The amendment to the anti-avoidance provisions contained in section 67 of the Law, which took effect for 2008 and beyond, followed two States Reports.

In the June 2006 States Report it was stated that effective anti-avoidance measures would be required to support the taxation strategy and to counter any hidden opportunities for legal avoidance which might result from the introduction of the zero/10 regime. That was qualified in the May 2007 States Report, when the Policy Council said that the anti-avoidance measures used in practice would depend on the experience of the new system over a period of time.

The Director of Income Tax ("the Director") accepts, therefore, that the States intended that whilst there should be sufficiently robust legislation to address any attempts at tax avoidance as they arise, the exercise of those measures will be tempered to the circumstances (and, in this regard, the Director acknowledges that commercial realities should not be ignored simply because the outcome of a transaction is the reduction, deferral, etc of a tax liability).

Guidance on the Income Tax Office application of the section 67 legislation

1. Section 67 will not be invoked in relation to any transaction which already gives rise to a tax charge on the whole of the income as a consequence of the operation of any other provision of the Law. (For example, section 67 would not be invoked in order to "double tax" income, either in the hands of one person or to tax the same income in the hands of two, or more, persons.) However, this should not be taken to mean that where a transaction falls to be taxed twice, the Director will accept the basis that gives rise to the lowest liability. For example, a company may have an asset which it allows an employer/"participator" (see section 66A(8)(b)) to use on which a benefit in kind arises (of, say, tax of £2,000) and a qualifying loan (of, say, tax of £10,000). Whilst the Director may pursue the liability on the qualifying loan, he would not, in addition, pursue the benefit in kind.

2. In accordance with the spirit of the States Resolutions, it is not intended that section 67 should be applied in relation to "ordinary life events" which are themselves isolated and do not form part of a series or chain of transactions or events.

   Examples are:

   - A person incorporating a business (even if with the principal purpose of having the benefit of the "distribution basis" of taxation of company income). However, section 67 would be invoked in the event an individual attempts to transfer, or otherwise attribute income personal to him to a company (e.g. with the purpose of benefiting from the distribution basis).

- A company or trader scaling down a trade or ceasing to trade.

- A company choosing not to distribute its profits.

- A subjective decision to apply funds to one particular project or investment in preference to any other (e.g. where the choice exists as between an investment giving rise to income and an investment with capital appreciation, section 67 would not be invoked to tax income foregone by choosing the latter) other than where a Statement of Practice exists in relation to a specific situation, such as life assurance policies (including single premium life assurance bonds) – M18 – and investments in funds – M19.

- A decision to borrow money for a particular purpose in preference to utilising available funds.

3. It should be anticipated that section 67 will be invoked in relation to “circular schemes” (e.g. where a person makes a payment, which is claimed as a deduction for tax purposes, and subsequently receives a payment – in money or in kind – in what is purported to be a capital, or otherwise not taxable, form), schemes that involve steps or transactions which have no real commercial purpose and “alchemy schemes” (e.g. where a transaction purports to convert income to capital). Regard will be given to the economic substance of the transaction rather than the legal form it takes.

4. Where a company has more than one class of shares in issue, the Director will make a direction under the provisions of section 67, if he is not satisfied that the operation of the differential share structure is for bona fide commercial purposes and if it gives rise to the avoidance or reduction of the liability to tax of any person.

5. It should be anticipated that section 67 will be invoked if excessive loans were found to be made by shareholders to companies, for example by introducing a significant asset into a company's balance sheet (such as a property not used for the company's activities), and then "loan repayments" were taken against that asset instead of making distributions.

6. It should be anticipated that section 67 will be invoked if an employee enters into arrangements with their employer to limit the impact of any withdrawal of allowances for high earners, for example by negotiating a lower salary (or no annual increase) in return for an employer increasing the employer contributions into a pension scheme.

A “distribution” is defined by section 62AA and includes any distribution made out of the assets of a company, save that it shall not include any repayment of capital to the member.

The Director wishes to clarify that any return to the shareholders on liquidation of a company will fall within the definition of a distribution. If on a repurchase of shares by the company the amount which the shareholder receives exceeds the amount originally subscribed, this premium would be treated as a distribution.

Pre-transaction clearances

A taxpayer or their agent may seek advance clearance from the Director that he will not seek to apply the provisions of section 67. This will be based on a complete and accurate, written, disclosure being made of the transaction or transactions contemplated, along with an explanation of the rationale for their being entered into. Whilst any clearance issued by the Director as a result may be regarded as binding on him, if it subsequently transpires to have been issued based on incorrect or incomplete information or, if the transaction was not carried out in accordance with the facts presented to the Director, it will be void. If there are changes to the proposed transaction, the revised facts should be resubmitted for a further clearance.

Appeals process

Where the Director makes any adjustment to a person’s income tax liability under the provisions of section 67, that adjustment is subject to the normal, long standing, appeals process set out in Part VII of the Law.

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