DEFINING TAX AVOIDANCE

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As there is no legal difference between successful tax mitigation and successful tax avoidance, any distinction must lie outside the law. This article argues that the difference is in objectionability; and this objectionability should be approached, as is the case with the GAAR, by addressing the egregious or abusive nature of the attempt to reduce tax. What is important is the nature of the opportunity to reduce tax that is being exploited, which must be considered independently of any moral judgment on the conduct of the taxpayer. Avoidance opportunities are arbitrary and capricious, in distinction to those deliberately offered by the legislature for policy reasons, however contestable.

INTRODUCTION

There is something of Don Quixote about tax adjudication. The good Don having read far too many books of chivalry than were good for him, measured the world against the forms of those novels: to him, every inn was measured as a castle, and every woman, however dubious, was a princess. The same problem of interpreting the world through a narrow frame of reference is seen in tax: viewing the world though the language of taxing statutes and case law, judges whose wisdom and sanity is normally beyond dispute will insist on the extraordinary. A bank leaving a transaction with a profit of £358,151 will be declared to have lost £3,975,473. A businessman will not lament the sudden of loss of £1.4m found by the tax judge, the money being, as he intended, with his wife. And a bank repays the capital of a short term loan, and declares the sort of loss which, if it had any basis in reality, would see the finance director dismissed without a reference. It is easy for those who have lived long in the world of tax to lose sight of how extraordinary a thing it is to come to such conclusions, the process of tax avoidance being sanctified by over a century of judicial dicta that if there be a means [in law] of evading the duty, so much the better for those who can evade it, or ‘[e]very man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would

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1 HMRC v Bank of Ireland Britain Holdings Ltd (Bank of Ireland) [2008] EWCA Civ 58; [2008] STC 38.
be.\textsuperscript{4} Or that ‘nobody owes any duty to pay more than the law demands’ thus ‘taxes are forced exactions, not voluntary contributions’ and ‘to demand more in the name of morals is mere cant.’\textsuperscript{5} Or that ‘there is not even a patriotic duty to increase ones taxes.’\textsuperscript{6} And the result ‘depends wholly upon the construction of the taxing Act’.\textsuperscript{7} With such sentiments in mind, we hardly question the idea that tax law should find a money flow that has no basis in any practical analysis of the flow of money; and those who seek to restore sanity may find themselves regarded as tilting at windmills. The recent GAAR Study and subsequent legislation accepts the idea that such results may be a bad thing, but sharpens its focus on the egregiousness of the conduct of the taxpayers rather than on the absurdity of the result per se.\textsuperscript{8}

This paper will seek to identify the objections that, it shall be argued, define tax avoidance. We shall consider the nature of tax avoidance, and by ‘tax avoidance’ we mean this: what are we objecting to when we use that phrase? The aim will be to avoid the confusion of dealing with the personal morality of those within the avoidance profession and those who use its schemes. The morality of the tax avoider is an important subject, which has recently been dealt with extensively elsewhere.\textsuperscript{9} But this paper will deal instead with the objections to the relevant opportunities to avoid existing – objections which are certainly based in the natural dislike of capricious results. By doing this, we hope to better understand what can properly be described as tax avoidance.

Before starting, we should note a few issues as to the subject matter of the article. Firstly, this article concerns direct taxation and not indirect taxation. Taxes on transactions concern not a broad concept such as income but, as John Prebble puts it, ‘a fact that occurs, that exists, and that can be identified.’\textsuperscript{10} This does not make them entirely straightforward, but it does mean that different considerations will apply. Secondly, although the article refers to ‘income’, it equally applies to capital gains. The article seeks to draw no particular distinction between income and capital profits, although it is recognised that there a cogent reasons why distinct treatment arises in tax codes. Thirdly, it is not the intention to critique in any detail the new General Anti-Avoidance Rule


\textsuperscript{5} \textit{Commissioner v Newman} 159 F 2d 848, 850-851 (2d Cir, 1947) (Hand J).

\textsuperscript{6} \textit{Helvering v Gregory} 69 F 2d 809, 810 (2d Cir, 1934) (Hand J).


\textsuperscript{8} Graham Aaronson, \textit{GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system}, HM Treasury, 11 November 2011, and Finance Act 2013, s 206-215.


\textsuperscript{10} John Prebble, ‘Should Tax Legislation be Written from a Principles and Purpose Point of View or a Precise and Detailed Point of View?’, [1998] BTR 112, 123.
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(‘GAAR’) that has been enacted,\textsuperscript{11} except that the approach recommended here concentrates on an analysis which is results centred, as whereas the GAAR is conduct-centred – looking at the reasonableness of the response of the taxpayer who enters into tax planning.

THE LIMITS OF LAW IN DEFINING TAX AVOIDANCE

What is tax avoidance? There is, of course, a considerable body of opinion that the phrase ‘tax avoidance’ is meaningless or rather, as Lord Hoffmann said, a contradiction in terms. As Parliament speaks through its Acts, its intentions are to be found in the words that it uses. There is considerable force in what Lord Hoffmann said extra-judicially:\textsuperscript{12}

‘The first question is what you mean by tax avoidance. Whole conferences and seminars have been held to discuss this question. At one of these, in 1997, Lord Templeman said: ‘Tax avoidance reduces the incidence of tax borne by an individual taxpayer contrary to the intentions of Parliament.’ Others have said much the same in various different ways: the central idea is that you have arranged your affairs so as not to pay the tax which you ought to have paid. But this raises a logical difficulty. Why ought you to have paid tax? Presumably, because Parliament intended you to pay it. So Lord Templeman says that it reduces your tax ‘contrary to the intention of Parliament’. But how do we know the intention of Parliament? There is only one way to know the intention of Parliament and that is to read the statute. So avoidance of tax assumes that you are not paying a tax which, on a fair reading of the statute, you ought to have paid. But why in that case are you not liable to pay it? How can the courts give the statute a construction which means that people do not pay the tax which the statute shows that Parliament intended them to pay?’

Lord Hoffmann attributes ‘what the Revenue regard as tax avoidance’ to now outmoded literalism on the part of judges, and to overly prescriptive drafting of statutes on the part of the Revenue.\textsuperscript{13} His Lordship dismisses the idea that tax avoidance occurs when the taxpayer ‘receives the […] income, but structures the transaction to fall outside the taxing statute’, arguing that this approach ‘depends upon the assumption that Parliament imposes taxation by reference to economic and other events in the real world.’\textsuperscript{14} However, taxing statutes often create choices or employ prescriptive forms to describe the real world, which can have the effect of misdescribing the real world. It follows that ‘tax avoidance… should be a contradiction in terms’,\textsuperscript{15} because the assumption that Parliament

\textsuperscript{11} Finance Act 2013, s 206-215.
\textsuperscript{12} Lord Hoffmann, ‘Tax Avoidance’, [2005] BTR 197, 204. See also, Aaronson, above fn.14, para 5.17.
\textsuperscript{13} Ibid, 205.
\textsuperscript{14} Ibid, 205.
\textsuperscript{15} Ibid, 206.
intends to replicate the real world is wrong, and what Parliament intended is only knowable through what it has done in the statute book.

But this does not wish away the subject, and to think it does would presuppose that when people talk in terms of tax avoidance, they have in mind an offence against Parliamentary intent. Doubtless, when the Revenue talk of ‘tax avoidance’ in framing an argument on statutory construction, they place Parliamentary intent at the centre. But they will do the same when talking about the application of a taxing statute outside the context of tax avoidance, and sometimes they will conspicuously fail to talk about tax avoidance in avoidance cases where statutory construction offers a clearer route to victory.\(^\text{16}\) Lord Hoffmann’s approach presupposes that the concern over what many (not just the Revenue) regard as tax avoidance rests on a sense of outrage on behalf of integrity of the legislature’s commands and nothing else.

This is manifestly not the case. No one who reads the coverage in the national press can be of any illusion that the controversy over tax avoidance arises from concern for Parliamentary intent or would in any way dissipate if the public would engage with Lord Hoffmann’s critique.\(^\text{17}\) In any case, rule avoidance cannot itself be an explanation as to why tax avoidance receives so much public attention: we are often neutral as to whether Parliament’s intention has been thwarted. In fact, we often applaud the thwarting of established legal rules. Established but obsolete legal rules may be avoided by means of legal fictions without any objection, a process with which the courts collude.\(^\text{18}\) As Brian Arnold points out, ‘Many artificial or unnatural transactions are specifically permitted, either by statute or by administrative concession.’\(^\text{19}\) Legal history is full of legal fictions and pointless rigmaroles adopted to avoid awkward and obsolete rules of law. Our system of equity has its foundations in the avoidance of law.\(^\text{20}\)

There is another fundamental difficulty with defining tax avoidance in terms of the legal construction of the statutory provisions that are being ‘avoided’. The classic trichotomy for analysing different ways of reducing how much tax a

\(^\text{16}\) Eg: Cadbury Schweppes v Williams [2006] EWCA Civ 657, [2007] STC 106, as to whether a bond with a fixed rate of accrual, but a variable rate of payment carried interest at a fixed or floating rate.

\(^\text{17}\) The Guardian’s coverage of the subject is grouped at http://www.theguardian.com/business/taxavoidance accessed 5 August 2014. A recent example linked tax avoidance to ‘cognitive dissonance’ in society wanting projects undertaken, but the individuals who make up society not wanting to pay themselves, see Josh Bornstien, ‘The joy of tax: why payment should be a pleasure’, Guardian Online, 2 June 2014 http://www.theguardian.com/commentisfree/2014/jun/02/the-joy-of-tax-why-payment-should-be-a-pleasure accessed 5 August 2014.

\(^\text{18}\) For example, twenty years of user allows a person to assert a loss grant of an easement despite no one seriously thinking that any such grant had existed, see: Midland Bank Trust Co Ltd v Green (No. 3) [1982] Ch 529.

\(^\text{19}\) Brian Arnold, ‘Canadian General Anti-Avoidance Rule’ in Graeme Cooper (ed), Tax Avoidance and the Rule of Law, (IBFD Publications 1997), 228 (fn. 18), which gives ‘consolidation of the profits and losses of corporations in a related group’ as an example.

\(^\text{20}\) That equity remedied the inadequacies of the common law through the creation of new concepts such as the trust, and new defences such as fraud, forgery and duress, see W. Holdsworth, A History of English Law: Vol 1, (5th ed, Methuen 1931), 454-459.
person pays is, (a) tax evasion (failures to comply with the law, often criminal),\(^{21}\) (b) tax avoidance (legal, but morally controversial), and (c) tax mitigation (legal, and morally supportable).\(^{22}\) However, what should be immediately apparent is that there is no legal difference between a successful tax avoidance scheme and successful tax mitigation planning – each reduces the taxpayer’s liability to tax. Equally, there is no difference between unsuccessful tax mitigation and unsuccessful avoidance – both fail to reduce the liability to tax. So, how can the concept of tax avoidance be analysed through statutory provisions when those statutory provision will produce the same outcome regardless of whether it is called avoidance or mitigation?

Writing in the 1930s, Felix Cohen, an American legal realist, drew from science as to how we recognise something’s nature: ‘A thing must be defined according to the way in which it is in practice recognized and not according to some ulterior significance that we suppose it to possess.’\(^{23}\) The law cannot be the means by which we in practice recognise ‘tax avoidance’ because legal analysis of itself will not identify any difference in outcome between successful tax avoidance and successful tax mitigation, nor any difference between unsuccessful avoidance and unsuccessful mitigation. If we think like lawyers, we see the legality of the scheme as negating the accusation of tax avoidance. We find essentially the same idea in Wittgenstein’s injunction to “[l]et the use teach you the meaning”,\(^{24}\) we can see that tax avoidance is invoked to complain about a legal scheme. Thinking as lawyers, we may look at the term “tax avoidance” and analyse it within our artificial system of legal reasoning and decide that it is a contradiction in terms. But if we are to understand the nature of the problem that non-lawyers complain about, we must leave our legal thinking behind in our legal practices, and look to see the nature of the complaints being made.\(^{25}\) So, when Lord Hoffmann correctly says that “tax avoidance” is a contradiction in terms if we mean the avoidance of statutory intention, what we really draw from this is that we must look elsewhere to discover what people are talking about when they complain about avoidance – an approach that will lead us to separate between complaints about tax being avoided per se, and complaints about the social or economic policy behind an opportunity to reduce tax liability.

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21 As Lord Templeton pointed out in Commissioner of Inland Revenue v Challenge Corporation [1986] STC 548, 554, a tax can be evaded by innocent error as well as criminal intent.

22 Challenge Corporation, ibid 554-555.


25 Wittgenstein, ibid, at [66]: “Consider for example the proceedings that we call ‘games.’ I mean board-games, card-games, ball-games, Olympic games, and so on. What is common to them all?- Don’t say: ‘There must be something common, or they would not be called ‘games’” -but look and see whether there is anything common to all.-For if you look at them you will not see something that is common to all, but similarities, relationships, and a whole series of them at that. To repeat: don’t think, but look!”
THE CORE IDENTITY OF TAX AVOIDANCE

We shall argue that the nature of tax avoidance is obscured by contentious moralising about personal motives – we should take a results not a conduct based approach. Doubtless it is natural that if tax avoidance is objectionable that many people will make a moral criticism of those responsible. But if someone says, ‘Smith is immoral to try to achieve result-X’, an objection to result-X obviously precedes the accusation of immorality against Smith. It may be that achieving result-X is bad for society, yet it may be argued on libertarian or other grounds that no moral blame should attach to Smith. It may be that the means used to achieve result-X ought not to be permitted, yet Smith does a good thing in achieving result-X. By fixing ourselves on a moral judgement of Smith, we fail to engage with what it is about result-X that we find objectionable in the first place. This does not mean that, in contradiction to the previous paragraph, we are ignoring the actual public use of the term “tax avoidance”, but rather we are looking at the detail of the circumstances of when it is used rather than wallowing in moralistic accompaniments.

To make the point clearer, consider the following hypothetical. In wartime, conscription is implemented but, among the exceptions, are those working for the Special Operations Executive. Adam, Brian and Charlie all use contacts to obtain a posting at the Executive: Adam is regularly parachuted into enemy territory; Brian uses his expertise to crack codes; and Charlie uses his contacts to obtain a job as a filing clerk. If that is all, then it is fairly obvious who should be sent four feathers, but an analysis of the conscription rules will not easily supply that answer. Conscription rules just tell us whether result-X, being military service, is achieved or not – it does not address any other results that might deserve consideration. Nor indeed can it be answered by a simple object test which asks whether the person’s main object or objects included avoiding army service – for this might well apply to all three. To understand what is an objectionable way of avoiding conscription, and thus what ought to be addressed by any anti-avoidance provisions, requires not the analysis of rules and concern for their integrity per se; it requires the use of natural reasoning to tell us that being a spy is more dangerous than being a soldier, and working as a code breaker (if you have the skills) is more beneficial to the war effort than fighting as a soldier. But for a man to use contacts to wangle a job as a filing clerk with the object of not having to fight is objectionable. Doubtless they also serve who only stand and wait, but opportunities to pass a war by only standing and waiting ought not to be legally given with partiality. Now let us advance the scenario a little: let us suppose that Charlie has an invalid wife and disabled children, and that had he been a day older he would not even have been eligible for conscription. We might well now chose to not judge Charlie too harshly, but it would still be objectionable that there was an opportunity to replace dangerous military service with a safe clerical job open on a capricious basis such as personal contacts. We might complicate the scenario yet further and say that Adam is a posturing fool who will cause only disaster as a spy, so we would not in fact judge him well. But all this concentration on personal morality hides an objection that is common to all, which is that the opportunity to avoid the rule is unprincipled and based on the corrupting factor of personal contacts.
It must therefore be stressed that it is quite possible to object to tax avoidance whilst avoiding being side-tracked into moral criticism of the avoider – it is the opportunity to reduce tax liability that is the heart of our enquiry, not the conduct of the person who seeks to make use of it. Malcolm Gammie is entirely correct to say that we all have different ideas as to the personal morality of tax planning and tax avoidance, and that this is not a useful concept to incorporate into adjudication, as has happened with the GAAR. The difficulty of defining acceptability by virtue of the choices of the individual actor is summed up well by Joseph Heller in Youssarian’s justification for his decision not fight:

‘So I’m turning my bombsight in for the duration. From now on I’m thinking only of me.’ Major Danby replied indulgently with a superior smile, ‘But, Yossarian, suppose everyone felt that way.’ ‘Then I’d certainly be a fool to feel anything else.’

So the fact that a course of conduct may have bad results in the public sphere, and if universalised would be disastrous, does not necessarily lead to a clear cut moral judgement against the individuals concerned. Heated arguments in the media as to the morality of this or that celebrity may be the clearest sign that there is something objectionable going on, but the arguments as to morality of the individual ‘avoider’ are liable to side-track us from defining the sort of tax planning scenarios that are in issue when complaints are made. We turn away from a debate on individual morality, and look at the nature of tax planning involved in avoidance and where objections to the success of those schemes are answerable or unanswerable.

THE INHERENT PRINCIPLE IN TAXATION

In seeking to define tax avoidance as something more than the paradoxical concept of avoiding the rule, we say what is achieved by tax avoidance that differs from any other objections that might be made to the outcomes created by a particular statute or otherwise. The existence of the objection to tax avoidance results presupposes a failure on the part of the statutory scheme. Neil Brooks provides a high level but useful starting point:

‘In interpreting a tax provision, the first thing judges have to decide, or should decide, is whether they are interpreting a technical tax provision, the basic purpose of which is the accurate measurement of income,’ or

26 For a practitioner’s view of a taxpayer’s decisions in response to avoidance/mitigation opportunities, see Francesca Lagerberg, ‘When is avoidance unacceptable’, Simon’s Tax Briefing, 1 March 2010, 1; and see Zoe Prebble and John Prebble (n 9) for a detailed moral critique of the tax avoider.

27 Gammie (n 9) 588.


29 Neil Brooks, ‘The Role of Judges’ in Cooper (n 19) 126.

30 This reference to ‘income’ includes both ‘income’ and ‘capital’ profits. As said earlier, this approach is taken throughout this article.
whether they are interpreting a tax expenditure provision, the basic purpose of which is to provide financial assistance to encourage taxpayers to engage in particular kinds of defined activity and thus further some social or economic goal of the government.'

The point that we can draw from Neil Brooks’s explanation is that no taxing legislation is entirely without principles. It is said that ‘the most serious problems of tax avoidance arise where there is no principle underlying the legislation’, but look high enough, and the legislation is trying to measure income or expenditure, and any fictions employed exist to serve that purpose and are employed for an understandable (if often contestable) reason.

It is in the nature of what is commonly called tax avoidance that either income or expenditure is mismeasured. In *Bank of Ireland*, the legislation as interpreted by all three levels that heard the case measured the taxpayer as having lost £3,975,473, when in fact it had profited by £358,151. Had one of the taxpayer’s counterparties, Bank of Ireland (Eire) Ltd been in the jurisdiction, it would have been measured as having made a profit of about £7m, twice its actual profit.

We can go through all tax avoidance schemes and find the same theme: in *Campbell v HMRC*, the tax payer did not lose £1.4m, the money was with his wife as he had intended. In *MacNiven v Westmoreland*, no one was better or worse off, but Westmoreland Investments Ltd was measured as having made income expenditure of £20,220,000. In *First Nationwide v HMRC*, a series of transactions of Heath Robinson complexity meant that in theory the taxpayer incurred a capital gain from receiving a short term loan, and an income loss on repaying.

It is typical of many failed schemes that they sought to measure as money spent on an objective (e.g. research) which in fact went in a blocked bank account, or was bounced back to repay investors rather than contribute to pharmaceutical research. The position is more complex where purchase moneys are recirculated, given that there is no necessary reason why the purchase price should not be required for security for the performance of the asset. Hence, in *Barclays Mercantile*, the purchase price for the income

32 *Bank of Ireland* (n 1). For the figures, see 2006 UKSPC SPC544 [23]-[27]. In argument, Counsel for the taxpayers contended that, as the scheme created a matching deemed profit and loss, HMRC’s real complaint was that Bank of Ireland (Eire) Ltd (who incurred the deemed profit) was outside the jurisdiction. But all that this means was that the scheme generated two mismeasurements, only one of which had consequences for tax liability.
33 *Campbell* (n 2).
34 Mrs Campbell made a partial profit though obviously rates of tax may vary
36 *First Nationwide* [2012] STC 1261. In argument, Counsel for the taxpayer suggested that this created a balance, which is the sort of nonsense that only those bound by the artificial reasoning of law could greet with anything over than incredulity. Two wrongs can only make a right when they cancel out, and obviously the whole point of the scheme was that they did not: the capital gain with no relationship with reality would not increase the tax burden; but the equally unreal income loss would very much reduce the final tax payment.
38 *Vaccine Research Limited Partnership v HMRC* [2013] UKFTT 73 (TC).
producing asset (i.e. the pipeline) was security for that income. The statute measured the price paid for the pipeline accurately, but there the law did not measure cash flows the absence of net expenditure in the Barclays group which would be the beneficiaries of the capital allowances claimed. The result was a transaction designed so that the statute would only measure (accurately in itself) part of a composite whole, and thus told the truth, but not the whole economic truth. If, as Helen Letherby says, ‘[n]o real finance was provided by the Barclays group to the counterparty group’, then the reality of the transactions have not been properly measured.

This is not to say that there are not difficult cases. If Mr and Mrs Jones own a company, Arctic Systems, of which Mr Jones is the sole employee, is the income to be attributed to the work of Mr Jones or as a return on the capital investment in the company. Such, if we strip away the legal arguments of construction of the settlement legislation, is the objection to the result in Jones v Garnett. By working for negligible salary, the product of Mr Jones’s labours could be distributed as dividends to both husband and wife and taxed separately. Whilst instinctively we may see this as a mismeasurement, it is an intrinsic aspect of modern capitalism that an absentee shareholder is no less entitled (legally or morally) to dividends than a shareholder who contributes directly to the creation of value.

Of course, mismeasurement will not do for a complete definition. Firstly, as we can see possibly in Barclays Mercantile and definitely in Jones v Garnett, a suggestion of mismeasurement cannot be sealed off from consideration of what it is that should be measured. If the tax code can be said to mismeasure the income and expenditure relating to Barclays Mercantile’s purchase of the pipeline it can only be because it was wrong not to measure income expenditure beyond the headline sale and purchase. Similarly, to say that the income from Arctic Systems is wrongly measured in Mrs Jones’s hands is only true if we see Mrs Jones’s ownership of the shares as being insufficient in these circumstances to tell the whole story. So, an argument (even a compelling argument) that the tax code has failed to accurately measure everything within a transaction is only a starting point to bring together transactions requiring further examination.

Secondly, even though tax avoidance involves mismeasurement, it does not follow that all mismeasurement is tax avoidance. The truth is that no system of income tax will in fact aspire to reproduce the classic Haig-Simons definition of income from an economist’s perspective:

39 Barclays Mercantile Business Finance v Mawson[2004] UKHL 51; [2005] STC 1. The happenstance scenario would be more difficult to wholly satisfactorily analyse in terms of mismeasurement as the purchase price paid would have sat with a different bank. What was not happenstance was that the purchase price paid by Barclays Mercantile had to remain within its grasp, and outside that of the party raising the finance, until such time as equivalent amounts were made good by rental payments.


41 Income and Corporation Taxes Act 1988, s 660.


‘Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question.’

Not every ‘right exercised in consumption’ and not every part of ‘the store of property rights’ will be measured. There will often be a positive decision not (reverting to more familiar language) to look only at certain sources of income, or to be concerned with only certain expenses. There are many types of moral, practical and economic objections to how Parliament defines the tax burden creating exceptions so that certain income and expenses go unmeasured. Such objections may reinforce each other. Equally, they may point in opposite directions with it being perfectly arguable as to what is right and wrong.

What we must ask is whether beneath the pros and cons of legislative choices, there are any core characteristics which make some opportunities for advantageous mismeasurement count as tax avoidance.

The defining objectionability of tax avoidance

What we shall do is to decouple objections against the existence of the tax avoidance opportunity and consideration of conduct and motives of the tax avoider. This is where the GAAR Study takes a wrong turn. It took a uselessly broad definition of what it means by ‘an abusive tax result’, which includes pretty much anything that reduces liability, but nothing follows by way of counteraction unless the choices made by the taxpayer ‘can reasonably be regarded as a reasonable exercise of choices of conduct afforded by the provisions of the Acts’.  

The conduct-centred approach adopted since the GAAR Study recognises avoidance in elaborate schemes which successfully tick a number of statutory boxes on their way to success. The only example given in the GAAR Study of an unacceptable scheme was that in Mayes v HMRC, which ‘gave UK taxpayers a seven step route to creating an artificial tax loss’, in respect of which the study’s authors express a decidedly emotional ‘distaste’. But it is very hard to see why it should matter whether a scheme requires seven intricate steps to achieve the tax advantage, or gets there in one bold bound, as was the case with Barclays

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44 GAAR Study (n 8), Appendix 1, draft section 3(2). The proposed GAAR applies to ‘the achievement of an abusive tax result by (a) avoiding the application of particular provisions of the Acts, or (b) exploiting the application of particular provisions of the Acts, or (c) exploiting inconsistencies in the application of provisions of the Acts, or (d) exploiting perceived shortcomings in the provisions of the Acts.’

45 Ibid, Appendix 1, draft section 4(1): ‘An arrangement does not achieve an abusive tax result if it can reasonably be regarded as a reasonable exercise of choices of conduct afforded by the provisions of the Acts.’

46 GAAR Study (n 8) 3.20 and 4.6, Mayes v HMRC (Mayes) [2011] EWCA Civ 407, [2011] STC 1269.
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tile which is stated to be GAAR-compatible, even if in its totality the scheme was an economically pointless rigmarole which produced nothing of value for its participants other than fiscal gain. If the result for both is objectionable we should be seeking a definition of avoidance that includes both instead of seeking to bless as innocuous the scheme in Barclays Mercantile.

The better approach is to be results-centred. This means to look at the very existence of the putative opportunity to reduce taxation – and ask whether it would be tolerable to deliberately enact the relevant opportunity to avoid tax, or else to deliberately maintain the relevant opportunity on the statute book once its existence is appreciated. At some point a choice will be made as to whether to tolerate the existence of the ‘tax avoidance opportunity’. Curiously, in considering what this means in detail, an excellent starting point for analysis is provided by the most notable of all free market economists, Milton Friedman:

‘[T]hey have stimulated both legislative and other provisions to evade tax – so-called ‘loopholes’ in the law such a percentage depletion, exemption of interest on state and municipal bonds, specially favorable treatment of capital gains, expense accounts, other direct ways of payment, conversion of ordinary income to capital gains, and so in bewildering number and kind. The effect has been to make the actual rates imposed far lower than the nominal rates and, perhaps more important, to make the incidence of the taxes capricious and unequal. People at the same economic level pay very different taxes depending on the accident of the source of their income and the opportunities they have to evade tax.’

We have already seen that mismeasurement cannot of itself explain why we object to tax avoidance, given that exemptions and deeming provisions will mismeasure income and expenditure. But what we see from Professor Friedman are insights into why we object to those parts of the tax code that give rise to tax avoidance, or, to be more precise, why we are justified in those objections. The objection is in the ‘capricious and unequal’ results. The objection is that ‘the accident of the source of income’ and whether fortune gives them ‘opportunities ... to [avoid] tax’ has become more important than their ‘economic level’ of income. We now begin to see the force that attaches to the objections against some mismeasuring provisions, and in considering an obvious objection to Professor Friedman’s examples, we shall begin to see it more clearly.

47 GAAR Guidance - Approved by the Advisory Panel with effect from 15 April 2013 (HMRC 2013) D7.5.
48 Helen Lethaby, ‘Aaronson’s GAAR’, [2012] BTR 27, 32: ‘No real finance was provided by the Barclays group to the counterparty group; rather the Barclays group simply shared the benefit generated by the tax savings made by the Barclays group with the counterparty group.’ See Barclays Mercantile (n 39).
50 Friedman uses the words ‘evade’ and ‘evasion’ where we would normally talk of ‘avoid’ and ‘avoidance’. From an economists point of view the avoidance/evasion distinction is largely meaningless, see Michael Brooks and John Head, ‘Tax Avoidance: in Economics, Law and Public Choice’ in Cooper (n 19) 54.
Two of Milton Friedman’s examples of what he considers ‘make the incidence of tax capricious and unequal’ are these:

- exemption of interest on state and municipal bonds
- specially favourable treatment of capital gains

We should consider their objectionability in the eyes of those who decide on whether to enact and/or repeal such rules. As regards, making the interest on state and municipal tax free, could be objected on the grounds that this might harm investment in the private sector which would have to pay higher rates of interest to attract capital. Yet, the state may be in need of funding: it may be better for the state to pay out $5 in interest on every $100, than to pay out $7 of which $2 will be recouped later in taxation. Further, the legislator might take the view that for the state to both make and tax the same payment is a nonsense creating unnecessary bureaucratic cost. As regards, the especially favourable treatment of capital gains is a recurring theme in taxing systems because there are legitimate arguments for treating capital gains more favourably than income. Indeed, there are legitimate arguments against taxing capital gains, which was the position in the UK until 1965.

Such mismeasurements are common. To exempt interest in its entirety as is the case in some jurisdictions is to mismeasure income. If the legislation measures a capital gain if you sell an antique bracelet, but not if you sell an antique watch, then it mismeasures gains. A watch is a machine, and machines are not subject to capital gains tax as they are generally wasting assets. If entertainment expenses are not deducted, but advertising is, then are we mismeasuring income in one or the other cases? If we do not include income earned abroad, from one view we might be correctly measuring the income that falls within the natural tax base; or are we inaccurately measuring the income of a person who is part of the natural base? The settlements legislation creates a regime where people are deemed to have received money on the grounds that it could return to them or a spouse – it does not matter how unlikely it is that the taxpayer will ever receive the money (or acquire a spouse).

Similarly, and equally clearly, an invocation of objectionability of itself will not of itself suffice to identify tax avoidance. Some might find it objectionable that inheritance tax may be avoided by giving away part of the estate seven years or more before death; others find the existence of inheritance tax objectionable. Consider the film legislation that allowed capital expenditure to be deducted in arriving at income in order to provide an incentive to invest in the British film industry: even setting aside the many stratagems that grew up in this area, it can be argued both ways as to whether helping the film industry was an excellent or

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51 In our era of the Single Market, such a rule would favour UK taxpayers and be of questionable legality under EU law, see dividend exemption cases such as Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue (C-446/2004) [2006] ECR I-11753.
52 P. Whiteman, Capital Gains Tax, (Sweet & Maxwell, 1988) [1-01].
53 Taxation of Chargeable Gains Act 1992, s 44.
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objectionable use of the tax code.\(^{54}\) It is difficult to think of any decision as to where the burden of tax should or should not land that is not capable of dispute. Even in Elizabethan times we find debates on progressive taxation as to whether all should pay for the defence of the realm, whether the rich should pay more so as to relieve the burden of the poor, what should be the dividing lines, and whether such a system might create an opportunity for avoidance.\(^{55}\) Almost any choice can be championed or denounced by applying liberal, libertarian, utilitarian or collectivist notions of the state, or by applying different theories of economics.

Whatever might ultimately be accepted as the case, for many of the ‘so-called loopholes’, a cogent argument could be put for their existence. In many cases the legislature would have deliberately brought the ‘loophole’ into existence because a cogent argument had been put to and accepted by the revenue authorities and presented to the legislature. It may be that the argument is framed by a self-serving lobbyist, but it will be translated plausibly into terms of the public good. Neil Brooks notes that opportunities to avoidance, ‘are often outcomes of efforts by the taxpayers and their representatives to influence the tax structure itself through participation in political processes.’\(^{56}\) Doubtless, he is right. Economic sectors press for more favourable fiscal treatment in the same way that some press for subsidies. There is a strong element of special pleading involved, but this article takes the optimistic view that for such special pleading to succeed in legislation it will require some base in rationality or in ordinary human sentiment.\(^{57}\) For example, perhaps the most extreme example of a cause being singled out for favourable statutory treatment is the perpetual copyright to Peter Pan granted to Great Ormond Street Hospital – but that is supported by a sense of charity to sick children.\(^{58}\)

In the practitioner press, Levy and Greene may rebuke talk of ‘unacceptable’ tax avoidance by posing the questions: ‘unacceptable to whom’,\(^ {59}\) but it is a question that deserves to be thrown back at the posers. To whom could the particular opportunity to reduce tax liability be acceptable? We are in search of opportunities to reduce tax liability that are so far from any plausible public benefit that the opportunity can only be acceptable to those who will directly


\(^{56}\) Brooks and Head (n 50) 79.

\(^{57}\) Should such opportunities be deliberately created for the benefit of the legislators and their clientele, talk of ‘avoidance’ would be the least of the moral objections. Such talk would be subsumed within general allegations of corruption. Although such matters may overlap, it is best to deal with the problem at hand, rather than abandon the search because of extreme hypotheticals.

\(^{58}\) Copyright, Designs and Patents Act 1988, s 301.

benefit – something condemned by both republican and liberal theories of government. 60

We must, therefore, draw a qualitative distinction between opportunities to reduce liability where acceptability is debatable to ones which are beyond debate objectionable. The acceptability of any public expenditure and the legislature’s choice of the tax base will be contestable, and sometimes bitterly so. It is no purpose of tax adjudication or taxation jurisprudence to choose between contested theories of the public good, or between the compromises that arise from the democratic process. We must extract the objectionability that defines tax avoidance.

Let us consider Bank of Ireland again: if two parties entered into a repo transaction, they would be taxed as if the purchase price were a loan and the profit for the original seller were interest. 61 But, if the repo involved three parties, then the original seller would be taxed twice over, and party who buys from him would be deemed to have suffered a loss even if in profit. 62 If, as has been rightly said, all laws are deemed to be passed ‘pro bono publico’, 63 it is hard to see what public good could be recommended for such a state of affairs. However, acceptability may be founded on efficiency for the tax system. We noted that Jones v Garnett, on the use of family companies to shift income between spouses, was a difficult case in respect of mismeasurement due to the problematic nature of whether income derives from labour or capital, 64 but it also shows how efficiency may make acceptable within a tax code something with anomalous results because to truly address the vice would be prohibitively complex. 65 As Baroness Hale pointed out, be to pick apart for all family companies the relationship between labour and profit, 66 and is a gift between

60 According to the republican theory of government, a measure is non-arbitrary if the person who does not benefit could not see the measure as being in his interest, eg: P. Pettit, ‘Republican Freedom: Three Axioms, Four Theorems’, in Cecile Laborde and John Maynor, Republicanism and Political Theory, (Blackwell 2008) 117. Laws that make arbitrary distinctions is similarly anathema to liberal theory by virtue that ‘principles are to be universal in application’, see, John Rawls, A Theory of Justice (Oxford University Press, 1999) 114. Arbitrary distinctions are a failure to follow this approach. Far from being universalisable, they ought to be removed once identified, representing as they do a failure to give a principle universal application.

61 ‘Repo’ is short for ‘repurchase transaction’. The definition is this ‘An agreement with a commitment by the seller (dealer) to buy a security back from the purchaser (customer) at a specified price at a designated future date. Also called a repo, it represents a collateralized short-term loan for which, where the collateral may be a Treasury security, money market instrument, federal agency security, or mortgage-backed security. From the purchaser's (customer's) perspective, the deal is reported as a reverse repo.’ See http://financial-dictionary.thefreedictionary.com/Repo+transaction accessed, 12 October 2010.

62 Bank of Ireland (n 1).


64 Jones v Garnett (n 42).

65 Another example of an efficiency based mismeasurement is that of antique watches (n 53). It would not be efficient to distinguish between watches which are wasting assets as their value is as time-telling machines, and those which owe their value to a special antique status.

66 Jones v Garnett (n 42) [68].
spouses of an income earning asset so objectionable? In any case, the tolerability of the opportunity to reduce tax considered in Jones is made clear by the absence of remedial legislation.

With what are commonly called avoidance schemes, if correctly described, no argument could be put in favour of deliberately creating the relevant fiscal opportunity nor could anything be said against prospectively closing the opportunity when it is discovered. Therefore, the mismeasuring of income in such schemes, to draw from Neil Brooks’s definition of tax avoidance, ‘is not a mismeasurement of economic income that was contemplated for administrative or policy reasons by the structure of the tax legislation.’ But our objection is not as such in the bare fact that the mismeasurement was not ‘contemplated’, a point that would lead us back to viewing avoidance as the avoiding of Parliamentary intentions; but that the mismeasurement could not have been contemplated due to the absence of ‘administrative or policy reasons’ for creating such a situation.

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The point can be put higher: not only will the opportunity itself be typically indefensible, but equally indefensible will be the manner of its creation, ie: not openly proclaimed on the face of the legislation, but requiring discovery by an elite cadre of tax advisers capable of detecting what the authors of the legislation had missed.

When a part of the tax code is enacted, it is published. On the pages of the Taxes Acts are a series of syllogisms: IF A... THEN B, IF B THEN C, and so on. The rules set out the income or expenditure that is to be measured, and how it is to be measured. The results may be startling at times, but the basic pattern of risks and rewards are signposted even if an expert guide is required to traverse the more detailed part of the code. But, the existence of the opportunities commonly called ‘tax avoidance’ will not be clear on the face of the legislation. Hidden at random within the legislation will be offers of extraordinarily generous tax advantage (IF A, B, C BUT NOT D... THEN JACKPOT). These offers will have

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67 Ibid [70].
68 As regards retrospectively closing tax avoidance opportunities, there is always a rule of law objection that can be made to such a step, although such objections are not necessarily conclusive when weighed against all factors, see R (Hutson) v HMRC [2011] EWCA Civ 893, [2011] STC 1860.
69 Neil Brooks (n 19) 96. The three principles are essentially, 1) ‘mismeasurement’, 2) ‘sole or primary purpose’, and, 3) ‘not contemplated for administrative or policy reasons’. The analysis in this article comes to the same conclusion as regards the first and third principles – but, as it concentrates on the morality of the opportunity to avoid, makes no comment on the ‘purpose’ condition.
been almost certainly unknown to those drafting the legislation, and would go undetected to most tax professionals reading the legislation.

The existence of the rule allowing an individual to remove significant parts of their burdens under the legislation will be discovered by tax planners after publication of the legislation, and communicated to selected clients and prospective clients (and HMRC, if the disclosure regulations apply). This is a very imperfect form of publication. The existence of an opportunity to make ones tax bill simply disappear ought to be spoken clearly, even if the details might require technical assistance. With tax avoidance, we see that the Acts loudly proclaim a headline rate, but whisper in the ears of the select few that there exists a rule that points in the opposite direction. If it were typical of the law that important principles should be hidden and shared only amongst a select few, it would clearly undermine the integrity of the system as a system of law.\footnote{This significant imperfection of the publication of avoidance opportunities can be said as representing a failure of the second principle of legality as explained by Lon Fuller, see Lon Fuller, \textit{The Morality of Law}, (Yale University Press; New Haven, 1969), 36-38. Although there is not the space to further advance this argument, it would turn on its head a more orthodox approach that sees the rule of law as a principle arguing for the success of avoidance schemes that tick the statutory boxes, see Lief Muten, ‘The Swedish Experiment With a General Anti-Avoidance Rules’, in Cooper (n 19) 319: ‘the rule of law [is]... a value that overrides the fiscal interest in efficient taxation’.}

\textbf{CONCLUSION}

The basic characteristics of tax avoidance are that there is an opportunity to achieve a mismeasurement of income which is (a) overlooked in its creation; (b) unjustifiable in its existence; and (c) intolerable to continue. Personal morality does not enter into it. Nor does it matter whether a taxpayer might reasonably regard a particular tax planning scheme as ‘a reasonable course of action in relation to the relevant tax provisions’, the definition of abusive in the new GAAR legislation.\footnote{Finance Act 2013, s 207(2): ‘Tax arrangements are ‘abusive’ if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances...’}

The unjustifiability of the tax advantage identified by tax avoidance schemes is, of course, closely related to the lack of any intention of Parliament (or anyone else) to offer the opportunity to reduce tax liabilities. We are not here seeking to reinvent the argument that tax avoidance is defined by Parliament’s intentions. The point here is that an unjustifiable tax advantage will almost certainly be, quite literally, unjustified in that no one has ever proposed its creation and offered a defence for its creation – whether that justification be to advance a particular policy or simply to make taxation efficient. By contrast, it will almost certainly be the case that the existence of deliberate offer by the legislature to reduce tax will be clearly signalled in the legislation, even if the precise rules might require professional help to navigate. But the existence of a tax avoidance
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opportunity will be hidden so deeply that the skill of uncovering such opportunities is a rare and extremely well paid commodity.

It follows that there is likely to be a particular vice in tax avoidance schemes that goes beyond Milton Friedman’s objection that the availability of such opportunities depends on ‘the accident of the source of [ones] income’ (although certainly this applies); the opportunity to employ a tax avoidance scheme will also depend on the limited availability of the knowledge that the scheme exists. It is not quite as Professor Tiley said, that the avoidance scheme in Ramsay ‘would have destroyed the tax system by making it optional’, as taxation would only have been made optional for the privileged few, i.e. those who are informed about the scheme and whose affairs are such as that they can exploit it. Anyone objecting to this argument ought to consider how often those marketing avoidance schemes include confidentiality agreements before disclosing details to prospective clients. A bit like taking out a patent for a conjuring trick, publicity for how an avoidance scheme works spoils its value to its inventor.

Having thus we hope tolerably defined tax avoidance, the only question remains as to what practical importance such a step may have. The answer is given by the GAAR: what can be identified as avoidance can be counteracted. The present GAAR allows for any advantages gained by entering into an abusive scheme to be removed. Those simple and effective enforcement procedures would be just as simple and just as effective to remove the advantage of any tax scheme identified as objectionable or as abusive under any principle. It may be that the two approaches would have similar results in most cases, although Barclays Mercantile being an obvious point of difference. What has been proposed is an approach that looks to what, above all the moralisation, is the core and genuine objection to tax avoidance.

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73 Friedman (n 49) 172-173.
75 It is quite possible for tax legislation to deliberately offer advantages to the privileged few, eg: in order to attract foreign millionaires. A good example of this is the ‘Category 2’ tax status in Gibraltar, see Qualifying (Category 2) Individuals (Gibraltar) Rules 2004.
76 Which, of course, is much of the theory behind the Disclosure of Tax Avoidance Scheme rules.
77 Finance Act 2013, s 209.