



**HM Revenue
& Customs**

Tax Treaties Anti-avoidance

Technical Note
1 August 2011

Contents

Introduction

Chapter 1 Background

Chapter 2 Overview of legislation

Chapter 3 Draft legislation relating to UK residents

Chapter 4 Explanatory commentary relating to UK residents

Chapter 5 Draft legislation relating to non-UK residents

Chapter 6 Explanatory commentary relating to non-UK residents

Introduction

The Government announced at the Budget on 23 March 2011 that it intended to introduce legislation in Finance Bill 2012 to counter avoidance schemes that exploited the provisions of double taxation agreements (DTAs). The draft legislation included in this note forms the basis of consultation on this proposal.

The consultation is being conducted in line with the Tax Consultation Framework. There are five stages to tax policy development and implementation:

- Stage 1 - Setting out objectives and identifying options;
- Stage 2 - Determining the best option and developing a framework for implementation including detailed policy design;
- Stage 3 - Drafting legislation to effect the proposed change;
- Stage 4 - Implementing and monitoring the change; and
- Stage 5 - Reviewing and evaluating the change.

This consultation is taking place during Stage 3 of the process. The draft legislation included in this note is being published now to provide as much time as possible to consult and ensure that the legislation will operate as intended.

HMRC welcomes views on the approach that the draft legislation takes to tackling tax avoidance using DTAs, as outlined in Chapter 2. We would also be grateful to hear views on whether the formulation of the tests achieves its objective, and whether there are any perceived unintended consequences, including arrangements caught by the draft legislation that are considered to be ones to which it should not apply and the persons that might be unintentionally affected. A tax information and impact note on this measure will be published in the autumn taking into account comments received.

Comments on this note should be made by 22 September 2011 to Tom Matthews (telephone: +44 (0)20 7147 2661, email tom.o.matthews@hmrc.gsi.gov.uk). This feedback will be used to inform the final version of the draft legislation that will be published in the Autumn when interested parties will have a further opportunity to comment.

Chapter 1

Background

1. The UK has around 120 bilateral DTAs with other countries and territories. The purpose of these DTAs, as set out in their preamble, is the avoidance of double taxation and the prevention of fiscal evasion. Their intention is to secure that, as far as possible, the taxpayers of each country may trade or invest in the other country without the deterrent of unrelieved double taxation. At the same time, it is important to ensure that taxpayers do not exploit the terms of the agreements and differing tax systems in each country for tax avoidance purposes.
2. However, both UK resident and non-UK resident persons continue to exploit the provisions of DTAs through the use of tax avoidance arrangements. These arrangements attempt to access the benefits of treaties when they are not properly due to secure the result that items of income, profit or gain are not subject to tax in the UK.
3. The past response to these schemes has been to legislate to close them down as they have arisen or to rely on anti-avoidance measures in DTAs themselves. However, avoidance activity exploiting the provisions of DTAs has continued and the Government now considers that a broader anti-avoidance measure is required to prevent further loss of tax in this area.
4. Provisions such as those in the draft legislation are sanctioned by the Organisation for Economic Cooperation and Development (OECD); the commentary to the Model Tax Convention on Income and on Capital, on which the UK's DTAs are based, states that countries "do not have to grant the benefit of a double taxation convention where arrangements that constitute an abuse of the convention have been entered into."¹ The proposed legislation will therefore ensure that the UK's DTAs are interpreted and applied in accordance with generally accepted international principles.

¹ Commentary to Article 1 of the OECD Model Taxation on Income and Capital, paragraph 9.4

Chapter 2

Overview of the legislation

1. The purpose of the draft legislation is to ensure that individuals, companies and other persons cannot benefit from the provisions of a DTA where the claim to such benefit is part of an arrangement whose main purpose is to reduce a liability to UK taxation. The draft legislation contains separate measures dealing with tax avoidance by UK residents and non-UK residents.
2. The effect of both measures is that a provision of a DTA will not limit the right of the UK to tax income or gains where certain conditions are met.

UK residents

3. The proposed legislation is intended to reinforce the principle that, except in narrow and explicit circumstances (for example articles dealing with students or government service), DTAs do not restrict the right of the UK to tax its residents.
4. The proposed legislation will apply where a DTA makes provision that income, profits or gains of a UK resident are either not subject to UK tax, not to be subject to UK tax at a rate exceeding the rate specified in the DTA or not to be treated as income, profit or gains of a UK resident and chargeable to UK tax.
5. Where certain avoidance conditions are met, the proposed legislation will apply such that the provision in the DTA will not prevent the income, profits or gains either being charged to UK tax, being charged to UK tax at a rate exceeding that specified in a DTA or being treated as the income, profits or gains of the UK resident and chargeable to UK tax.
6. The avoidance conditions are that:
 - A scheme is put in place by one or more persons;
 - The provision would not apply to the income, profits or gains in the absence of the scheme; and
 - The main purpose, or one of the main purposes, of a person in putting the scheme in place is to ensure that the provision does apply to the income, profits or gains.
7. The reference in paragraph 3 above to residents means residents for DTA purposes. However, for the purposes of the draft legislation, the meaning of UK resident is based on UK law. As a result a person resident in both the UK and another state for the purposes of their domestic tax laws, but resident in the other state for the purposes of the DTA it has with the UK, will still be a UK resident for the purposes of the proposed legislation. This is to prevent UK residents manipulating the residence tie-breaker provisions in the UK's DTAs – for example by moving their permanent home overseas for a short period in order to avoid UK tax on income or

chargeable gains but without ever losing their UK residence. We recognise that the definition of UK resident may need to be revisited in the light of the outcome of the consultation on the introduction of a statutory residence test².

8. The proposed legislation will apply to all income arising on or after the date of enactment, and to chargeable gains accruing from disposals made on or after the date of enactment.

Non-UK residents

9. The purpose of the proposed legislation is to ensure that non-UK residents cannot use a DTA to reduce their liability to income tax on UK source income unless that reduction is properly due under the DTA. In practice, this means that it will counter what are sometimes referred to as “treaty shopping” arrangements. Such arrangements are employed by persons resident in a foreign country to reduce their liability to UK income tax by accessing the benefits of a treaty between the UK and a third country.
10. The proposed legislation will apply where a DTA makes provision that specified categories of income will not be subject to income tax in the UK, or will not be subject to tax at a rate exceeding the rate specified in the DTA, and certain avoidance conditions are met.
11. These conditions are that:
 - A scheme is put in place;
 - The provision would not apply to the amount of the income in the absence of the scheme; and
 - The main purpose, or one of the main purposes, of a person in putting the scheme in place is to ensure that the provision does apply to the amount of the income.
12. Where it applies, the draft legislation provides that the DTA will not limit the income tax that can be otherwise be charged on the relevant income under the Taxes Acts.
13. The proposed legislation will only apply to UK source income that is described in a DTA as dividends, interest or income from debt-claims, royalties or income falling within the Other Income article of a DTA (i.e. income about which no specific provision is made in a DTA). The question whether income has a UK source is decided on the basis of the terms of the relevant DTA.
14. The proposed legislation will apply to all income arising on or after the date of enactment regardless of when the DTA was made or the scheme was put in place.

² See “[Statutory definition of residence: a consultation](#)” HM Treasury and HMRC June 2011

Chapter 3

Draft legislation relating to UK residents is contained on the following pages.

1 Abuse of double taxation arrangements: UK residents

- (1) Chapter 3 of Part 2 of TIOPA 2010 (double taxation relief: miscellaneous provisions) is amended as follows.
- (2) Before section 130 (but after the italicised heading preceding that section) insert –

“129A Interpreting provision affecting taxation of UK residents

- (1) This section applies if, but for provision made by double taxation arrangements –
 - (a) income of a UK resident would be chargeable to relevant UK tax,
 - (b) the rate at which income of a UK resident is chargeable to relevant UK tax would be higher, or
 - (c) income would be treated as income of a UK resident and chargeable to relevant UK tax.
- (2) Where the avoidance conditions are met, the provision does not prevent the income being (as the case may be) –
 - (a) chargeable to relevant UK tax,
 - (b) chargeable to relevant UK tax at that higher rate, or
 - (c) treated as income of the UK resident and chargeable to relevant UK tax.
- (3) The avoidance conditions are –
 - (a) that a scheme is put in place by one or more persons,
 - (b) that the provision would not apply to the income in the absence of that scheme, and
 - (c) that the main purpose, or one of the main purposes, of a person in putting the scheme in place is to ensure that the provision does apply to the income.
- (4) Sub-paragraph (3)(c) may be satisfied even if the double taxation arrangements came into existence only after the scheme was put in place.
- (5) A person is a UK resident for the purposes of this section if –
 - (a) in the case of income that would be chargeable to income tax, the person is resident in the United Kingdom in the tax year for which income tax would be chargeable on the income,
 - (b) in the case of income that would be chargeable to corporation tax, the person is resident in the United Kingdom in the accounting period by reference to which corporation tax would be chargeable on the income, and
 - (c) in the case of income that would be chargeable to capital gains tax, the person is –

- (i) resident in the United Kingdom during any part of the tax year for which capital gains tax would be chargeable on the income, or
- (ii) ordinarily resident in the United Kingdom during that tax year,

and “resident” means resident under the law of the United Kingdom relating to tax, disregarding section 18 of CTA 2009.

- (6) A reference in this section to income “of” a UK resident includes income treated by virtue of any enactment relating to tax as income of or arising or accruing to a UK resident.
- (7) In this section –
 - “income” includes profits and chargeable gains;
 - “relevant UK tax” means income tax, corporation tax or capital gains tax;
 - “scheme” means any scheme, arrangement or understanding of any kind whatever, including (in the case of a scheme, arrangement or understanding put in place by more than one person) a scheme, arrangement or understanding that is not or not intended to be legally enforceable.
- (8) Nothing in this section limits the operation of –
 - (a) section 10A(9C) of TCGA 1992 (temporary non-residents),
 - (b) section 59(2) and (3) of that Act (UK resident partners of non-resident partnerships),
 - (c) section 79B of that Act (attribution to trustees of gains of non-resident companies),
 - (d) section 83A of that Act (trustees both resident and non-resident in a tax year),
 - (e) section 858 of ITTOIA 2005 (resident partners and double taxation agreements),
 - (f) section 1266 of CTA 2009 (resident partners and double taxation agreements), or
 - (g) section 130 of this Act.”
- (3) Omit section 130A.
- (4) In section 10A of TCGA 1992 (temporary non-residents), in subsection (5), at the end insert “or by virtue of section 129A of TIOPA 2010”.
- (5) The amendments made by this section have effect –
 - (a) for income tax purposes and for the purposes of the charge to corporation tax on income, in relation to income arising on or after the day on which this Act is passed, and
 - (b) for capital gains tax purposes and for the purposes of the charge to corporation tax on chargeable gains, in relation to disposals occurring on or after that day,regardless of when the double taxation arrangements were made or when the scheme was put in place.

1 Abuse of double taxation arrangements: non-UK residents

(1) After section 133 of TIOPA 2010 insert—

“133A Interpreting provision about income arising from a UK source

- (1) This section applies if double taxation arrangements make provision about relevant income to the effect that, if it is relevant UK income—
 - (a) income tax is not to be charged on it, or
 - (b) income tax is not to be charged on it at a rate exceeding the rate specified in the arrangements.
- (2) The provision does not prevent income tax being charged on an amount of relevant UK income, or being charged on an amount of relevant UK income at a rate exceeding the rate specified in the arrangements, if the avoidance conditions are met.
- (3) The avoidance conditions are—
 - (a) that a scheme is put in place by one or more persons,
 - (b) that the provision would not apply to the amount of relevant UK income in the absence of the scheme, and
 - (c) that the main purpose, or one of the main purposes, of a person in putting the scheme in place is to ensure that the provision does apply to the amount of relevant UK income.
- (4) Sub-paragraph (3)(c) may be satisfied even if the double taxation arrangements came into existence only after the scheme was put in place.
- (5) “Relevant income”, in relation to double taxation arrangements, means—
 - (a) income described in the arrangements as interest, as income from debt-claims, as dividends or as royalties, and
 - (b) income that does not fall within any specific description of income for which provision is made in the arrangements.
- (6) Relevant income is “relevant UK income” if—
 - (a) in the case of income described in the arrangements as dividends, it is paid by a company resident in the United Kingdom, and
 - (b) in any other case, it arises in the United Kingdom.
- (7) Subsection (6) is to be read with any provision in the arrangements about the place where a company is treated as residing or income is treated as arising.
- (8) “Scheme” means any scheme, arrangement or understanding of any kind whatever, including (in the case of a scheme, arrangement or understanding put in place by more than one person) a scheme,

arrangement or understanding that is not or not intended to be legally enforceable.”

- (2) The amendment made by this section has effect in relation to relevant UK income arising on or after the day on which this Act is passed, regardless of when the double taxation arrangements were made or when the scheme was put in place.

Chapter 4

Explanatory commentary on UK residents

1. Subsection (2) inserts new section 129A before section 130 Taxation (International and Other Provisions) Act 2010 (TIOPA).
2. Subsection (1) of new section 129A provides that the section applies where, but for provision made in a DTA, either:
 - a. income of a UK resident would be chargeable to relevant UK tax;
 - b. the rate at which income of a UK resident is chargeable to relevant UK tax would be higher; or
 - c. income would be treated as income of the UK resident and chargeable to relevant UK tax.
3. Subsection (2) provides that where avoidance conditions are met the provision of the DTA referred to in subsection (1) will not prevent the income:
 - a. being chargeable to relevant UK tax;
 - b. being chargeable to relevant UK tax at a higher rate; or
 - c. being treated as income of the UK resident and chargeable to relevant UK tax.
4. Subsection (3) defines the avoidance conditions referred to in subsection (2). They are that:
 - a. a scheme is put in place by one or more persons;
 - b. the provision would not apply to the income in the absence of the scheme; and
 - c. the main purpose, or one of the main purposes, of a person in putting the scheme in place is to ensure that the provision does apply to the income.
5. Subsection (4) provides that the avoidance conditions will be met even if the DTA containing the relevant provision only became effective after the scheme was made.
6. Subsection (5) defines “UK resident” for the purposes of the section. A person is UK resident if:
 - a. In the case of income tax, they are resident in the UK in the tax year in which income tax would have been chargeable on the income.
 - b. In the case of corporation tax, they are UK resident in the accounting period by reference to which corporation tax would have been chargeable on the income.
 - c. In the case of capital gains tax, they are UK resident during any part of the tax year in which the capital gains tax would be chargeable on the income, or they are ordinarily resident in the UK during that tax year.
7. Subsection (6) provides that where income is deemed by the Taxes Acts to be that of a UK resident, it will be income of a UK resident for the purposes of the section.

8. Subsection (7) defines some of the terms referred to elsewhere in the section.
9. Subsection (8) provides that new section 129A will not limit the operation of any of listed sections found elsewhere in the Taxes Acts.
10. Subsection (3) of the clause provides for the omission of section 130A TIOPA.
11. Subsection (4) amends section 10A(5) of the Taxation of Chargeable Gains Act 1992 (TGCA). The amendment provides that a chargeable gain will not be treated as accruing to a person under section 10A(2) TCGA where it has already been brought into account by virtue of new section 129A.
12. Subsection (5) provides for the amendments made by the clause to have effect:
 - a. For the purposes of tax on income, in relation to income arising on after the date of enactment; and
 - b. For the purposes of tax on chargeable gains, in relation to disposals made after the date of enactment.

The clause will have effect regardless of when the DTA was made or the scheme was put in place.

Chapter 5

Draft legislation relating to non-UK residents is contained on the following pages.

1 Abuse of double taxation arrangements: non-UK residents

(1) After section 133 of TIOPA 2010 insert—

“133A Interpreting provision about income arising from a UK source

- (1) This section applies if double taxation arrangements make provision about relevant income to the effect that, if it is relevant UK income—
 - (a) income tax is not to be charged on it, or
 - (b) income tax is not to be charged on it at a rate exceeding the rate specified in the arrangements.
- (2) The provision does not prevent income tax being charged on an amount of relevant UK income, or being charged on an amount of relevant UK income at a rate exceeding the rate specified in the arrangements, if the avoidance conditions are met.
- (3) The avoidance conditions are—
 - (a) that a scheme is put in place by one or more persons,
 - (b) that the provision would not apply to the amount of relevant UK income in the absence of the scheme, and
 - (c) that the main purpose, or one of the main purposes, of a person in putting the scheme in place is to ensure that the provision does apply to the amount of relevant UK income.
- (4) Sub-paragraph (3)(c) may be satisfied even if the double taxation arrangements came into existence only after the scheme was put in place.
- (5) “Relevant income”, in relation to double taxation arrangements, means—
 - (a) income described in the arrangements as interest, as income from debt-claims, as dividends or as royalties, and
 - (b) income that does not fall within any specific description of income for which provision is made in the arrangements.
- (6) Relevant income is “relevant UK income” if—
 - (a) in the case of income described in the arrangements as dividends, it is paid by a company resident in the United Kingdom, and
 - (b) in any other case, it arises in the United Kingdom.
- (7) Subsection (6) is to be read with any provision in the arrangements about the place where a company is treated as residing or income is treated as arising.
- (8) “Scheme” means any scheme, arrangement or understanding of any kind whatever, including (in the case of a scheme, arrangement or understanding put in place by more than one person) a scheme,

arrangement or understanding that is not or not intended to be legally enforceable.”

- (2) The amendment made by this section has effect in relation to relevant UK income arising on or after the day on which this Act is passed, regardless of when the double taxation arrangements were made or when the scheme was put in place.

1 Abuse of double taxation arrangements: UK residents

- (1) Chapter 3 of Part 2 of TIOPA 2010 (double taxation relief: miscellaneous provisions) is amended as follows.
- (2) Before section 130 (but after the italicised heading preceding that section) insert –

“129A Interpreting provision affecting taxation of UK residents

- (1) This section applies if, but for provision made by double taxation arrangements –
 - (a) income of a UK resident would be chargeable to relevant UK tax,
 - (b) the rate at which income of a UK resident is chargeable to relevant UK tax would be higher, or
 - (c) income would be treated as income of a UK resident and chargeable to relevant UK tax.
- (2) Where the avoidance conditions are met, the provision does not prevent the income being (as the case may be) –
 - (a) chargeable to relevant UK tax,
 - (b) chargeable to relevant UK tax at that higher rate, or
 - (c) treated as income of the UK resident and chargeable to relevant UK tax.
- (3) The avoidance conditions are –
 - (a) that a scheme is put in place by one or more persons,
 - (b) that the provision would not apply to the income in the absence of that scheme, and
 - (c) that the main purpose, or one of the main purposes, of a person in putting the scheme in place is to ensure that the provision does apply to the income.
- (4) Sub-paragraph (3)(c) may be satisfied even if the double taxation arrangements came into existence only after the scheme was put in place.
- (5) A person is a UK resident for the purposes of this section if –
 - (a) in the case of income that would be chargeable to income tax, the person is resident in the United Kingdom in the tax year for which income tax would be chargeable on the income,
 - (b) in the case of income that would be chargeable to corporation tax, the person is resident in the United Kingdom in the accounting period by reference to which corporation tax would be chargeable on the income, and
 - (c) in the case of income that would be chargeable to capital gains tax, the person is –

- (i) resident in the United Kingdom during any part of the tax year for which capital gains tax would be chargeable on the income, or
- (ii) ordinarily resident in the United Kingdom during that tax year,

and “resident” means resident under the law of the United Kingdom relating to tax, disregarding section 18 of CTA 2009.

- (6) A reference in this section to income “of” a UK resident includes income treated by virtue of any enactment relating to tax as income of or arising or accruing to a UK resident.
- (7) In this section –
 - “income” includes profits and chargeable gains;
 - “relevant UK tax” means income tax, corporation tax or capital gains tax;
 - “scheme” means any scheme, arrangement or understanding of any kind whatever, including (in the case of a scheme, arrangement or understanding put in place by more than one person) a scheme, arrangement or understanding that is not or not intended to be legally enforceable.
- (8) Nothing in this section limits the operation of –
 - (a) section 10A(9C) of TCGA 1992 (temporary non-residents),
 - (b) section 59(2) and (3) of that Act (UK resident partners of non-resident partnerships),
 - (c) section 79B of that Act (attribution to trustees of gains of non-resident companies),
 - (d) section 83A of that Act (trustees both resident and non-resident in a tax year),
 - (e) section 858 of ITTOIA 2005 (resident partners and double taxation agreements),
 - (f) section 1266 of CTA 2009 (resident partners and double taxation agreements), or
 - (g) section 130 of this Act.”
- (3) Omit section 130A.
- (4) In section 10A of TCGA 1992 (temporary non-residents), in subsection (5), at the end insert “or by virtue of section 129A of TIOPA 2010”.
- (5) The amendments made by this section have effect –
 - (a) for income tax purposes and for the purposes of the charge to corporation tax on income, in relation to income arising on or after the day on which this Act is passed, and
 - (b) for capital gains tax purposes and for the purposes of the charge to corporation tax on chargeable gains, in relation to disposals occurring on or after that day,
 regardless of when the double taxation arrangements were made or when the scheme was put in place.

Chapter 6

Explanatory commentary

1. Subsection (1) inserts new section 133A after section 133 TIOPA.
2. Subsection (1) of new section 133A provides that it applies if a DTA contains certain provisions about relevant income that is relevant UK income. Those provisions are that either:
 - a. Income tax is not be charged on that income; or
 - b. Income tax is not to be charged on that income at a rate exceeding the rate specified in the DTA.
3. Subsection (2) provides that the provision mention in subsection (1) does not prevent income tax being charged on relevant UK income, or being charged on it at a rate exceeding the rate specified in the DTA where the conditions in subsection (3) are met.
4. The conditions in subsection (3) are that:
 - a. a scheme is put in place;
 - b. the provision would not apply to the amount of relevant UK income in the absence of the scheme; and
 - c. the main purpose, or one of the main purposes, of a person in putting the scheme in place was to ensure that the provision would apply to the amount of relevant UK income.
5. Subsection (4) provides that the avoidance conditions will be met even if the DTA containing the relevant provision only became effective after the scheme was made.
6. Subsection (5) defines “relevant income”, a term introduced in subsection (1). The term means income that is described in a DTA as dividends, interest (or, alternatively, income from debt claims), or royalties. It also means income about which no specific provision is made in the DTA (i.e. income falling within provisions in a DTA similar to Article 21 (Other Income) of the OECD Model Tax Convention on Income and on Capital).
7. Subsection (6) defines “relevant UK income”, a term also introduced in subsection (1). The terms means, in the case of dividends, dividends paid by a company resident in the UK and, in any other case, income arising in the UK.
8. Subsection (7) provides that provisions in the DTA will determine the place where a company resides or income arises for the purposes of subsection (6).
9. Subsection (8) defines “scheme”, a term introduced in subsection (3)(a).

10. Subsection (2) of the clause provides that new section 133A will apply to income arising on or after the date of enactment, regardless of when the DTA was made or the scheme was put in place.