THE LISBON INTERNATIONAL & EUROPEAN TAX LAW SEMINARS

A GENERAL ANTI-AVOIDANCE RULE (GAAR) FOR THE UK?

PROF. DR. JUDITH FREEDMAN (UNI. OF OXFORD)

MAY 4, 18:00-20:00

Background Materials

- Current Reform Proposals (HM Treasury), GAAR Study - A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system, Report by Graham Aaronson QC [11 November 2011];
- Lord Hoffmann, Tax Avoidance [2005] British Tax Review 197;
GAAR STUDY

A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system

REPORT BY GRAHAM AARONSON QC

11 NOVEMBER 2011
THE GAAR STUDY GROUP

Study Leader

GRAHAM AARONSON QC (Pump Court Tax Chambers)

Advisory Committee

JOHN BARTLETT (Group Head of Tax, BP plc)

JUDITH FREEDMAN (Professor of Taxation Law, Oxford University Law Faculty, and Director of Legal Research, Oxford University Centre for Business Taxation)

SIR LAUNCELOT HENDERSON (Judge of the Chancery Division of the High Court of Justice)

THE RT. HON LORD HOFFMANN (formerly Lord of Appeal, Non-Permanent Judge of the Court of Final Appeal of Hong Kong)

HOWARD NOWLAN (formerly Tax Partner at Slaughter & May, part time Judge of the First-Tier Tribunal (Tax Chamber))

JOHN TILEY CBE QC (Hon) FBA (Emeritus Professor of the Law of Taxation, Founding Director of the Centre for Tax Law, Cambridge University, Emeritus Leverhulme Fellow)

Secretariat

JONATHAN BREMNER (Pump Court Tax Chambers)

ZOE LEUNG-HUBBARD (HMRC)
SECTION 1
Summary of Conclusions

1.1 Subject to one reservation, the conclusions set out in this section, and developed in the rest of this Report, reflect the views of the Advisory Committee. The reservation is that the two members of the Advisory Committee who are serving judges in the United Kingdom (Sir Launcelot Henderson and Howard Nowlan) wish to maintain a position of strict public neutrality on the policy issues discussed in this Report, and therefore on the question whether or not a GAAR should be introduced. They do, however, agree with their colleagues on the Advisory Committee that, if a GAAR is to be introduced, a model of the type recommended in this Report appears to be the most suitable for adoption in the UK.

1.2 In broad terms the purpose of the study was to consider whether the introduction of some type of general anti-avoidance rule would be beneficial for the UK tax system.

1.3 Beneficial does not mean simply providing another weapon in the armoury to challenge unappealing tax avoidance schemes. The issue is more complex, and a number of important factors have to be taken into account to determine whether, looked at overall, introducing a GAAR today would be a positive step.

1.4 Most critical among these factors is whether such a step might erode the attractiveness of the UK’s tax regime to business. The continuing turbulence in financial markets and the fragility of the UK economy has kept this issue in the forefront of the Study Group’s discussions.

1.5 I have concluded that introducing a broad spectrum general anti-avoidance rule would not be beneficial for the UK tax system. This would carry a real risk of undermining the ability of business and individuals to carry out sensible and responsible tax planning. Such
tax planning is an entirely appropriate response to the complexities of a tax system such as the UK’s.

1.6 To reduce the risk of this consequence a broad spectrum rule would have to be accompanied by a comprehensive system for obtaining advance clearance for tax planning transactions. But an effective clearance system would impose very substantial resource burdens on taxpayers and HMRC alike. It would also inevitably in practice give discretionary power to HMRC who would effectively become the arbiter of the limits of responsible tax planning.

1.7 However, introducing a moderate rule which does not apply to responsible tax planning, and is instead targeted at abusive arrangements, would be beneficial for the UK tax system. Such a rule could bring a number of significant benefits -

(i) First and foremost, it would deter (and, where deterrence fails, counteract) contrived and artificial schemes which are widely regarded as an intolerable attack on the integrity of the UK’s tax regime. Such schemes make a mockery of the will of Parliament. In discussions with various representative bodies of the tax profession there has been unanimity of view that such schemes are wholly unacceptable.

(ii) Introducing such a targeted rule should contribute to providing a more level playing field for business: enterprises which conduct responsible tax planning would no longer have their competitiveness undermined by others which seek to reduce their tax burden by contrived and artificial schemes. Likewise tax professionals who are not willing to recommend or implement such schemes will not have their client base eroded by those who are prepared to do so.
(iii) At the moment, in the absence of any such anti-abuse rule, the task of judges in the Tax Tribunals and the Courts in dealing with abusive schemes is confined to deciding whether such schemes succeed or fail by applying the normal principles of statutory interpretation to the tax provisions concerned. Judges inevitably are faced with the temptation to stretch the interpretation, so far as possible, to achieve a sensible result; and this is widely regarded as producing considerable uncertainty in predicting the outcome of such disputes. In practice this uncertainty spreads from the highly abusive cases into the centre ground of responsible tax planning. A GAAR specifically targeted at abusive schemes would help reduce the risk of stretched interpretation and the uncertainty which this entails.

(iv) The UK’s tax legislation is notoriously long and complex. In many places it is virtually impenetrable. A significant contributing factor to the length and complexity is the need for the drafting of any given set of rules to anticipate attempts by some taxpayers to avoid the application of those rules, or exploit their application, in a way that Parliament could not rationally have contemplated. Enacting an anti-abuse rule should make it possible, by eliminating the need for a battery of specific anti-avoidance sub-rules, to draft future tax rules more simply and clearly. Also, fewer schemes would be enacted and so there will be less call for specific remedial legislation.

(v) In time, once confidence is established in the effectiveness of the anti-abuse rule, it should be possible to initiate a programme to reduce and simplify the existing body of detailed anti-avoidance rules. The Office of Tax Simplification would be the obvious agency to do this. This would lead to a significant improvement in the certainty of operation of the existing body of tax rules.
(vi) An anti-abuse rule which is targeted at contrived and artificial schemes will not apply to the centre ground of responsible tax planning. Consequently there will be no need for a comprehensive system of clearances, with the resource burdens which such a system would require.

(vii) The centre ground will of course have its outer limit; and taxpayers who wish to test the location of that limit by their tax planning will remain free to do so. A mechanism such as an independent advisory panel would be a quick and cost-effective way of helping taxpayers and HMRC identify the location of this outer limit, without running the risk of giving greater discretionary powers to HMRC.

In this particular context it is important to note that at present the effectiveness of some tax planning is uncertain, given the willingness of HMRC to challenge such schemes and the unpredictability of the response of the Tax Tribunals and Courts to such cases. Accordingly, a specifically targeted anti-abuse rule should not significantly increase the area of uncertainty.

(viii) It should help and inform the public debate about tax avoidance and abusive practices; and it should help build trust between taxpayers and HMRC, as the boundaries between acceptable and unacceptable behaviours are clarified.

1.8 These benefits which a specifically targeted anti-abuse rule would bring are substantial and valuable. Accordingly, I strongly recommend that such a rule should be enacted. This also reflects the views of the Advisory Committee\(^1\).

\(^1\)Subject to the reservation, as regards the serving judges, noted in paragraph 1.1.
1.9 To make the introduction of such a GAAR manageable, for taxpayers and HMRC alike, it should initially apply to the main direct taxes – income tax, capital gains tax, corporation tax, and petroleum revenue tax. It should also cover national insurance contributions (which would require separate legislation). At a later stage, when the GAAR is seen to operate fairly and effectively, consideration should be given to including other taxes such as stamp duty land tax. However, it would not be sensible to include VAT, as this tax has its own anti-abuse rules derived from EU law, and applying a UK GAAR in parallel could raise issues of consistency with EU law.

1.10 The tax rules in many areas have become extremely complex and in practice can give rise to very anomalous results. A GAAR would not remove the need to improve the specific legislation where this is so. Indeed, it will highlight the need for this, as the GAAR will operate most effectively where the principles underlying the specific tax rules are clear. Accordingly, one of the advantages of a GAAR would be to encourage legislators, and drafters, to consider more carefully the principles behind proposed legislation. In some areas, for example trust taxation, specific guidance notes in relation to the application of the GAAR may, as an interim measure, need to be agreed between HMRC and representative bodies working in this area. This exercise should also be used to highlight the need for reform of the rules rather than simply providing a continuing form of guidance.

1.11 It should be possible to draft such a rule so that it would operate effectively and fairly. Appended to this Report (Appendix I) is an illustrative draft of a general anti-abuse rule and an accompanying Guidance Note (Appendix II) which must be read with it. These incorporate principles which should enable abusive schemes to be specifically targeted and appropriately counteracted. The draft GAAR includes a series of important safeguards to ensure that the centre ground of responsible tax planning is effectively protected. These safeguards are –
(i) an explicit protection for reasonable tax planning ("safeguard 1");

(ii) an explicit protection for arrangements which are entered into without any intent to reduce tax ("safeguard 2");

(iii) placing upon HMRC the burden of proving that an arrangement is not reasonable tax planning ("safeguard 3");

(iv) having an Advisory Panel, with relevant expertise and a majority of non-HMRC members, to advise whether HMRC would be justified in seeking counteraction under the GAAR ("safeguard 4"). This Advisory Panel should publish (appropriately anonymised) digests of its advice.

(v) giving taxpayers and HMRC the right to refer to material or information which was publicly available when the tax planning arrangement was carried out. This could provide valuable help in determining whether an arrangement should be regarded as reasonable tax planning: This material should be available as evidence even if it would not otherwise be admissible as a matter of law.

(vi) requiring that potential application of the GAAR has to be authorised by senior officials within HMRC. This is to ensure consistency and responsibility in its application by HMRC.

1.12 It must be emphasised that the general anti-abuse rule appended to this Report has been drafted as an illustration to demonstrate that it is possible to incorporate in the form of legislation the principles which I consider must govern a general anti-abuse rule if it is to be beneficial for the UK. The key principles are the safeguards summarised in the sub-paragraphs (i)-(vi) above. Those key safeguards, and the other
principles incorporated into the draft, are discussed in greater depth later in this Report.

1.13 While recommending the enactment of such a specifically targeted anti-abuse rule, I note two particular concerns which have been frequently expressed during discussions with representative bodies.

(i) The first is a fear of “mission creep”: that the essential safeguards to protect the centre ground of responsible tax planning may be eroded by subsequent amendment.

(ii) The second is that the prospect of reducing the volume and complexity of specific anti-avoidance rules, which an anti-abuse rule should facilitate, will not be fulfilled.

If the Government decides to introduce a GAAR of the sort recommended, then I trust that it will take these concerns into account. Provision for a regular, say five yearly, review of progress would instil confidence that the benefits which the GAAR should bring will be delivered.
SECTION 2
The Study – Establishment and working methods

Appointment and terms of reference

2.1 In December 2010 I was asked to lead a study programme to establish whether a GAAR could be framed so as to be effective in the UK tax system and, if so, how the provisions of the GAAR might be framed.

2.2 I was asked to consider in particular whether such a GAAR could –

(i) provide the Government with an effective means of deterring and countering tax avoidance;

(ii) ensure that the rules work fairly;

(iii) ensure that the rules would not erode the UK tax regime’s attractiveness to business;

(iv) ensure that sufficient certainty about the tax treatment of transactions could be provided without undue compliance costs for businesses and individuals;

(v) keep any increase in resources for HMRC to an acceptable level and ensure that there would be a minimal need for resources to be diverted from other priorities.

2.3 The Government invited me to create an advisory committee to work with me on the study. I thought it appropriate to have a group which was small enough to work cohesively while having diverse backgrounds in the field of taxation. I considered that it would be very helpful if the advisory committee could include –
(i) judges with extensive experience in the field of taxation and, if possible, with particular experience in the operation of general anti-avoidance rules in other jurisdictions;

(ii) academic lawyers, again with extensive experience in the field of taxation and, if possible, with particular knowledge of the issues relating to GAARs; and

(iii) an experienced tax practitioner in the field of commerce and industry.

Such expertise, coupled with my own experience in the field of commercial taxation, would bring a rounded perspective to the study.

2.4 Accordingly I invited the following to be members of the Advisory Committee, and I am very grateful that they each immediately agreed to do so. I must add that this is dwarfed by my gratitude for the rigour and thoroughness of their analysis of every issue, however detailed, which arose for consideration during the entire course of the study. They are –

- John Bartlett (Group Head of Tax, BP Plc);

- Professor Judith Freedman (Professor of Taxation Law, Oxford University Law Faculty, and Director of Legal Research, Oxford University Centre for Business Taxation);

- Sir Launcelot Henderson (Judge of the Chancery Division of the High Court of Justice);

- The Rt. Hon. Lord Hoffmann ( Formerly Lord of Appeal, and Non-Permanent Judge of the Court of Final Appeal of Hong Kong);
• Howard Nowlan (Formerly Tax Partner at Slaughter & May, and part time Judge of the First Tier Tax Tribunal); and

• Professor John Tiley CBE, QC (Hon), FBA, (Emeritus Professor of the Law of Taxation, founding Director of the Centre for Tax Law, Cambridge University, Emeritus Leverhulme Fellow).

2.5 A small secretariat was established to manage most of the practical aspects of the study, and also to carry out some research. The secretariat comprises –

• Jonathan Bremner (a barrister at Pump Court Tax Chambers); and

• Zoe Leung-Hubbard (seconded by HMRC)

2.6 We are all particularly grateful for their outstanding efficiency and effort, which have made a major contribution to the smooth running of the study.

Study group methodology

2.7 The field of study was divided into a number of topics, which were considered in sequence. Periodically the Advisory Committee convened to discuss these issues with me. There have been five full meetings of the Advisory Committee, each preceded by a briefing paper which I prepared to deal with the issues to be covered. Between meetings discussion continued by email correspondence. During this period, note was taken of extensive academic and practitioner material from many jurisdictions as well as the UK.
2.8 For the first five months the attention was focused on the question whether there was a need for some form of GAAR; and, if so, then what framework of principles should the GAAR embody.

2.9 To complete this first stage of the study I also held a round of discussions with a number of representative bodies –

- The Tax Committee of the Confederation of British Industries;
- The Tax Committee of the Institute of Chartered Accountants in England and Wales;
- The Tax Committee of the Institute of Chartered Accountants of Scotland;
- The Tax Committee of the Law Society;
- The Tax Committee of the City of London Law Society;
- The Chartered Institute of Taxation;
- The Tax Committee of the Trades Union Congress;
- The Tax Directorate of the Institute of Directors;
- The Revenue Bar Association.

2.10 The framework of principles set out in section 5 of this Report reflects the views expressed by members of the Advisory Committee\(^2\) and takes account of the points raised by the representative bodies.

2.11 The next stage of the study focused on seeing whether it would be possible to embody the agreed framework of principles in the form of a draft of an illustrative GAAR. To inform this process I held a second round of discussions with the same representative bodies, together this time with the Law Society of Scotland.

2.12 The draft GAAR which is set out at Appendix I to this Report, and which is discussed in section 6, also reflects the views of the Advisory

\(^2\)Subject to the reservation, as regards the serving judges, noted in paragraph 1.1.
Committee and takes account of comments and suggestions made during the second round of discussions with the representative bodies.

Drafting the Report

2.13 I have drafted the Report myself, and therefore any failings are solely my responsibility. In reaching the conclusions of principle set out in this Report, and also in adopting the approach which the draft GAAR takes to embodying those principles, I have endeavoured to reflect the views of the Advisory Committee\(^3\), to whom I am greatly indebted for the comprehensiveness and quality of the advice which they offered throughout the period of the Study.

\(^3\) Subject to the reservation, as regards the serving judges, noted in paragraph 1.1.
SECTION 3
Does the UK need a GAAR?

3.1 Some people hold the view that while Parliament might have expected tax legislation to apply to a particular transaction in such a way as would produce a predictable amount of tax, nonetheless every taxpayer is entitled to use his wiles and skill without limit in order to secure a lower tax charge. To those who hold this view the appropriate response is for Parliament to introduce specific rules to block such attempts. This is therefore a sort of fiscal chess game, but with an ever increasing number of moves and pieces.

3.2 This approach had more adherents in earlier days, when it was common to regard tax as a form of confiscation by the state, and which to be lawful had to be justified by the letter of the law. It went hand in hand with a very strict approach to the interpretation of tax statutes.

3.3 My approach to taxation, tax avoidance and the question of whether a GAAR would be beneficial for the UK is based on the premise that the levying of tax is the principal means by which the state pays for the services and facilities which it provides for its citizens. As Mummery LJ expressed it in a very recent Court of Appeal judgment, tax is a contribution “towards the costs of providing community and other benefits for the purposes of life in a civil society”\(^4\).

3.4 On this approach it is reasonable to impose some limit on the ability of taxpayers to escape their share of the tax burden by looking for loopholes or weaknesses in the tax rules, and then constructing elaborate schemes designed to exploit them. To be consistent with the rule of law this limit should be imposed by legislation.

\(^4\) R (Huitson) v HMRC [2011] EWCA Civ 893, paragraph 94.
3.5 That, then, is my approach. But it does not mean that we should move straight to the conclusion that the UK needs to introduce a GAAR to deal with the problem. Before approaching any such conclusion it is essential first to consider whether the problem can be dealt with adequately by the means available in the UK tax regime as it exists.

3.6 In discussing this I shall use the very broad expression “tax avoidance”, but without intending to imply that every attempt to reduce a tax bill is something to be frowned upon, let alone treated as an affront to society. As is made clear throughout this Report, there is a large area of entirely legitimate tax planning.

3.7 At the moment tax avoidance is addressed in three main ways –

(i) purposive interpretation of tax statutes by the Courts;
(ii) specific anti-avoidance legislation; and
(iii) rules requiring the disclosure of tax avoidance schemes.

Purposive interpretation

3.8 Purposive interpretation of tax statutes is a relatively recent development. Until the ground-breaking speech of Lord Wilberforce in *Ramsay*\(^5\) Courts tended to interpret tax statutes in a strict, literalist, manner. As Lord Loreburn LC put it\(^6\) -

> “But still more important, in the present context, is the special constitutional convention which jealously safeguards the exclusive control exercised by Parliament over both the levying and expenditure of the public revenue. It is trite law that nothing less that clear, express and unambiguous language is effective to levy a tax.”

3.9 Adding to the difficulty of confronting tax avoidance which this strict interpretation imposed was another principle which required Courts, in

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\(^5\) *Ramsay v IRC* [1982] AC 300 at 323.
\(^6\) *Vickers Sons & Maxim Ltd v Evans* [1910] AC 444 at 445.
cases where the statutory language was ambiguous, to opt for the interpretation which favours the taxpayer –

“It is quite clear that if in a taxing statute words are reasonably capable of two alternative meanings the Court will prefer the meaning more favourable to the subject”.7

3.10 The turning point came (but was not immediately recognised as such) with the speech of Lord Wilberforce in Ramsay, where he stated –

“A subject is only to be taxed on clear words, not on the “intendment” or on the “equity” of an act. Any taxing act of Parliament is to be construed in accordance with this principle. What are “clear words” is to be ascertained upon normal principles; these do not confine the Court to literal interpretation. They may, indeed should, be considered the context and scheme of the relevant act as a whole, and its purpose may, indeed should, be regarded…..”

3.11 This has developed in subsequent cases, and the current approach to the interpretation and application of taxing statutes is succinctly summarised by Ribeiro PJ in the Arrowtown case in the Hong Kong Court of Final Appeal8 in a passage which was explicitly endorsed by the House of Lords in BMBF v Mawson9 -

“The driving principle in the Ramsay line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.”

3.12 By using purposive interpretation, and looking beyond the literal language of the particular provisions to seek the true meaning from their wider context, the Courts have frustrated many attempts to avoid tax which, pre Ramsay, would have succeeded.

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3.13 As a general proposition I regard this as a very positive development. However I share the view of a large number of tax professionals that in some cases the Courts, under the guise of purposive interpretation, have been prepared to stretch the interpretation of tax legislation in order to thwart tax avoidance schemes which they regard as abusive. I shall revert to this because the temptation to give stretched interpretations in such cases is particularly relevant to the major issue of uncertainty which I address later.

Specific anti-avoidance legislation

3.14 Specific anti-avoidance provisions have been part of the UK tax legislation landscape for more than fifty years. An early example of this was section 28 FA 1960, which was designed to counteract the use of dividend stripping and bond washing to create tax losses where no economic loss was suffered.

3.15 In the meantime the volume and complexity of anti-avoidance legislation has increased exponentially and now forms a substantial portion of the body of the UK’s tax legislation. The most recent example, dealing with so called “disguised remuneration” takes up more than 68 pages of the statute book; and it is estimated that there are now more than 300 targeted anti-avoidance rules (or “TAARs”).

Disclosure Of Tax Avoidance Schemes (“DOTAS”)

3.16 The DOTAS rules are relative newcomers, initially introduced for a limited class of cases and then extended to cover additional areas of tax. DOTAS requires the very early notification of tax avoidance

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10 “Stretching” statutory language in this context has been recognised in the recent Supreme Court judgment in *HMRC v DCC Holdings* [2010] UKSC 58. Lord Walker, delivering the judgment of the Court, at paragraph 25 noted – “argument has focused, in particular, on whether and how far the words in section 84(1) [FA 1996]….can be stretched (or need to be stretched) in order to avoid the absurd result of….”.  
11 Schedule 2, FA 2011
schemes, so as to enable HMRC to evaluate them and, where it thinks appropriate, enact specific legislation to counter them.

3.17 It is still early days to determine the value of the DOTAS scheme as a whole. However, it is plainly a useful source of information for HMRC. That, of course, has to be weighed against the additional burden which DOTAS places on taxpayers, and the additional complexity which consequential anti-avoidance legislation adds to the already vast body of tax legislation. There will also inevitably be instances where counteracting legislation comes too late to deal with early users of particular schemes: by their nature these schemes are often complex, and HMRC have to apply a great deal of intellectual effort in determining whether the scheme would be effective under existing rules and, if not, precisely what changes to the rules are needed to deal with them.

3.18 There is no doubt that the combination of purposive interpretation, specific anti-avoidance rules and DOTAS substantially reduces the scope for tax avoidance. Accordingly, the UK context is very different from that which applied in other common law jurisdictions, such as Australia and Canada\(^\text{12}\), when GAARs were first introduced there.

3.19 The critical question is whether it is effective enough in preventing the sort of tax avoidance schemes which many citizens and taxpayers regard as intolerable. If it is effective enough, then I would not consider there to be a sufficient case to recommend the introduction of a GAAR for the UK. This would be so even though it is possible that a well-designed GAAR could, in time, lead to simpler tax legislation and would reduce the temptation to stretch the interpretation of tax legislation.

\(^{12}\) The Canadian GAAR was introduced in 1987 in response to the *Stubart* case, where the Supreme Court rejected the general application of a business purpose test (which some saw as emanating from *Ramsay*). Likewise the Australian GAAR was introduced against a background of highly literalist interpretation of tax statutes.
3.20 Regrettably, however, it is clear that purposive interpretation, specific anti-avoidance rules and DOTAS are not capable of dealing with some of the most egregious tax avoidance schemes. Such schemes focus on prescriptive tax rules which are not susceptible to contextual interpretation. A recent example is the “SHIPS 2” scheme, which gave UK taxpayers a seven step route to creating an artificial tax loss which could be used to set off against their other tax liabilities. In the High Court Proudman J sympathised “with the instinctive reaction that such an obvious scheme ought not to succeed”\(^{14}\). However given the prescriptive nature of the statutory rules in question she was unable to find a purposive interpretation sufficient to defeat it.

3.21 The Court of Appeal\(^{15}\) reached the same conclusion. In the present context it is particularly pertinent to note the comments of Thomas LJ and Toulson LJ. Thomas LJ\(^{16}\) said –

“I agree with the judgment of Mummery LJ which sets out with great clarity why the appeal and cross appeal have to be dismissed. However, for the reasons given by Toulson LJ, my concurrence is reluctant. The higher-rate taxpayers with large earnings or significant investment income who have taken advantage of the scheme have received benefits that cannot possibly have been intended and which must be paid for by other taxpayers. It must be for Parliament to consider the wider implications of the decision as it relates to the way in which revenue legislation is structured and drafted.”

3.22 Toulson LJ\(^{17}\) said –

“I also agree. On the corresponding deficiency issue I add a brief summary to explain the reason for my reluctant concurrence in a result which instinctively seems wrong, because it bears no relation to commercial reality and results in a windfall which Parliament cannot have foreseen or intended.”

\(^{13}\) Mayes v HMRC [2011] EWCA Civ 407.
\(^{15}\) The judgment of the Court of Appeal is final. Permission to appeal to the Supreme Court was refused on 1\(^{st}\) November 2011.
\(^{16}\) (at paragraph 100)
\(^{17}\) (at paragraph 101)
3.23 I agree with Thomas LJ that it would be appropriate for Parliament to consider the implications of that decision. SHIPS 2 shows the inadequacy of the existing means of combating highly artificial tax avoidance schemes. It, and other schemes like it, provide the answer to the question “does the UK need a GAAR?” The answer is that it does.

3.24 That, however, is not a sufficient answer. To give a sufficient answer it is essential to determine the principles which should underlie any GAAR which might be introduced for the UK. Having done this it is then necessary to see that those principles can be embodied in legislation which would operate effectively. These considerations are addressed in the following sections of this Report.
SECTION 4
The views of representative bodies

4.1 As noted in paragraphs 2.9 – 2.11 above, I have discussed the study with ten representative bodies who have an interest in the proper administration of tax laws in the UK. These discussions were in two rounds. The first round was for the purpose of discussing the problems which were encountered in practice with, or as a result of, tax avoidance schemes. The second round was to discuss their reaction to specific proposals in the form of early drafts of an illustrative GAAR.

4.2 It is not only politeness which leads me to express my gratitude for the quality of the representations which they made. The articulation of their concerns and aspirations have played a very major role in shaping the principles which should form the basis for any potential GAAR. They also helped refine a great deal of the detailed provisions in the illustrative GAAR.

4.3 As a general observation I would note a remarkable uniformity of view as to the issues which need to be considered and the concerns which need to be addressed. There was also considerable uniformity of aspiration as to how the tax system could be improved and what role a GAAR might or should play in achieving those aspirations.

4.4 This is not to say that each representative body was equally enthusiastic or unenthusiastic about the prospect of a potential GAAR, or indeed that within each representative body there was uniformity of enthusiasm or lack of enthusiasm.

4.5 The degree of emphasis placed on different points varied between the representative bodies, and sometimes within the representative bodies. It is not necessary to set out a summary of each of the representations. Rather, I think it best to address their representations under four broad
Attitude to tax avoidance

4.6 There was unanimous disapproval, indeed distaste, for egregious tax avoidance schemes: schemes such as SHIPS 2 (discussed in paragraphs 3.20-3.23 above) should be deterred or, if undeterred, defeated. There was consensus in the view that purposive interpretation, even coupled with DOTAS, would fail to deal with carefully contrived schemes that rely on the application of prescriptive rules where no underlying principle can be discerned in the rules as set out in the statute.

4.7 It was a widely, and strongly, held view that highly aggressive schemes of that type made for an un-level playing field. It put tax professionals, whether advisers or company tax managers, in the invidious position of having to decide whether they should try to reduce the tax bill by using such schemes, given that on the present law the schemes would almost certainly produce that result, even though they personally regarded the schemes with distaste. The obvious dilemma lies in the fact that their competitors might set aside such scruples and gain a commercial advantage by recommending or adopting the scheme.

4.8 There was substantial concern that the existence of such schemes tended to affect HMRC’s attitude towards more conventional tax planning.

4.9 It was unanimously considered that the fear of aggressive tax planning led HMRC to require tax rules to be protected by a mass of provisions, some highly detailed and some very broad, which made the main rules difficult to discern. In some instances these rules create serious traps for taxpayers to fall into if they carry out transactions which the main
provisions were not intended to apply to. This was particularly stressed in the context of trust taxation.

4.10 There was also unanimous agreement that aggressive tax avoidance schemes encouraged judges to give a stretched interpretation to the relevant statutory provisions. The degree of willingness to do so varied from judge to judge, and also reflected the degree of disapproval with which the judge regarded the particular transaction. This produced considerable uncertainty.

_GAARs in general_

4.11 Without exception the representative bodies were concerned about the possibility that some HMRC officials would use a GAAR in cases for which it was not designed. In particular there was a fear that the use of the GAAR might in some cases be threatened as a means of applying pressure in tax disputes over non-abusive tax planning.

4.12 There was also unanimous concern that GAARs could give the revenue authorities a great deal of discretionary power. This could be either by enabling them to decide which type of transaction they would challenge; or it could be by publishing a volume of guidance which would inevitably affect taxpayers’ willingness to carry out certain transactions even though such transactions seemed in principle to fall outside the scope of the GAAR.

4.13 It was widely thought that GAARs were conceptually paradoxical. Complex tax systems such as the UK’s positively invite taxpayers to carry out certain transactions by according them special tax advantages; and yet experience with GAARs in other jurisdictions showed that these responses might nonetheless be susceptible to challenge under the terms of the GAAR because the transaction was unquestionably motivated, at least in part, by the desire to access the tax advantage.
4.14 A unanimous concern was that uncertainty might be created in the interaction of a GAAR with particular reliefs or other tax advantages which appeared to be available for certain transactions under the relevant tax rules.

4.15 Concern was expressed by some representative bodies that a GAAR would make it impossible to escape from the unintended traps which complex tax rules put in the way of ordinary commercial or personal transactions.

The illustrative GAAR

4.16 As noted above, during the second round of discussions the representative bodies were invited to consider an early draft of the illustrative GAAR. Their main areas of concern with this were as follows.

4.17 There was general recognition that the safeguards written into the illustrative draft would reduce the risk of giving HMRC undue discretionary power over tax planning transactions.

4.18 However, there was strong concern that the safeguards written into the illustrative GAAR may not survive in practice. This might happen at the stage prior to enactment (i.e. by significant changes in the version put before Parliament); or it might happen by subsequent amendment. To use the expression currently in vogue, there was a palpable fear of “mission creep” after the GAAR reached the statute book.

4.19 The main fear directed to the terms of the illustrative GAAR itself was uncertainty as to where any given transaction or arrangement would fall on the spectrum of tax avoidance. Although clearly intended to apply only to egregious, or very aggressive, tax avoidance schemes, it was thought likely that HMRC may seek to apply the GAAR more
widely. To restate views already noted above, while there was unanimous agreement that a GAAR would be beneficial if it eliminated egregious tax planning schemes, there was substantial concern that it may in fact be invoked by HMRC and applied by the Courts against a wider range of tax planning.

4.20 There was very strong support for the concept of an Advisory Panel, with an independent chairman and a non-HMRC member. This was seen as having a three-fold impact on reducing the area of uncertainty.

(i) First, on the assumption that one of the independent members has expertise in the area of the transaction in question, the Panel should reduce the risk of the GAAR being invoked by HMRC as a result of their failing to understand the nature or purpose of the transaction. This was not raised as a criticism of HMRC; rather that it is simply a fact of life that HMRC can not be expected to have up to date experience in many fields of commercial (and especially financial) activity.

(ii) Secondly, if the Advisory Panel published its decisions in anonymised form, this would build up a database which taxpayers and tax professionals could use to calibrate their own response to prospective tax planning exercises.

(iii) Thirdly, it was proposed that the Advisory Panel would be an effective instrument for updating and expanding guidelines for the operation of the GAAR. This would reduce uncertainty as to where an arrangement would fall on the spectrum of tax planning. It would also ensure that a growing body of guidance would be given by an independent body, and therefore guard against any increase in HMRC’s discretionary powers.
**Aspirations**

4.21 Some representative bodies expressed very strongly their view that the protection against abusive tax schemes which the GAAR would bring should be used to ensure that future tax legislation is drafted more simply. While acknowledging that it would take some time before HMRC are confident that the GAAR works as an effective deterrent, they considered it essential that a programme should then be initiated to review and simplify the existing body of legislation. In their view the GAAR would provide an opportunity to gain this very substantial benefit, and that opportunity must not be wasted.

4.22 A number of representative bodies expressed the hope that, given the protection against unacceptable tax schemes which the GAAR would provide, the Courts should not seek to extend the application of the Ramsay principle beyond the stage already reached in the decided cases. This was, again, in order to reduce the uncertainty affecting the centre ground of tax planning.
SECTION 5
The framework of principles for a GAAR

Overarching principle

5.1 I have concluded that a GAAR which is appropriate for the UK must be driven by an overarching principle. This is that it should target those highly abusive contrived and artificial schemes which are widely regarded as intolerable, but that it should not affect the large centre ground of responsible tax planning.

5.2 Critically, I consider that this overarching principle must be supported by the simple proposition that where there can be reasonable doubt as to which side of the line any particular arrangement falls on, then that doubt is to be resolved in favour of the taxpayer so that the arrangement is treated as coming within the unaffected centre ground.

5.3 The other principles to be adopted are likewise designed to support and give effect to this overarching principle.

Not a rule of interpretation

5.4 Before turning to these supporting principles it should be made clear that the GAAR is not to be regarded as a rule of construction, or interpretation, of statutory language. Rather, it operates on the hypothesis that the particular tax rules engaged by the arrangement would, on conventional purposive interpretation, succeed in achieving the advantageous tax result which it set out to obtain. The GAAR then provides an overriding statutory principle to which other tax legislation is subject.

5.5 Recognising that the GAAR is a rule which overrides the consequences which would otherwise flow from tax legislation brings an advantage, but it also imposes heavy responsibilities.
5.6 The advantage is that the GAAR can use concepts which could not be
developed by applying conventional interpretation to the tax rules. A
significant example of this is to define “an arrangement” in the sensible
terms which were rejected by the majority of the House of Lords in
*Craven v White* 18 because in their opinion those terms went beyond
the scope of permissible judicial interpretation.

5.7 The heavy responsibility is to ensure that the GAAR must be operated
by HMRC in the public interest. This means that it is not to be wielded
as a weapon to intimidate taxpayers in relation to arrangements to
which it could not apply. Nor should it be allowed to become a means
of increasing HMRC's discretionary powers.

5.8 I consider it appropriate to adopt two unconventional approaches in
order to secure those objectives, bearing in mind that the GAAR itself
would be an unconventional type of tax legislation.

5.9 The first of these is to provide for an authoritative source of guidance
as to the sort of cases to which the GAAR should apply. This could be
achieved by having guidance notes included as a schedule to the
Finance Act which enacts the GAAR itself, so that it gains the authority
attaching to legislation. Appended to this Report is an illustrative
Guidance Note of the type envisaged.

5.10 To serve as an ongoing source of guidance, such guidance notes
would need to be updated from time to time. To avoid the risk of
increasing HMRC’s discretionary powers it would be appropriate for the
updating of the Guidance Note to be the responsibility of an

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18 [1989] AC 398. The majority held that a composite transaction could not include a step if
there was a possibility that it might not take place, even though it was part of the plan and it
did in fact take place. The minority preferred to regard a composite transaction as including
any step which was planned to be included and which was in fact carried out. In the
illustrative draft GAAR sub-section 15(3) adopts the minority approach.
independent body. The Advisory Panel referred to later is an example of the sort of body that could serve this purpose.

5.11 Secondly, in any potential dispute relating to the application of the GAAR there should be available all material which may help to determine whether a particular arrangement falls within the intended target area of the GAAR or, conversely, falls within the unaffected centre ground. This material should include available evidence, as at the time of the arrangement, in the form of official material or HMRC practice or widespread taxpayer practice, which is capable of throwing light on the inquiry; and this should be admissible even if it would not otherwise be admissible under the normal rules of evidence.

Differentiating between responsible tax planning and abusive schemes

5.12 Reverting now to the overarching principle, I have of course had many long and probing discussions with the Advisory Committee about how best to differentiate between the abusive tax schemes at which the GAAR is targeted and the centre ground of responsible tax planning which it is not to affect.

5.13 In many overseas GAARs, and indeed in many of the UK’s specific anti-avoidance rules, the approach has been to target arrangements which have the sole or main purpose of achieving a tax advantage. There are many variants in the language, but the underlying concept is the same: if one of the objects of the arrangement is to achieve a tax advantage, then for that very reason the tax advantage should be denied.

5.14 I do not consider this to be the right approach for a GAAR that is suitable for the UK tax regime. The insuperable problem is that the UK tax rules offer, and indeed in many instances positively encourage, the opportunity for taxpayers to reduce their tax liability. Taking advantage of this can be described as a form of tax avoidance, but clearly it is not
something to be criticised and therefore it should not be counteracted by a GAAR. Obvious examples are arrangements designed to access capital allowances for investment in plant, or enhanced reliefs for scientific research expenditure, or tax incentives given for investment in enterprise zones. There are myriad other more subtle instances where there are different tax regimes for different, but not very distant, types of transactions (e.g. loan relationships, repos, derivatives etc.).

5.15 The conclusion reached is that to identify the sort of abusive scheme which the GAAR is intended to deter or counteract it is necessary to adopt a more pragmatic and objective initial approach. The starting point should be to see whether the arrangement is abnormal, in the sense of having abnormal features specifically designed to achieve a tax advantageous result. If an arrangement has such an abnormal feature or features then it becomes in effect “short listed” for consideration as a potential target for the GAAR. Conversely, if there is no such feature then it is immediately dismissed from consideration.

5.16 Placing an arrangement on this notional shortlist is a preliminary step. This leads to the critical stage of determining whether the arrangement does in fact fall within the GAAR’s intended target area.

5.17 At first blush one might think this could be achieved by asking whether the arrangement is designed to achieve a tax result which Parliament, or the legislation, did not intend. The insuperable problem here, though, is the established principle of statutory interpretation in the UK which holds that the intention of Parliament can be discerned only from the language of the legislation itself. Ex hypothesi the GAAR is designed to deal with cases where the language of the legislation would, under normal principles of interpretation, indeed achieve a favourable tax result (e.g as in the SHIPS 2 scheme). So this question could never be answered in the affirmative.
5.18 Variants of this approach have been examined in an attempt to avoid the paradox created by that principle of statutory interpretation: for example, using criteria such as whether the tax result which the arrangement seeks to achieve is a result which is inconsistent with the “scheme of the legislation”, or with the intention of the legislation “viewed as a whole”, or “having regard to the wider context”. The insuperable problem here is that the very essence of conventional purposive interpretation is to have regard to the context in which the particular provisions are set\(^{19}\).

5.19 I have reached the conclusion that the better approach is to identify what it is that makes the centre ground of responsible tax planning unobjectionable; and to use this as the way to exclude from the shortlist of abnormal transactions those which come within that centre ground.

5.20 I consider that the reasoning developed by the Court of Final Appeal in Hong Kong, dealing with its GAAR\(^{20}\), leads to the best approach for the UK. That approach is to recognise that tax rules may give taxpayers a number of reasonable choices as to the sort of transactions which they may carry out and, depending on the choice, the tax result which could be achieved. Ribeiro PJ expressed the principle in this way –

“….the statutory purpose of section 61A is not to attack arrangements made to secure benefits which are legislatively intended to be available to the taxpayer.”\(^{21}\)

5.21 Because of the established principle of statutory interpretation in the UK, which requires the legislative “intention” to be established solely from the wording of the legislation, the language needs to be modified. Accordingly, I have modified it so as to refer to arrangements made to

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\(^{19}\) See the passage cited from Lord Wilberforce’s speech in *Ramsay*, in paragraph 3.10 above.

\(^{20}\) S.61A Inland Revenue Ordinance

\(^{21}\) *Ngai Lik Electronics Company Ltd v Commissioner of Inland Revenue*, FACV No.29 of 2008, paragraph 101.
secure tax benefits which can be regarded as a reasonable response to choices afforded by the legislation.

5.22 This then is the approach which I consider most appropriate for a UK GAAR, and it is adopted in the illustrative draft GAAR appended to this Report.

Reducing uncertainty

5.23 There will, of course, be cases where it is arguable, but not clear, that an arrangement can be regarded as a reasonable exercise of choices made available by the tax rules. In such cases I consider that the appropriate principle is to give the taxpayer the benefit of the doubt. This would be achieved by placing on HMRC the burden of demonstrating that the arrangement can not reasonably be regarded as a reasonable exercise of choice.

5.24 Doing this should substantially reduce the scope for doubt as to whether an arrangement falls within the intended target area of the GAAR.

5.25 As previously noted, there is already considerable uncertainty in identifying the limit of effective tax avoidance; and no legislative or other framework will ever remove it entirely. However, it is important to reduce the scope of uncertainty as far as possible. To this end it would be desirable for there to be some mechanism to enable doubts to be addressed as quickly as possible. An effective mechanism for achieving this could be an advisory panel who would advise HMRC whether there are reasonable grounds for invoking the GAAR in the case of any particular arrangement. I envisage an advisory panel with a majority of non-HMRC members, which would receive written representations from the taxpayer as well as from HMRC. Establishing such a panel could have several advantages.
(i) First, it would provide an element of impartial supervision of the administration of the GAAR by HMRC.

(ii) Secondly, if the Advisory Panel’s conclusions in each case are published (anonymised, so as to protect taxpayer confidentiality), then this would build up a body of guidance which could be used by taxpayers and HMRC to calibrate their understanding of where the dividing line falls between responsible tax planning and abusive tax schemes. This would be further helped if the Panel were to publish regular digests of its anonymised opinions.

(iii) Thirdly, the Advisory Panel could be used as an appropriate body to update the guidance notes referred to above.

5.26 Introducing these measures to give the taxpayer the benefit of the doubt and to reduce the scope for uncertainty would make it unnecessary to introduce a general system of clearances for the GAAR. Such a system would impose very considerable resource burdens on taxpayers and HMRC alike; and if a general clearance system were to be operated by HMRC themselves, then it would give them additional discretionary powers – which would be wrong as a matter of constitutional principle.

5.27 However, no such objection applies to extending existing clearance arrangements (such as for company reorganisations or de-mergers) so that the application, and the clearance if granted, would extend to confirmation that the GAAR would be inapplicable to the arrangement concerned. Accordingly I consider that it would be appropriate, and sensible, to include such a provision in the GAAR.

5.28 On the issue of uncertainty there are two further points which need to be made.
5.29 First, there will inevitably be cases where tax planning arrangements test the outer limits of the centre ground, giving rise to uncertainty as to whether the GAAR applies. However, in most if not all of these cases it is likely that there would in any event be uncertainty as to whether such tax planning would succeed in achieving its objective on the basis of the tax rules themselves, without any consideration of the GAAR. The comments of Lord Walker in the recent Supreme Court *Tower MCashback*[^22] case are a powerful reminder of this fact of life.

> “The composite transactions in this case, like that in *Ensign* (and unlike that in *BMBF*) did not, on a realistic appraisal of the facts, meet the test laid down by the CAA, which requires real expenditure for the real purpose of acquiring plant for use in a trade. Any uncertainty that there may be will arise from the unremitting ingenuity of tax consultants and investment bankers determined to test the limits of the capital allowances legislation.”

5.30 Secondly, there are some areas of taxation, such as trusts, where the present statutory rules are extremely complex and can give rise to many anomalous consequences. This is not a reason to recommend against a GAAR. Rather, it calls for rationalisation of these rules. As an interim measure specific guidance notes will need to be agreed between HMRC and representative bodies working in such cases.

**Exclusion for arrangements with no tax intent**

5.31 There is one further principle which I consider should be included in the UK GAAR. This is that there should be an automatic exclusion from the operation of the GAAR for any arrangement which is entered into entirely for non-tax reasons. It is, of course, unlikely that arrangements which have no tax intent at all would in fact give rise to a tax advantage. However, that is nonetheless possible[^23].

[^23]: See, in the commercial context, *Five Oaks Properties Ltd v HMRC* [2006] STC (SCD) 769
5.32 I think it important that this reassurance is given, if only to avoid unwarranted fears by small business concerns or private individuals that arrangements such as providing financial assistance to suppliers or relatives, and without any intention of seeking tax reduction as a result, might come within the scope of the GAAR.

5.33 In such cases it is reasonable to require the taxpayer to prove that the arrangement was not entered into with any intention of reducing his tax liability. Accordingly this particular safeguard differs from the general rule adopted in the GAAR by imposing the burden of proof on the taxpayer.

Counteraction

5.34 One of the main objectives of the GAAR is to deter taxpayers from entering into the sort of abusive arrangements at which it is targeted. If that deterrence fails, and the taxpayers go ahead with arrangements which fall within the GAAR’s target area, then consideration needs to be given to the form of counteraction which should be applied by HMRC.

5.35 The basic principle which I consider should be adopted is that counteraction should produce a result which is reasonable and just. The determination of a reasonable and just result is an issue which should be justiciable before the Tax Tribunal, and not left to HMRC’s discretion.

5.36 There are two ways in which this can be achieved. The first is simply to leave it to the Tax Tribunal to determine what would be a reasonable and just result in all the circumstances. This would be the appropriate treatment for cases, like Ramsay itself, where the arrangement is effectively self-cancelling. In such cases it may be reasonable and just simply to treat the transaction as if it did not take place (so that any loss claim would be ignored); but there might be instances where such
arrangements do in fact change the economic position of the persons involved, in which case that change should be respected by the counteraction.

5.37 In other types of cases, where the arrangement is designed to achieve some real commercial or personal purpose in addition to the intended abusive tax result, I consider that the appropriate counteraction should, where possible, be to base the assessment and computations on a hypothetical equivalent transaction which would achieve the same commercial or personal result but without the abusive tax result.

5.38 In such cases there would inevitably be concern that HMRC might seek to identify or construct an equivalent arrangement producing the highest possible tax liability. To guard against this the counteraction provisions of the GAAR should place the onus on HMRC to establish that its designated equivalent arrangement is appropriate to the circumstances.

5.39 As a further protection I consider it important that, if the taxpayer does not agree with HMRC’s proposed counteraction, then on appeal the Tax Tribunal should reach its own conclusion as to what would be the appropriate equivalent arrangement. Further, if the Tribunal forms the view that it is either impossible or excessively difficult to identify such an arrangement, then it should apply whatever counteraction appears to it to be reasonable and just.

5.40 It is also important that where counteraction is applied, then consideration must be given to the tax liability of the same taxpayer for other periods, or of other taxpayers for that period or other periods, so as to ensure so far as possible that the counteraction does not lead overall to excessive taxation.
Introduction of the GAAR

5.41 Counteraction under the GAAR would have the effect of overriding the result which would otherwise follow from the tax rules. There is a case, therefore, for arguing that the GAAR should not apply to arrangements which are entered into (even if they are not completed) by the time when the GAAR itself enters into force.

5.42 However, I consider that this would be inappropriate. Ex hypothesi the GAAR is designed to apply only to artificial and abusive tax schemes which, as previously discussed, are widely regarded as intolerable. It is also important to note that if the GAAR is enacted, then its enactment will have been preceded by a period of consultation, and that period will have been preceded in turn by the publication of this Report.

5.43 I therefore see no unfairness in applying the GAAR to an arrangement which is not yet completed before the date when it comes into force; and it would in my view be appropriate to do so.

Scope of the GAAR

5.44 I consider that if a GAAR is to be enacted, it should initially be confined to the main direct taxes, namely income tax, corporation tax, capital gains tax and petroleum revenue tax. It should also extend to national insurance contributions, although this would require separate enactment as NICs are not regarded as a tax for the purposes of Parliamentary procedure.

5.45 It is sensible to restrict the operation of the GAAR to these taxes in the first place, in order to allow experience to be gained before consideration is given to extending it to other taxes, such as SDLT.
5.46 However, it would not be appropriate for that consideration to extend to VAT, as this tax has its own (still developing) abuse of law doctrine: issues could therefore arise as to possible inconsistencies between terms of the GAAR and the EU doctrine of abuse of law.

**Penalties or penal interest**

5.47 In some jurisdictions\(^\text{24}\) there are provisions applying special penalty or rates of interest regimes to tax recovered under a GAAR. Including similar measures in a UK GAAR would certainly increase its deterrent effect, and may be regarded by a significant proportion of taxpayers as no more than just retribution for schemes designed to avoid paying a fair share of tax.

5.48 However, I consider that including such provisions would be seen as presenting an irresistible temptation to HMRC to wield the GAAR as a weapon rather than to use it, as intended, as a shield. For this reason I do not consider that it would be appropriate to include any provisions for applying special rates of interest or penalties to tax recovered by use of the GAAR.

\(^{24}\text{For example Australia, New Zealand and South Africa, and see the USA economic substance codification.}\)
SECTION 6
Embodying those principles in a GAAR

6.1 A substantial part of the period of the GAAR Study has been taken up with considering whether, and if so how, the principles discussed in section 5 above can be incorporated as legislation.

6.2 The conclusion reached is that it is possible to do so, and the illustrative GAAR in Appendix I is an indication of what might be appropriate legislation. The Guidance Note at Appendix II highlights particular points to note in the draft GAAR, and importantly gives guidance on the operation of the critical protection of responsible tax planning.

6.3 Rather than setting out here an extensive restatement of what is in the illustrative GAAR and the Guidance Note readers of this Report are invited to read the texts of Appendices I and II. For present purposes it is sufficient to note that the illustrative GAAR follows the route indicated in section 5 of this Report. In broad terms the GAAR imposes two main requirements -

(i) The first is that the GAAR applies only to abnormal arrangements: an abnormal feature has to be identified, its inclusion has to be for the purpose of achieving the intended tax result, and the intended tax result has to be achieved in one of a number of specified ways.

(ii) The second is that the GAAR will operate only if the arrangement cannot reasonably be regarded as a reasonable exercise of choices of conduct afforded by the legislation. This is the most important of the protections (termed “safeguards”) for responsible tax planning. As emphasised in the previous section of this Report, cases where there may be doubt as to whether the arrangement falls within that description are to be
resolved by giving the taxpayers the benefit of the doubt. This is achieved in the illustrative draft GAAR by using the expression –

“If it can reasonably be regarded as a reasonable exercise of choices of conduct…….”.

The test is objective, and in practice it means that in the event of dispute the Tax Tribunal will decide in the taxpayer’s favour not only if the judge himself regards the arrangement as a reasonable exercise of choices of conduct but also, where he does not himself take that view, he nonetheless considers that such a view may reasonably be held.

6.4 With the burden of establishing the point placed on HMRC this may be seen as a high hurdle which the GAAR needs to clear. Indeed, it is intended to be a high hurdle. However, I am satisfied that the GAAR will clear this hurdle when dealing with the highly artificial tax avoidance schemes, of which SHIPS 2 is a very visible example, which it is designed to deter or defeat.

6.5 The other protections referred to in section 5 of this Report are set out in the GAAR, whether under the caption “safeguards” or in section 10 of the illustrative draft which deals with the admissibility of relevant evidential material.

6.6 There is one particular point which it may be worthwhile highlighting here. This is the control and management regime set out in section 13 of the illustrative draft. This requires a senior HMRC official to authorise any prospective use of the GAAR. Its purpose is to ensure consistency and responsibility in the use of the GAAR by HMRC.

6.7 Section 13 goes on to provide that the taxpayer must be notified of the prospective use of the GAAR by HMRC, and must be given the opportunity to make representations as to why in his view the GAAR is
inapplicable. This particular provision addresses the concern that HMRC may otherwise invoke the GAAR in cases where they do not have a sufficient understanding of the nature of the arrangement or the context in which that arrangement was carried out. This would be particularly important for areas such as finance and derivatives where it is difficult to keep pace with the development of new types of instrument.

6.8 The next section of the illustrative draft, section 14, provides for the referral of disputed matters to the Advisory Panel. The draft envisages that this Panel will be established under regulations made by statutory instrument. I envisage that there would be an overall panel of members, comprising individuals with experience in a range of commercial activities, and also individuals experienced in what is known as private client taxation. The Panel would also have members appointed by HMRC. I envisage that in any given case a small sub-panel of three members would be appointed to consider the representations of HMRC and the taxpayer. On this sub-panel, two of the members would be independent, and at least one of them would have expertise relevant to the arrangement concerned.

6.9 The Panel would operate on an advisory basis only, and its conclusions would not be binding on either HMRC or the taxpayer. However, the opinions of the Panel would be available to be taken into account by the Tax Tribunal on any appeal against counteraction under the GAAR.

6.10 Finally, it should be emphasised that the illustrative draft is just that. All of its features could be incorporated in a draft which is more succinct or compressed. Conversely, some of its provisions could be expressed more extensively. It is also quite possible that some of its provisions may need to be adjusted to ensure that the GAAR does not itself have any gaps or loopholes which can be exploited by the ingenuity of the promoters of artificial tax schemes.
6.11 Accordingly, while I would be happy to see a suitably refined version of the illustrative GAAR enacted into legislation, my main concern is not pride of authorship, but rather that there should be enacted a GAAR which reflects the principles which I have set out and which can put a stop to the abusive schemes at which it is targeted.
APPENDIX I – ILLUSTRATIVE DRAFT GAAR

PART XY
GENERAL ANTI-ABUSE RULE

Scope of this Part

1. (1) This Part applies for the purposes of income tax, corporation tax, capital gains tax and petroleum revenue tax (“the taxes”).

(2) The enactments which apply to the taxes, including -

(a) subordinate legislation, and

(b) relevant double taxation arrangements (see section 15) given effect under section 2 of the Taxation (International and Other Provisions) Act 2010

are in this Part referred to as “the Acts”.

2. Section 8 applies to counteract abnormal arrangements (see sections 6 and 7) which, but for this Part, would achieve an abusive tax result from the application to the arrangements of the provisions of the Acts, and which are contrived to achieve such a result.

3. (1) For the purposes of this Part an “abusive tax result” is an advantageous tax result (see section 15) which would be achieved by an arrangement that is neither reasonable tax planning (see section 4) nor an arrangement without tax intent (see section 5).
(2) For the purposes of this Part an abnormal arrangement is contrived to achieve an abusive tax result if, and only if, the inclusion of any abnormal feature (see sections 6 and 7) can reasonably be considered to have as its sole purpose, or as one of its main purposes, 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.

Safeguard 1 - reasonable tax planning

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.

(2) Accordingly, section 8 (counteraction) shall not apply to such arrangements.

(3) Such arrangements are in this Part referred to as “reasonable tax planning”.

Safeguard 2 - arrangements without tax intent

5. (1) An arrangement does not achieve an abusive tax result where the advantaged party shows, to the civil standard of proof, that it was neither designed nor carried out with the intention of achieving an
advantageous tax result, and that no step or feature was included in or omitted from it with that intention.

(2) Accordingly, section 8 (counteraction) shall not apply to such arrangements.

(3) Such arrangements are in this Part referred to as “arrangements without tax intent”.

Abnormal arrangements and abnormal features

6. (1) For the purposes of this Part an “abnormal arrangement” is an arrangement which, considered objectively –

(a) viewed as a whole, and having regard to all the circumstances, has no significant purpose apart from achieving an abusive tax result (so that in the context of such an arrangement all of its features shall be regarded as abnormal); or

(b) has features which would not be in the arrangement if it did not also have as its sole purpose, or as one of its main purposes, achieving an abusive tax result.

(2) The provisions of section 7 apply for the purposes of sub-section (1)(b).

(3) For the purposes of this Part “abnormal features” are the features referred to in sub-section (1)(b) read together with section 7.

Abnormal arrangements: features which may be taken into account

7. (1) Sub-section (3) sets out features which in the context of the particular arrangement may be regarded as abnormal features, and
which accordingly may be taken into account in determining whether that arrangement is an abnormal arrangement.

(2) Features other than those set out in sub-section (3) may be so regarded and taken into account; but the fact that the arrangement has one or more of the features set out in that sub-section shall not necessarily lead to the conclusion that the arrangement is an abnormal arrangement.

(3) The features are -

(a) that the arrangement would, apart from the operation of this Part, result in receipts being taken into account for tax purposes which are significantly less than the true economic income, profit or gain;

(b) that the arrangement would, apart from the operation of this Part, result in deductions being taken into account for tax purposes which are significantly greater than the true economic cost or loss;

(c) that the arrangement includes a transaction at a value significantly different from market value, or otherwise on non-commercial terms;

(d) that the arrangement, or any element of it, is inconsistent with the legal duties of the parties to it;

(e) that the arrangement includes a person, a transaction, a document or significant terms in a document, which would not be included if the arrangement were not designed to achieve an abusive tax result;
(f) that the arrangement omits a person, a transaction, a document or significant terms in a document, which would not be omitted if the arrangement were not designed to achieve an abusive tax result; and

(g) that the arrangement includes the location of an asset or a transaction, or of the place of residence of a person, which would not be so located if the arrangement were not designed to achieve an abusive tax result.

Counteraction

8. (1) An abnormal arrangement which is contrived to achieve an abusive tax result shall be counteracted as follows.

(2) If the arrangement viewed as a whole is contrived to achieve an abusive tax result, and has no significant purpose apart from this, the receipts and deductions of an advantaged party (see section 15) shall be computed and assessed in such manner as is reasonable and just (including, if appropriate, by treating the arrangement as if it had not taken place).

(3) If the arrangement viewed as a whole has a significant purpose apart from being contrived to achieve an abusive tax result, the receipts and deductions of the advantaged party shall, subject to sub-section (5), be computed and assessed as if a corresponding non-abusive arrangement had been carried out instead of the actual arrangement.

(4) A “corresponding non-abusive arrangement” is an arrangement which would enable the achievement of a purpose which is the same as or similar to that which the actual arrangement was intended to achieve, but which does not achieve an abusive tax result.
(5) If, having regard to the particular arrangement, it is not possible to
determine what would be a corresponding non-abusive
arrangement, then the receipts and deductions of an advantaged
party shall be computed and assessed in such manner as is
reasonable and just.

Safeguard 3 – burden of proof on HMRC

9. It shall be for HMRC to show, to the civil standard of proof –

(a) that the arrangement is an abnormal arrangement;

(b) that the advantageous tax result of the arrangement would be an
abusive tax result (and accordingly that the arrangement is not
reasonable tax planning);

(c) that the counteracting computations and assessments are
reasonable and just; and

(d) where relevant, what is to be taken as the corresponding non-
abusive arrangement.

Guidance Note and admissibility of evidence

10. (1) In determining the matters set out in sub-section (2) -

(a) there shall be taken into account the Guidance Note in
Schedule XY, and

(b) there also may be taken into account any material referred to
in sub-section (3), whether or not such material would
otherwise be admissible in evidence.
(2) The matters referred to in sub-section (1) are –

(a) whether the arrangement is an abnormal arrangement;
(b) whether any particular feature is an abnormal feature;
(c) whether the arrangement constitutes reasonable tax planning;
(d) whether the tax result is an abusive tax result; and
(e) what is to be taken as the corresponding non-abusive arrangement.

(3) The material which may also be taken into account is –

(a) any relevant Parliamentary, Ministerial or HMRC material which is in the public domain at the time of the arrangement;
(b) published guidance or determinations of the Advisory Panel;
(c) evidence of HMRC practice at the time of the arrangement; and
(d) evidence of practice commonly adopted at the time of the arrangement.

**Corresponding adjustments to the computation and assessment of other periods or other persons**

11. (1) Where the receipts or deductions of an advantaged party are counteracted under the provisions of section 8, such corresponding adjustments shall be made to the computation and assessment of receipts or deductions, whether for the same or for other periods and whether for that party or for other persons, as are reasonable and just having regard to the nature of the counteraction applied.

(2) Any person who is dissatisfied with a refusal to make a corresponding adjustment, or with the nature of the corresponding
adjustment made, shall have the right to appeal to the tribunal. On such appeal the tribunal shall reach such determination as it considers reasonable and just.

Clearances

12. Where the arrangement is, or involves, a transaction or a step which is within a provision of the Acts which provides for an application by any person for clearance, then that person may, subject to the same time limits and procedures, apply for confirmation that the provisions of section 8 (counteraction) shall not be applied to the arrangement.

Control and management

13. (1) There shall be no counteraction under section 8 in respect of any arrangement unless it is authorised, in accordance with the procedure set out in this section, by an officer of HMRC who is designated by the Board for this purpose.

(2) Where a designated officer considers that counteraction may be applicable in the case of any arrangement, he shall so notify the party whom he considers to be the advantaged party.

(3) Within six weeks of receipt of such notification that party shall be entitled to send to the designated officer written representations stating why in his opinion counteraction is not applicable to the arrangement.

(4) If no representations are sent within six weeks the designated officer shall be entitled to authorise counteraction under section 8.
Safeguard 4 – referral of potential counteraction to Advisory Panel

14. (1) If representations are sent within that period the designated officer shall consider them, and if having done so he considers that counteraction is applicable he shall within four weeks of receiving them send to the Advisory Panel:

(a) the notification referred to in sub-section 13(2),

(b) the representations referred to in sub-section 13(3), and

(c) any comments of his in respect of the representations.

(2) Within six weeks of receipt of the documents referred to in sub-section (1) the Advisory Panel shall advise the designated officer whether in its opinion it would be reasonable for him to authorise counteraction under section 8 in respect of the arrangement.

(3) The designated officer shall consider the opinion of the Advisory Panel, and shall within two weeks of its receipt send to the party concerned –

(a) a copy of the opinion, and

(b) his decision whether or not to authorise counteraction.

(4) On any appeal against counteraction under section 8 the opinion (or opinions, if not unanimous) of the Advisory Panel shall be admissible in evidence.

(5) The Advisory Panel shall be constituted in accordance with regulations made under this section [NB the composition specified in the regulations should be - an independent chairman, an
Other definitions

15. (1) An “advantaged party” is any party to an abnormal arrangement whose tax liability would be reduced, or entitlement to a tax relief, credit or payment would be increased, if the arrangement achieved the abusive tax result.

(2) An “advantageous tax result” is a result which –

(a) achieves a significant reduction in receipts or a significant increase in deductions taken into account for the purpose of computing or charging any of the taxes;

(b) achieves a significant deferral of the time when receipts are so taken into account, or a significant acceleration of the time when deductions are so taken into account; or

(c) achieves a significant reduction in the rate of tax chargeable.

(3) An “arrangement” -

(a) includes any plan or understanding, whether or not legally enforceable; and

(b) also includes any step or feature which is intended to be included, and which is in fact included, as an element of an arrangement, whether or not the inclusion of that element as part of the arrangement is legally enforceable or factually inevitable.
(4) “Deductions” includes expenses, charges, reliefs, losses and tax credits.

(5) “HMRC” means The Commissioners for Her Majesty’s Revenue and Customs.

(6) “Receipts” includes income, profits and chargeable gains.

(7) “Relevant double taxation arrangements” are those to which this Part can lawfully apply.

(8) “Tribunal” means the First-Tier Tribunal or, where determined by or under Tribunal Procedure Rules, the Upper Tribunal.

Commencement

16. (1) This Part applies to arrangements wholly or partially carried out after the commencement date.

(2) If an arrangement to which section 12 (clearances) applies is carried out partly before the commencement date, then the time for applying for confirmation under the provisions of that section shall be extended until sixty days after this Part comes into force.
OVERVIEW

Operation of the GAAR

1 Sections 1-16 in Chapter XY introduce the new general anti-abuse rule. This rule is designed to deter and counteract abnormal arrangements which go beyond reasonable tax planning and which are contrived to achieve an advantageous tax result. An advantageous tax result achieved by such an arrangement is referred to throughout the Chapter as an “abusive tax result”.

2 Counteraction under the GAAR comes into effect only if the application to the arrangement of the particular relevant tax rules, given their normal purposive interpretation, would produce an abusive tax result. Accordingly, the GAAR is not an extension to the normal principles of purposive interpretation, but rather is a separate rule which comes into operation when the application of those normal rules would fail to prevent the achievement of the abusive tax result.

3 This does not mean that consideration of the potential operation of the GAAR needs to be postponed until the application of the particular relevant rules has been tested to the point where it is established that they would lead to the achievement of an abusive tax result. In the interests of minimising the delay and costs involved in resolving disputes relating to the arrangement the assumption, and intention, is that in normal cases the application and interpretation of the particular relevant
rules and the potential application of the GAAR should be dealt with in parallel.

4 In broad terms, whether there should be counteraction by the GAAR is determined by answering a sequence of questions:

(i) Is the arrangement an abnormal arrangement?

(ii) If so, what is the abnormal feature in the arrangement?

(iii) Is that abnormal feature included with the sole, or with a main, purpose of achieving an advantageous tax result?

If so, proceed to (iv).

(iv) Is the arrangement protected by safeguard 1, which covers reasonable tax planning?

If so, there is to be no counteraction. If not, proceed to (v).

(v) Is the arrangement protected by safeguard 2, which covers arrangements designed and carried out without any intention of achieving an advantageous tax result?

If so, there is to be no counteraction. If not, there will be counteraction.

5 An important additional safeguard (referred to as “safeguard 3”) is given by placing on HMRC the burden of proving that the arrangement is abnormal, that the abnormal feature has the sole or a main purpose of achieving an advantageous tax result, and that the arrangement does not constitute reasonable tax planning.
6 Where counteraction is applicable, then its form depends upon the particular nature of the arrangement. Depending on the circumstances it may take the form of –

(i) adjusting computations and assessments as is reasonable and just; or

(ii) adjusting computations and assessments by reference to a hypothetical arrangement which would achieve the same non-tax result as the actual arrangement, but without achieving the abusive tax result which the actual arrangement sought to achieve.

7 Where counteraction takes place, then provision is made for corresponding adjustments to be made to computations and assessments (whether for the same or other periods or for the same or other persons) so as to ensure as far as possible that the counteraction will not have the effect of imposing an element of double taxation on income or profits derived from the arrangement.

**Evidence**

8 So as to permit a fully informed consideration of whether the arrangement is abnormal, whether it constitutes reasonable tax planning, and what would be the appropriate form of counteraction, provision is made for the admissibility of all relevant material which was in the public domain at the time of the arrangement, including evidence of practice (both HMRC and non-HMRC) at the time of the arrangement.

**Control and management within HMRC**

9 To ensure uniformity of application, and to minimise the risk that the GAAR may be invoked inappropriately by HMRC case workers,
authorisation by designated HMRC officials is required before HMRC can seek to apply the GAAR to any arrangement.

10 The designated officials are required to follow a set procedure which is designed, inter alia, to ensure that taxpayers are given the opportunity of explaining why in their view counteraction is inapplicable.

Advisory Panel

11 An additional safeguard (referred to as “safeguard 4”) against inappropriate use of the GAAR is given by requiring the designated HMRC officials to seek the opinion of an Advisory Panel as to whether HMRC have reasonable grounds for pursuing counteraction under the GAAR.

12 The constitution of the Advisory Panel will be laid down in a statutory instrument issued under the authority of this Part. In any given case this will comprise an independent chairperson, a person (who may be an HMRC official) nominated by HMRC, and an independent person who, where possible, will have relevant experience of the area of activities relevant to the arrangement.

13 Regulations will provide for the publication of a synopsis of each opinion (anonymised to preserve taxpayer confidentiality), and of regular digests of such opinions.

Clearances

14 The GAAR does not provide for a general system of clearances. This is because the elimination from the scope of counteraction of all arrangements which can reasonably be regarded as reasonable tax planning makes it unnecessary to commit the resources which a general system of clearances would involve (both for HMRC and taxpayers).
However, where the arrangement includes steps in respect of which existing legislation provides a clearance procedure, then the GAAR permits taxpayers to expand that clearance application so as to include an application for confirmation that there should be no counteraction under the GAAR. This will therefore maintain the certainty of treatment achieved by existing clearance procedures, without requiring significant additional resources (whether from taxpayers or HMRC).

SECTION 1

Sub-section 1(1) applies the new general anti-abuse rule to income tax, corporation tax, capital gains tax and petroleum revenue tax.

Sub-section 1(2) makes it clear that references to provisions in the relevant Acts which apply those taxes include provisions in statutory instruments and also double taxation arrangements. However, the expression “relevant double taxation arrangements” is used to make it clear (by reference to the definition provisions in section 15) that the GAAR does not operate in respect of double taxation arrangements (or articles in double taxation arrangements) in any case where the provisions of section 2 of the Taxation (International and Other Provisions) Act 2010 would prevent its application. This may depend upon the precise terms of the double taxation arrangement and of the relevant OECD commentaries applicable to the arrangement.

SECTION 2

Section 2 has two functions:

(i) First, the section makes it clear that the GAAR comes into operation after the normal purposive interpretation has been applied to the statutory provisions in question. In other words, the GAAR is not a part of, or an extension to, the normal process of statutory interpretation. It is instead a separate statutory rule
which has to be considered once the normal process of statutory interpretation shows that the arrangement would achieve an abusive tax result.

This does not mean that the possible application of the GAAR must be deferred until after the interpretation of the provisions, and their application to the arrangement, have been determined. Where the possible application of the GAAR is under consideration at any stage of a dispute, its potential application should be considered in parallel with consideration of the interpretation and application of the other statutory provisions.

Accordingly, it is important to note that the GAAR does not affect either the normal judicial interpretation of tax statutes, or HMRC’s right to challenge in the normal way arrangements which it considers ineffective in achieving a tax avoidance purpose. Likewise, the taxpayer’s right to contest such challenges is unaffected.

(ii) Secondly, the section introduces the key elements which need to be present before counteraction of tax advantageous arrangements is potentially engaged. The three elements are –

(a) that the arrangement in question is an abnormal arrangement;

(b) that the abnormal arrangement would, in the absence of the GAAR, achieve an abusive tax result; and

(c) that the abnormal arrangement is contrived to achieve the abusive tax result.
19 Sub-section (1) defines the term “abusive tax result”. It covers advantageous tax results (as defined in section 15) which would arise from arrangements which do not fall within the pivotal safeguard 1 (in section 4) for reasonable tax planning, or within safeguard 2 (in section 5) for arrangements without tax intent.

20 Sub-section (2) explains that an abnormal arrangement is to be taken as being contrived to achieve an abusive result if the inclusion of any abnormal feature (as defined in sections 6 and 7) has as its sole purpose or one of its main purposes the achievement of an abusive tax result. There are two particular points to note –

(i) The expression “if the inclusion of any abnormal feature …..can reasonably be considered to have …..” shows that the test is an objective one. It is not necessary to demonstrate that the promoter of the arrangement or the parties to it subjectively intended the abnormal feature to have such a purpose (although this would be very likely if not inevitable). Rather, the test is whether it would be reasonable to consider the inclusion of the abnormal feature as having such a purpose.

(ii) Some abusive tax arrangements operate by including a feature which has a dual purpose – one designed to achieve a particular tax result and the other designed to achieve some non-tax purpose. The language of sub-section (2) makes it clear that it is sufficient for the arrangement to be regarded as “contrived to achieve an abusive tax result” if the abnormal feature has as one of its main purposes achieving that result, whether or not it also has some other purpose.
21 Sub-section (2) then goes on to list four methods by which arrangements seek to achieve abusive tax results, and requires that the abnormal feature is used in one of these methods. The methods are –

(a) avoiding the application of particular provisions;

(b) exploiting the application of particular provisions;

(c) exploiting inconsistencies in the application of provisions; or

(d) exploiting perceived shortcomings in provisions.

22 Experience has shown that it is these methods which in practice are adopted by promoters and devisers of abusive tax avoidance schemes.

SECTION 4

23 Safeguard 1 in section 4 is of fundamental importance to the operation of the GAAR.

24 Its purpose is to protect arrangements which can reasonably be regarded as a reasonable response to choices of conduct which are made available by the relevant tax legislation. Arrangements which fall into this category are described, by sub-section (3), as “reasonable tax planning”.

25 In some cases the legislation does not merely make an advantageous tax result available, but it provides an incentive to taxpayers to carry out transactions in order to achieve that advantageous tax result. Obvious examples of this are enhanced capital allowances for investment in machinery and plant, and specific tax reliefs for investing in enterprise zones or in research and development.
There are, though, many additional cases where legislation less obviously offers choices of conduct. For example, the choice between debt or share capital as a means of funding companies results in quite different tax treatments. Likewise investment as a capital transaction is treated quite differently from investment by way of a dealing activity.

As more complex activities and structures have developed, particularly in the field of finance, so tax legislation has responded by creating different rules or regimes for different types of transactions. Financial instruments, loan relationships, foreign exchange dealings and derivative transactions are all fairly recent examples of subjects covered by detailed legislation where the tax treatment accorded to transactions falling within the regime is different from that accorded to those falling outside.

Similarly, complex business models may be adopted by commercial enterprises (particularly multinational enterprises), where assets, activities and personnel may be located in different entities and in different countries in order to increase the enterprise’s competitiveness; and sophisticated transactions may be required to meet the increasing complexities of modern commercial activities.

The purpose of safeguard 1 in section 4 is to ensure that any reasonable response by the taxpayer, whether an individual or a commercial enterprise, to the choices inherent in the existence of these different rules and regimes is not to be the subject of counteraction by the GAAR.

What can in any particular case reasonably be regarded as a reasonable response will, of course, depend on the precise circumstances. In exceptional circumstances this could include taking steps to avoid a wholly inappropriate tax disadvantage which might otherwise arise from carrying out an entirely commercial transaction.
31 The expression “if it can reasonably be regarded as a reasonable exercise of choices of conduct” demonstrates that the test can be satisfied even if the contrary view might also be held. In other words, safeguard 1 is designed to operate both in cases where it is clear that the arrangement constitutes a reasonable exercise of choices of conduct, and also in cases where, while contrary views may be held, it is reasonable to take the view that the arrangement should be regarded as a reasonable exercise of choices of conduct.

32 Applying this in the context of an appeal to the Tax Tribunal, it means that safeguard 1 would apply not only if the judge himself regards the arrangement as a reasonable exercise of choices of conduct but also, where he does not himself take that view, he nonetheless considers that such a view may reasonably be held.

SECTION 5

33 Safeguard 2 in section 5 protects taxpayers from the risk of counteraction in cases where they enter into transactions solely for business, investment, family or philanthropic reasons, without any thought being given to the possibility of achieving an advantageous tax result.

34 To come within this safeguard the advantaged party must show that the arrangement was neither designed, nor in fact carried out, with the intention of achieving an advantageous tax result, and must also show that no element of the arrangement was included or omitted with such an intention. The use of the passive expressions “designed” and “carried out” makes it clear that the absence of intent must be shown to extend to every person involved in the planning and execution of the arrangement.

35 If the advantaged party satisfies the burden of proving this, then no counteraction is applied even though, objectively, the arrangement would
be regarded as an abnormal arrangement contrived to achieve an abusive tax result.

SECTION 6

36 Sub-section (1) explains that “an abnormal arrangement” covers two situations.

(i) The first situation, set out in sub-section (1)(a), is where the arrangement, viewed as a whole (having regard to all the circumstances) has no significant purpose apart from achieving an abusive tax result.

The expression “significant purpose” is adopted to ensure that the inclusion of some trivial non-tax purpose will not affect the ability of the GAAR to counteract such an arrangement.

(ii) The second situation is set out in sub-section (1)(b). This covers an arrangement which, viewed as a whole, does have some significant non-tax abusive acceptable purposes, but includes features which would not be included if the arrangement did not also have a main purpose of achieving an abusive tax result.

37 Sub-section (2) notes that section 7 (which amplifies the concept of abnormal arrangements) applies for the purposes of sub-section (1)(b). There is no need for section 7 to apply for the purposes of sub-section (1)(a), because all the features of an arrangement falling within that paragraph (i.e. one with no significant purpose apart from achieving an abusive tax result) are conclusively presumed to be abnormal.

38 Sub-section (3) aligns the substance of the definitions of “abnormal arrangements” and “abnormal features”.
SECTION 7

39 Section 7 sets out a list of features which in the context of the particular arrangement may be regarded as abnormal features, and which in consequence may be taken into account to determine whether the arrangement is an abnormal arrangement.

40 Sub-section (2) makes it clear that the list of features is intended only as a guide: the presence of one or more of those features does not necessarily lead to the conclusion that the arrangement is ‘abnormal’. For example, a transfer at non-market value may be made for entirely non tax abusive reasons (such as to support a relative, a customer or a supplier). Whether such a feature is to be taken as an indication of abnormality depends very much on the facts and circumstances of the particular arrangement.

41 Conversely, sub-section 7(2) also makes it clear that the list is not exhaustive, so that there may be other, unlisted, features (such as non-recourse funding) which are included in the arrangement and which, again having regard to the facts and circumstances of the particular arrangement, can objectively be regarded as abnormal.

SECTION 8

42 Section 8 is the key operative provision in the GAAR. It states the nature of the counteraction to be applied to abnormal arrangements which are contrived to achieve an abusive tax result.

43 Sub-section (2) deals with the case where the abnormal arrangement has no significant purpose apart from achieving an abusive tax result. The counteraction to be applied in this case is to adjust the receipts or deductions of the advantaged party in such manner as is reasonable and just. In some cases the reasonable and just counteraction will take the form of simply treating the arrangement as if it had not taken place.
Arrangements which have no economic consequence at all (such as in *Ramsay v IRC* [1981] STC 174) will fall into this category. However there may be other arrangements which have no significant purpose apart from achieving an abusive tax result but which nonetheless produce an economic profit or loss. Accordingly for such cases sub-section (2) makes it possible to adjust the receipts or deductions to such amounts as reflect the economic consequence of the arrangement.

44 Sub-section (3) deals with cases where the abnormal arrangement has some other significant purpose in addition to achieving the abusive tax result. In such cases the counteraction may take one of two forms –

(i) Where it is possible to do so the counteraction operates by taking as a comparator a hypothetical arrangement which would achieve a purpose which is the same as, or similar to, that which the actual arrangement was intended to achieve, but without producing the abusive tax result. This is described by the expression “a corresponding non-abusive arrangement” (which is defined in sub-section (4)).

It should be emphasised that the adjustment of receipts or deductions by reference to a corresponding non-abusive arrangement is an objective and hypothetical exercise. It is not relevant whether the advantaged party would in practice have been willing to carry out a corresponding non-abusive arrangement.

(ii) There may be cases where it is not possible to identify or construct an arrangement which would serve as a corresponding non-abusive arrangement. If, having regard to the particular circumstances, this proves to be the case, then the counteraction to be applied is to adjust the receipts or deductions of the advantaged party in such manner as is reasonable and just.
SECTION 9

45 Safeguard 3 in section 9 uses the burden of proof to provide an additional protection for taxpayers and to strengthen the pivotal safeguard 1 in section 4.

46 For counteraction to be applied HMRC will need to demonstrate all the key factors required by the GAAR, namely –

(i) that the arrangement is an “abnormal arrangement”;

(ii) that the arrangement does not constitute reasonable tax planning;

(iii) that the arrangement is “contrived to achieve” an abusive tax result;

(iv) that the counteraction is reasonable and just; and, where relevant,

(v) what hypothetical arrangement should be taken as a corresponding non-abusive arrangement.

SECTION 10

47 Section 10 introduces rules of evidence which require the Tribunal and courts to take into account this Guidance Note, and also permit the Tribunal and courts to take into account any material which is in the public domain at the time of the arrangement and which may be relevant in showing –

(i) whether the arrangement is abnormal;

(ii) whether the arrangement constitutes reasonable tax planning;

(iii) whether the tax result is an abusive tax result; and
(iv) what would be the appropriate counteraction.

48 Sub-section (3) sets out the material which may be taken into account. It falls into four categories –

(i) these Guidance Notes;

(ii) any official (i.e. Parliamentary, ministerial or HMRC) material which is in the public domain;

(iii) evidence of HMRC practice at the time of the arrangement; and

(iv) evidence of practice commonly adopted at that time.

49 The admissibility of such contemporaneous material is intended to assist in determining whether particular arrangements could, or conversely could not, be regarded as reasonable tax planning, and what counteraction would be appropriate.

50 This provision addresses concerns that the GAAR might otherwise be used by HMRC to counteract arrangements where official material, or evidence of widespread practice, could reasonably be considered as demonstrating that the arrangement was not at the relevant time regarded by HMRC or other Government departments as abnormal or abusive.

51 The probative value of such material will, of course, depend upon its precise nature. In the case of any practice relied upon by the taxpayer its value will be affected by considerations of whether HMRC were aware of it at the time of the arrangement and, if so, whether HMRC had explicitly or tacitly led taxpayers to believe that such practice was unobjectionable.
SECTION 11

52 Sub-section (1) makes provision for corresponding adjustments to be made where counteraction takes place under the GAAR. Its purpose is to prevent unfair tax consequences arising from counteraction under section 8. The corresponding adjustments may be to the computation or assessment of –

(i) the receipts or deductions (as defined in section 15) of the advantaged party for earlier or later periods; or

(ii) the receipts or deductions of other persons, whether for that period or for earlier or later periods. In most case the “other persons” would be parties to the arrangement. However there may be cases (e.g. where trusts are involved) where it would be reasonable for a corresponding adjustment to be made to a person who is not strictly a party to the arrangement (e.g. a beneficiary where the trustee is the party).

53 The corresponding adjustment is to be such as is considered reasonable and just. In practice a corresponding adjustment will usually be specified initially by HMRC.

54 Sub-section (2) provides that if a person objects to the adjustment proposed by HMRC (which would include the case where HMRC does not propose an adjustment for that person) then there will be the normal right of appeal. On that appeal the Tribunal will itself determine what it considers to be the appropriate corresponding adjustment. Further appeals from the Tribunal will be on points of law only (i.e. in accordance with the normal rules for appeals from determinations by the Tribunal).
SECTION 12

55 Section 12 deals with applications for clearance. The general principle is that there is no rule providing for clearances under the GAAR.

56 However, where the arrangement is, or includes a step which is, within a provision of the Taxes Acts which itself provides for a clearance procedure, then the taxpayer may expand that application for clearance to include a request for confirmation that counteraction will not be applied to the arrangement. This will maintain the certainty of tax treatment of the arrangement without any significant additional costs or resources.

SECTION 13

57 This section deals with the control and management of the GAAR.

58 Sub-section 13(1) introduces a control over the exercise of the GAAR by requiring that within HMRC the GAAR can be applied only with the authorisation of specified officials. This is designed to ensure uniformity in the application of the GAAR and, specifically, to ensure that the possibility of counteraction under the GAAR is not inappropriately invoked as a means of putting pressure on taxpayers during the course of normal enquiries into their affairs.

59 Sub-sections (2)-(4) set out the procedure which needs to be followed in any case where the designated official within HMRC has to consider the application of the GAAR -

(i) The taxpayer has to be informed by the designated official that he is considering the application of the GAAR;

(ii) The taxpayer then has the opportunity to give written reasons why in his opinion the GAAR should not be applied;
SECTION 14

60 Section 14 sets out the role of the Advisory Panel in the operation of safeguard 4.

61 Safeguard 4 comes into operation if, having received the taxpayer’s representations, the designated HMRC official considers it appropriate to continue seeking counteraction under the GAAR. The procedure calls for –

(i) submission to the Advisory Panel of the designated official’s notification to the taxpayer, the representations received from the taxpayer in response to the notification, and any comments on those representations by the designated official; and

(ii) consideration by the Advisory Panel of these documents, which then gives the designated official its opinion as to whether it would be reasonable for him to authorise counteraction.

62 In carrying out its review the Advisory Panel will consider the case on the hypothesis that the arrangement would, apart from the possible application of the GAAR, achieve the advantageous tax result.

63 It needs to be emphasised that it is not the role of the Advisory Panel to determine whether counteraction should be applied, or what form counteraction should take. Rather, its function is to advise, having considered the taxpayer’s representations, whether in its opinion there is a sufficiently cogent case for HMRC to initiate the process of counteraction under the GAAR. If HMRC decide to do so it will then be for the Tribunal to determine whether counteraction is to be applied, and what form its application should take.

64 Sub-section (3) makes it clear that the opinion of the Advisory Panel is a recommendation, which HMRC is at liberty to heed or reject.
However, sub-section (4) provides that the opinion of the Advisory Panel is to be admissible in evidence in any appeal against counteraction. Accordingly, if the designated official decides to proceed with counteraction in cases where the opinion of the Advisory Panel was that it would not be reasonable so to proceed, then the opinion could be referred to by the taxpayer in any appeal proceedings. In cases where the Advisory Panel is not unanimous, each of its members’ opinions is admissible.

Sub-section (5) provides for regulations to be made governing the constitution of the Advisory Panel. In each panel of three members there will be an independent chairman and an independent member, together with one HMRC member. Where practical, the independent member would have experience relevant to the particular arrangement.

SECTION 15

Section 15 sets out additional definitions which, apart from sub-section (3), need no further explanation.

Sub-section (3) defines the word “arrangement”. The GAAR throughout uses the expression “arrangement” rather than “transaction”. This is because “arrangement” is a looser expression which is more appropriate to cover the elements that are currently found in tax abusive schemes. For example, it is questionable whether establishing or moving residence outside the UK is aptly described as a “transaction”, whereas it would fall within “arrangement”. Sub-section (3)(a) amplifies this by stating that an arrangement can include any plan or understanding, even if contractually unenforceable.

Sub-section (3)(b) states that an arrangement includes any step or feature which was intended to be, and is, comprised in the arrangement, even if the inclusion of that step is not legally enforceable or factually
inevitable. By doing so, sub-section (3)(b) adopts the approach advocated by the minority in the House of Lords in the case of Craven v White [1989] AC 398.

SECTION 16

70 Sub-section (1) provides for the GAAR to apply to arrangements which are carried out, or partly carried out, after the commencement date. The fact that the arrangement may have been initiated, and the first steps carried out, before the commencement date will be irrelevant if part at least of the arrangement is carried out after that date. This is appropriate, given that introduction of the GAAR will have been preceded by an extensive period of consultation and substantial notice of its enactment.

71 Sub-section (2) extends the period during which applications for confirmation under section 12 can be made in cases where the arrangement includes steps which straddle the commencement date. In such cases the time for making the application under section 12 is extended so as to expire no earlier than 60 days after the GAAR comes into force.
HM Treasury contacts

This document can be found in full on our website: http://www.hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000
Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk
Tax Avoidance

LEONARD HOFFMANN*

Abstract

In this article, Lord Hoffmann suggests that the decision of the House of Lords in Barclays Mercantile Finance Ltd v Mawson has killed off the Ramsay doctrine as a special theory of revenue law and subsumed it within the general theory of the interpretation of statutes. The courts should be trusted to give effect to the intention of Parliament as expressed by statute.

The interpretation of taxing statutes, especially for the purpose of deciding whether they apply to transactions designed to avoid tax, has, for too long, been regarded as a specialised craft, to which experience of the interpretation of language used for other purposes has nothing to contribute. Recent cases have attempted to counter this tendency by emphasising that tax statutes are statutes and should be interpreted according to the same principles as other legislation. I propose tonight to go further and suggest that useful lessons may be learned from the problems which have arisen in the interpretation of documents which are not statutes at all, namely the claims of patent specifications. This may seem, both to patent lawyers and to revenue lawyers, a remote and far-fetched analogy. Each group tends to live in a world of its own. But I think it is time they were introduced to each other.

I start with two seminal judgments of Learned Hand J. in the US Court of Appeals for the Second Circuit. The first will be well known to tax specialists, the second probably not. In Helvering v Gregory the question was whether shares issued to Mrs Gregory by the subsidiary of a company which she controlled were exempt from tax as a dividend because they had been issued “in pursuance of a plan of reorganisation”. Ordinarily, the issue of shares in a subsidiary directly to the controlling shareholder would count as a reorganisation because economically it makes no difference. It gives him a direct interest in a company in which he previously had an indirect interest. In Mrs Gregory’s case, however, the shares had been issued to her as part of a scheme under which the subsidiary had acquired an asset pregnant with capital gain and Mrs Gregory wanted to obtain the benefit of that gain without paying tax. Immediately after the share issue, the company went into liquidation and distributed the asset to Mrs Gregory, who sold it. Had the shares been issued to her pursuant to a plan of reorganisation? Learned Hand J. thought not. I quote from his reasons:

“If what was done here was what was intended by [the statute], it is of no consequence that it was all an elaborate scheme to get rid of income tax, as it certainly was... [But] the purpose of the section is plain enough; men engaged in enterprises... might wish to consolidate, or divide, to add to, or subtract from, their holdings. Such

* A Lord of Appeal in Ordinary. This article is based on the text of a lecture delivered at the Centre of Commercial Law Studies on December 1, 2004, commemorating the founding of the Centre by Prof. Sir Roy Goode in 1980. The lecture will also be published by LexisNexis in a volume of essays to mark the 25th anniversary of the Centre.

1 69 F 2nd 809 (1934).
transactions were not to be considered as realizing any profit, because the collective interests still remained in solution. But the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution...We cannot treat as inoperative the transfer of shares...The transfer passed title...and the taxpayer became a shareholder in the transferee. All these steps were real and their only defect was that they were not what the statute means by a ‘reorganisation’.”

Learned Hand J. makes it clear that he regards the matter as one of statutory construction. If it falls within the language of the Act, it does not matter that it was done solely to avoid tax. But in his opinion the concept of a “plan of reorganisation” involves doing something for a business purpose and not solely to avoid tax. The judgment was affirmed by the Supreme Court, which observed that Mrs Gregory had no “business or corporate purpose”. I shall come back in a moment to the interpretation which has been put upon this decision. To an English lawyer, it looks as plain a case as one could wish to find of what Lord Diplock would have called “purposive construction”. One looks at the purpose of the exemption from tax and sees that it is to allow people to readjust their shareholdings when it is commercially expedient to do so. One then construes that language as not applying to a case in which the adjustment has been solely to use the tax exemption. The judge is not applying any rule which steps outside the meaning of the statute.

The second case is Royal Typewriter Co v Remington Rand Inc. This time I need not bother you with the facts. The case is famous for its statement of principle. The claims at the end of a patent specification are a succinct description of the product or process for which the patentee is granted a monopoly. They are drafted in language which he has chosen and negotiated with the Patent Office. The question of whether someone has infringed the monopoly involves construction of the claims. Sometimes one finds that the alleged infringer has made a product or used a process which works in the same way as the invention and produces the same result but appears to differ in some respect from the way the invention is described in the claims. That raises a problem quite similar to that of the taxpayer who has entered into a transaction which, although having the same economic effect, is structured in a way which is intended, and perhaps appears, to fall outside the terms of the statute.

The American courts, during the nineteenth century, dealt with this problem by what is called the “doctrine of equivalents”. They gave the claims a literal construction but extended protection outside the claims to cover products or processes which were in practical terms equivalent to those described in the claims. This doctrine was well established when Learned Hand J. gave judgment in the Royal Typewriter case. This is how he explained it:

“After all aids to interpretation have been exhausted and the scope of the claims has been enlarged as far as the words can be stretched, on proper occasions courts make them cover more than their meaning will bear...They resort to the doctrine of equivalents to temper unsparing logic and prevent an infringer from stealing the benefit of the invention. No doubt this is, strictly speaking, an anomaly; but it is one which the courts have frankly faced and accepted almost from the beginning.”

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2 69 F 2nd 809 (1934).
3 168 F 2nd 691 (1948).
4 168 F 2nd 691 (1948).
Let us pause to notice the difference between Hand J.’s approach in *Gregory v Helvering* and his exposition of the doctrine of equivalents in the *Royal Typewriter* case. In *Gregory v Helvering* he is able to achieve the result by imaginative purposive construction. It is solidly based upon identifying the concept which the legislature had in mind (a “plan of reconstruction” suggests something done for a purpose) and then asking whether the facts answer to that description. In *Royal Typewriter* he was expounding a nineteenth century jurisprudence wedded to literal construction, in which the courts had decided that the only way to prevent abuse was to evolve a doctrine which went outside what the claims actually meant.

This tension between the constructional approach and resort to principles lying outside the meaning of the statute or the claims continues to reverberate, both in revenue law and in patent law, in the US today. Despite the fact that Hand J.’s judgment in *Gregory v Helvering* was based purely upon purposive construction, it and the Supreme Court judgment which affirmed it, have frequently been taken to mean that, whatever may be the terms of the statute, a transaction which has no business purpose cannot have any effect on liability for tax. This “business purpose” rule is the revenue counterpart of the doctrine of equivalents in patent law. It does not purport to be anchored in the meaning of the statute any more than the doctrine of equivalents is anchored in the meaning of the claims. It purports to be an all-purpose anti-tax avoidance remedy which dissolves the effect of tax avoidance schemes.

The difficulty about both the doctrine of equivalents and the business purpose rule is that their boundaries are extremely vague. Once one has left the actual language of the claims or the statute behind, it is hard to know where to draw the line. What if something is an equivalent but the patents claims clearly indicate that the patentee did not mean to claim it? Or a transaction has no business purpose except to avoid tax in a way which the legislator must clearly have contemplated would be open to the taxpayer? The purpose of making a patentee state the limits of the monopoly in the claims is, as Lord Russell of Killowen said in a famous judgment “so that others may know the exact area within which they will be trespassers”. Likewise, the purpose of stating the conditions of liability to tax in a statute is to enable citizens to know what transactions will attract tax. But the American courts, in order to prevent the doctrine of equivalents and the business purpose rule from over extending the scope of patent protection or tax liability, have had to develop very refined and technical supplementary doctrines to keep them in check. As a result, there are few branches of American law which stir up so much controversy among their respective practitioners and produce such unpredictable results.

The American background is of interest because in *W T Ramsay Ltd v IRC*, Mr Peter Millett Q.C. for the Revenue referred the House to some of the American cases on the business purpose rule. Lord Wilberforce handled them gingerly:

> “It is probable that the United States courts do not draw the line precisely where we do with our different system, allowing less legislative power to the courts than they claim to exercise, would draw it.”

To Lord Wilberforce in *Ramsay*, the question was very much a matter of construction:

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5 The “unscrupulous copyist” who “makes unimportant and insubstantial changes”: Jackson J. in *Graver Tank v Linde Air Products Co* 3339 US 605 (1956).

6 *Electric and Musical Industries Ltd v Lissen Ltd* (1938) 56 RPC 23 at 39.

7 [1982] AC 300.
“To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function.”

Mr Millett Q.C. had more success three years later, when he dangled Helvering v Gregory\(^9\) before the House of Lords in Furniss v Dawson,\(^10\) and indeed, the facts of the two cases bore a striking resemblance. This time the fly was taken, because Lord Brightman, in the famous passage that every tax lawyer knows, stated the principle in general terms which contain no mention of the statutory language. The American cases are not cited in his speech, but the reference to disregarding inserted steps having no business purpose has a distinctly transatlantic accent. After Furniss v Dawson it appeared that the full-blooded American doctrine had been imported into the UK.

The patent counterpart to Ramsay was Catnic Components v Hill & Smith,\(^11\) decided by the House of Lords within a few months of Ramsay in 1981. The patent was for a lintel for use in the building trade. It was essentially a steel box, open in the front, with which one bridged the gap over a door or window. The claim said that the back of the box should be vertical in relation to the bottom. The defendant’s lintel was six or eight degrees out of the vertical, which made a difference of 0.6 or 1.2 per cent to its load-bearing strength, that is to say, virtually no difference at all. The question for the House of Lords was whether one should deal with this as a matter of construction or say that vertical meant 90 degrees but that it infringed under a UK version of the doctrine of equivalents. Lord Diplock firmly rejected the doctrine of equivalents. It was, he said, a matter of construction, but a construction which bore in mind the purpose of the specification, which was to convey information to people in the construction industry: as my colleague Lord Hope put it recently in argument, to Bob the Builder. A patent specification, said Lord Diplock:

“should be given a purposive construction rather than a purely literal one derived from applying to it the kind of meticulous verbal analysis in which lawyers are too often tempted by their training to indulge.”\(^12\)

On that basis, six per cent or eight per cent out of the vertical, given that it made virtually no difference to the way the lintel functioned, was sufficiently vertical to count as vertical within the meaning of the claims.

Catnic produced some jokes about the vertical tower of Pisa, which was until recent restoration work 5.5 degrees out of the vertical, compared with the six or eight degrees of the Hill & Smith lintel, but I think that example only underlines Lord Diplock’s perception that the content of such words varies with context. Catnic’s patent was granted before the European Patent Convention came into force. That contains a Protocol on interpretation which says that claims should be interpreted so as to combine “fair protection for the patentee with a reasonable degree of certainty for third parties”. That seems to me a fair description of the way one should construe a revenue statute: in a way which combines fair protection for the revenue with a reasonable degree of certainty for

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\(^8\) [1982] AC 300 at 326.
\(^9\) 69 F 2nd 809 (1934).
\(^10\) [1984] AC 474.
\(^12\) [1982]RPC 183 at 243.
the taxpayer. Since *Catnic* there has been rumbling controversy over whether the purposive construction advocated by Lord Diplock was in accordance with the European Protocol. The doctrine of equivalents continued to have its supporters. But these questions were settled by the recent decision of the House in *Kirin-Amgen v Hoechst Marion Roussel Ltd*,\(^\text{13}\) which holds that purposive construction remains the sole test of infringement:

“The claims must be construed in a way which attempts, so far as is possible in an imperfect world, not to disappoint the reasonable expectations of either side. What principle of interpretation would give fair protection to the patentee? Surely, a principle which would give him the full extent of the monopoly which the person skilled in the art would think he was intending to claim. And what principle would provide a reasonable degree of protection for third parties? Surely again, a principle which would not give the patentee more than the full extent of the monopoly which the person skilled in the art would think that he was intending to claim.”\(^\text{14}\)

As between *Catnic* on the one hand and *Furniss v Dawson* on the other, a gap opened up between patent infringement and tax avoidance. In patent infringement, the courts were content with purposive construction to hold the balance between the patentee and the third parties who had to read the specification to see what they could or could not safely do. In tax avoidance, however, the courts had stepped outside the meaning of the statute and developed a general anti-avoidance doctrine based upon whether the transaction or parts of the transaction had a business purpose or not. The circumstances in which *Furniss v Dawson* was decided were not very dissimilar to those in which the nineteenth century American courts had produced the doctrine of equivalents. The American doctrine was a reaction to extreme literalism in the construction of claims which the courts felt that they were powerless to ameliorate by constructional tools. It was part of the general old-fashioned approach to construction in which it was considered that words or phrases had natural or ordinary meanings which, in the absence of some intrinsic ambiguity, could not be displaced by context and background, even if it was perfectly clear that the patentee could not have intended to express such a meaning. Likewise, *Furniss v Dawson* was in reaction to the *Duke of Westminster*\(^\text{15}\) and some of the more extraordinary cases of literalism which followed, of which *IRC v Plummer*\(^\text{16}\), to which Lord Wilberforce subscribed less than three years before *Ramsay*, is a good example. As Lord Steyn afterwards said in *IRC v McGuckian*\(^\text{17}\), tax law had remained “some island of literal interpretation”, despite the changing attitude of the courts to statutory interpretation and indeed to the interpretation of language generally. In *Ramsay* itself, Lord Wilberforce had been content to take a new approach to construction, but in *Furniss v Dawson* the law moved into territory which was previously uncharted except, and that rather inadequately, in the US.

There followed a period during which the limits of Lord Brightman’s formula were tested. In *Craven v White*\(^\text{18}\) there was a dispute over how seriously one took the requirement that there must have been a preordained scheme. Lord Templeman, who had


\(^{14}\) [2004] UKHL 46 at [47]; [2005] 1 All ER 667 at 684.

\(^{15}\) [1936] AC 1.

\(^{16}\) [1980] AC 896.

\(^{17}\) [1997] STC 908 at 915; [1997] 1 WLR 991 at 999.

been in the Court of Appeal for Ramsay and did not participate in Furniss v Dawson, wanted to concentrate on the business purpose rule. If steps had been taken for no business purpose but solely to secure a tax advantage at a later stage when the opportunity for a further transaction presented itself, then the tax-avoiding elements in the history of the taxpayer’s dealings should be disregarded. Lord Oliver, who had been reversed by the House of Lords in Furniss v Dawson (with the comment that he seemed determined to confine Ramsay as narrowly as possible), insisted upon the whole scheme being pre-ordained and said that Lord Brightman’s principle applied: there must be “no practical likelihood” that the whole scheme will not work as planned. Neither side seemed to think that the answer might be different depending upon the language and purpose of the particular taxing provision which was being applied. The matter was treated as a general extra-statutory rule.

After Craven v White a good deal of learning began to cluster around Lord Brightman’s formula: a good example of the complexity it could involve is the judgment of Hart J. in DTE Financial Services Ltd v Wilson (HM Inspector of Taxes). 19 It was in IRC v McGuckian, 20 and in particular in the speech of Lord Steyn, that the primacy of the statutory language began to reassert itself. He went back to Lord Wilberforce in Ramsay and asserted that the construction which the House there gave to the Capital Gains Tax Act:

“was not invented on a juristic basis independent of statute. That would have been indefensible since a court has no power to amend a tax statute. The principle was developed as a matter of statutory construction.” 21

Since the House in McGuckian did not explain how the Furniss v Dawson formula could be reconciled with pure purposive construction, the full implications of McGuckian took a while to sink in. It was only in MacNiven v Westmoreland Investments Ltd 22 that the House was faced with a clear conflict between a purposive interpretation of the statute and an extra-statutory application of the Furniss v Dawson formula. The question, you may remember, was whether a company could deduct interest for the purposes of corporation tax. In order to deduct, it had to have paid the interest. It had no money, so the lender, which happened to be its parent company, made a loan which it paid back in discharge of the interest liability. This was a circular transaction, undertaken purely to save tax because the lender happened to be exempt from tax on the interest which it received and the payment generated a tax loss in the insolvent borrower which gave it some value in the market. The transaction satisfied the Furniss v Dawson formula, to say nothing of the more general business purpose rule supported by Lord Templeman: it was preordained and the payment was solely for the purpose of securing a tax deduction. But the House considered that the statute, on its true construction, required no more than that the interest liability should have been discharged by a payment which was taxable in the hands of the lender, or would have been taxable if it had not been exempt. The purpose of the payment was irrelevant.

In choosing the constructional approach rather than the Furniss v Dawson formula, the House had to rewrite history in a way which struck some people as a little disingenuous.
We said that the formula was not a freestanding principle but rather the effect of construing a taxing provision in a particular way. If the statute required a transaction which had a business purpose, like the plan of reconstruction in *Gregory v Helvering*, why then, steps which had no business purpose would not satisfy the statute. If the statute required something which had a real commercial existence, like a profit or loss, then a series of preordained transactions which taken together produced no profit or loss would not satisfy the statute. On the other hand, if all that the statute required was something which had a particular legal effect, like discharging a debt or passing title to property, then a transaction which had that effect satisfied the statute even if it had no business purpose.

The sleight of hand which covered this retreat to constitutional propriety did not deceive Lord Templeman, who wrote a brilliant article for the *Law Quarterly Review* accusing the House of Lords of having deserted the true faith and opened the door to tax avoidance. I shall come back to this question in a moment. Lord Templeman said, correctly, that *MacNiven* satisfied the *Furniss v Dawson* formula and was therefore in his opinion wrongly decided. Lord Millett, who has been a supporter of the American business purpose rule since he successfully sold it to the House of Lords in *Furniss v Dawson*, was more equivocal. As a judge of the Court of Final Appeal of Hong Kong, he made his own analysis of the authorities in *Collector of Stamp Revenue v Arrowtown Assets Ltd.* He said that *IRC v Burmah Oil Co Ltd*, decided shortly after *Ramsay*, where Lord Diplock had said that in deciding whether a composite circular transaction had caused Burmah to suffer a loss for capital gains tax, one could ignore “inserted steps that have no commercial purpose” was an explicit application of the “no business purpose” test. The case, he said: “did not depend upon an analysis of the meaning of the word ‘loss’ or the nature of the concept which that word involves.”

On the other hand, later in his judgment he says that the basis of *MacNiven* was that:

“even if the payment in question was undertaken solely for the purpose of obtaining tax relief, the granting of such relief in such circumstances was nevertheless within the intendment of the statute.”

It would seem to follow that the reason why the transaction in Burmah did not produce an allowable loss was that such a transaction did not produce a loss within the intendment of the statute. If this does not involve an interpretation of the word “loss” or the concept which the word denotes, I find it hard to see what other question of construction can be involved.

The primacy of the construction of the particular taxing provision and the illegitimacy of rules of general application has been reaffirmed by the recent decision of the House in *Barclays Mercantile Business Finance Ltd v Mawson*. Indeed it may be said that this case has killed off the *Ramsay* doctrine as a special theory of revenue law and subsumed it within the general theory of the interpretation of statutes, perhaps the interpretation of utterances of any kind. The references which I have made to the construction of patent specifications are intended to counter the parochialism of tax specialists and show that

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26 [2003] HK CFA 46 at 118.
27 [2003] HK CFA 46 at 143.
other people have similar problems. But I think that Lord Templeman’s criticisms must be taken seriously and that the author should address the question of whether one should have a general theory of tax avoidance rather than a case-by-case analysis of the statutory requirements.

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.”29 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?

The first answer to this question is that there was a time, evidenced by cases like IRC v Plummer,30 to say nothing of the Duke of Westminster,31 when the courts did construe taxing statutes so literally and so blinkered that they did not give effect to the plain intention of Parliament. It was that approach which drove the Revenue to despair and inspired the legislatures in countries like Australia and New Zealand to enact general anti-avoidance provisions which they hoped, not always with success, would fill the gaps left by literal construction. But this peculiar technique for construing revenue statutes was, as Lord Steyn pointed out in McGuckian, abandoned by the House of Lords in Ramsay. Since then we have been able to say that employees who are paid in platinum sponge which is held at a bank where it can be instantly converted into money are, for PAYE purposes, being paid in money, or that a seller of shares who receives an interest-free debenture redeemable a fortnight later is, for stamp duty purposes, being paid in money. We need no superimposed anti-avoidance doctrine: the employees are not receiving payments in kind and the share vendor is not entering into a rearrangement of securities within the meaning of a taxing statute.

There is here a parallel with the doctrine of equivalents in patent infringement. It was necessary in the days of literal construction. Patents are pored over by well-paid lawyers who try to exploit literalism to devise products or processes which fall outside the terms of the claims just as revenue statutes are scrutinised to devise transactions which fall outside the terms of the charge to tax or within the terms of an exemption. And it is therefore tempting to reach for some all purpose solvent as a defence. But, as experience with the doctrine of equivalents and general anti-avoidance legislation has shown, the cure may be worse than the disease. It may produce an unacceptable degree of unpredictability which stifles invention on the one hand and commercial planning on the other. And once Catnic and Ramsay had liberated patent claims and taxing statutes from literalism, advocates of a doctrine of equivalents or general anti-avoidance principles were like generals who lose a war by concentrating on avoiding the mistakes that lost them the last one.

There is however another dimension. It is not only literalism on the part of the judges which leads to what the Revenue regard as tax avoidance. There is also the way in which taxing statutes are often drafted. Judges sometimes draw a distinction between acceptable tax avoidance, like giving up smoking, and unacceptable tax avoidance, like schemes with platinum sponge. The difference, said Lord Templeman in *IRC v Challenge Corp Ltd*,\(^{32}\) lies in the fact that in one case the taxpayer actually reorders his affairs: he stops buying the taxed commodity, or he receives less income or incurs more expense. In the other case, the taxpayer still buys the taxed commodity or receives the same income, but structures the transaction to fall outside the taxing statute. This distinction is, if I may say so, based upon sound instinct, but it depends upon the assumption that Parliament imposes taxation by reference to economic and other events in the real world. If only this were true. But Parliament, for various reasons, sometimes leaves the taxpayer a choice of achieving the same economic result by two different methods, one of which may attract tax and the other not.\(^{33}\) Worse still, Parliament may not be content to describe the economic event which should attract tax because it does not trust the courts to understand such a concept and apply it in a practical way. Instead, it enacts a mass of detailed rules which it is hoped will tie up the taxpayer in a net from which he cannot escape. But sometimes there are holes in the net and the courts find that they cannot plug them by appealing to the economic event which, at a higher level of generality, it appears that Parliament wished to tax. It is one thing to give the statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there.

The Revenue is sometimes astonished at decisions which seemed obvious to the courts that decided them. The inheritance tax took over from the Customs and Inland Revenue Act 1889 provisions which deemed a gift to remain part of the donor’s estate if he reserved any benefit to himself. These provisions came down to the inheritance tax burdened with a heavy freight of judicial exegesis over the preceding century. They had been interpreted to distinguish between retaining an interest in the donated property and dividing property into separate interests, giving one away and retaining the other. In the latter case, no interest in the donated property was reserved. Furthermore, one could have separate property interests in the same physical property, such as a freehold and a leasehold interest in the same land. In *Ingram v IRC*,\(^{34}\) Lady Ingram gave the freehold of her house to a trust for her children but retained a lease which enabled her to go on living there. The House of Lords decided that she had reserved no benefit out of the freehold interest. What she had kept was a separate item of property. The Revenue were outraged that she should be able to give away her house and go on living in it. That, they said, was the very thing which the statute was intended to prevent. Legislation was quickly passed to restore the law to what the Revenue thought it had previously been. It had, however, been clear for many years that one could have separate interests in the same house and, if Parliament meant to prevent people from retaining any benefit from the same physical property, as opposed to the same legal interest in that property, it should have amended the statute about 80 years earlier.

I am not one of those who heaps criticisms upon parliamentary draughtsmen. I think that they usually do an excellent job in trying to translate their instructions into

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\(^{32}\) [1987] 1 AC 155.

\(^{33}\) See for example *IRC v Wattie* [1998] STC 1160.

\(^{34}\) [2000] 1 AC 293.
legally-effective language. It is the instructions that concern me. To understand the
general economic effect of transactions which one intends to tax is usually relatively easy.
To understand the intricate and multifarious forms which some of them can take is often
much more difficult. But the Revenue appear to have no faith in the ability or willingness
of the courts to recognise the economic effect beneath the varied forms and often prefer to
legislate by reference to form rather than substance. In those circumstances, it is essential
that those instructing the draughtsman should have a complete understanding of the way
that particular activity is conducted. Before anyone can sit down to draft such a statute, it is
necessary to be clear about what the Revenue wish to achieve. Cases like Ingram arise out of
legislation in which the objective has been left uncertain.

The lesson, in my opinion, is that tax avoidance in the sense of transactions successfully
structured to avoid a tax which Parliament intended to impose should be a contradiction in
terms. The only way in which Parliament can express an intention to impose a tax is by a
statute which means that such a tax is to be imposed. If that is what Parliament means, the
courts should be trusted to give effect to its intention. Any other approach will lead us into
dangerous and unpredictable territory.
Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle

JUDITH FREEDMAN


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Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle

JUDITH FREEDMAN*

Abstract

This article examines tax avoidance in the context of regulatory and legal theory and developing ideas about corporate governance. Words such as "ethics" or "morality" are frequently called upon within the tax avoidance debate, whilst corporate directors argue that they have a "duty" to minimise taxation within the law. "Certainty" is given great weight and importance as an outcome, and this requirement is often thought to demand specific rules rather than a general anti-avoidance principle. This article concludes that the law should give more direction to taxpayers, especially company directors, on the balance of their duties. This cannot be left to morality but, it is argued here, can be best achieved by a legislative general anti-avoidance principle. It is not claimed that this would achieve certainty: rather that certainty is the wrong test of such a principle. Moreover, a legislative anti-avoidance principle would not, and would not be intended to, remove the need for judicial development, since judges will always have a role to play. Rather, a legislative general anti-avoidance principle would provide the overlay needed to give legitimacy to judicial development and offer a framework in which the uncertainty inherent in any system capable of tackling tax avoidance could be fairly managed.

Genesis of this article

THE ideas in this article emerged from an inaugural lecture delivered at the University of Oxford in May 2003.1 Giving an inaugural lecture is a daunting challenge. The inaugural lecturer must address not only experts in her field, but also, and perhaps even more alarmingly, colleagues working in other areas of law and other disciplines. It was, perhaps, especially foolhardy to pick tax avoidance as a topic for such a lecture, since so much has been written on the subject and such strong views are held. On the other hand, it is an ideal topic to show that tax law is not a technical, numerical subject standing apart from other legal studies but can and should be studied and researched in the same way as any other

* KPMG Professor of Taxation Law at Oxford University. The author thanks all those who commented on her inaugural lecture and all with whom she has discussed this topic, too numerous to mention individually, but who include fellow academics, staff and clients of KPMG and employees of the Inland Revenue. Almost all of them disagree with her on some aspect or another and frequently reject her entire thesis, but she hopes that the discussions have sharpened her arguments, which represent her personal views only. She also thanks Danny Priel, Osita Mba and Sam Freedman for research assistance.

1 This article is based on aspects of an inaugural lecture delivered on May 12, 2003 at the University of Oxford. An earlier brief summary of the lecture can be found in The Tax Journal June 2, 2003 (J. Freedman, “Tax and Corporate Responsibility”). The inaugural lecture explored tax avoidance as part of a wider survey of boundaries in tax law.
DEFINING TAXPAYER RESPONSIBILITY

legal topic, in addition to being studied from the perspective of other disciplines and in an interdisciplinary way.2

The study of tax law requires reference to many other areas of law, for example, here, regulation, criminal law, company law and legal theory. Tax belongs in the legal curriculum.3 It is hoped here to illustrate this, as well as to add to the debate on tax avoidance.

Introductory summary

In this article it is argued that morality can play only a limited role in defining taxpayer responsibilities and must be backed up by law. The principle derived from the Duke of Westminster’s case,4 that taxpayers may organise their affairs so as to pay the least tax possible under the law, is firmly established in the UK taxpayer’s psyche and will need legislation to qualify it definitively. The developing pressures on corporate taxpayers as part of the movement for greater corporate social responsibility will have a part to play, since tax–related behaviour may have an impact on reputation. Corporate governance mechanisms will only operate effectively to control taxpayer behaviour, however, within a framework giving clear legal direction. Likewise, although individual tax payers and their advisers may not relish criticism in the press for entering into tax avoidance schemes, the media should not be relied upon to set the boundaries of behaviour: these boundaries should be supplied by the legislature.

The proposal put forward here is that direction should be given by means of a legislative general anti-avoidance principle. It is important to note that it is not claimed that such a provision would provide certainty. Certainty has great significance in commercial law, and, even more so, in criminal law, but there are circumstances in which it should not be the overriding aim and where, in any event, it may be elusive or even undesirable.5 Previous rejection of a general anti-avoidance provision on the grounds that it would fail to provide certainty might therefore be misplaced: it depends entirely on the role envisaged for such a provision. It is argued here that a legislative provision is needed to provide an overlay to the substantive tax rules; the very overlay that Lord Hoffmann in MacNiven v Westmoreland6 rejected as being beyond the constitutional authority of the courts to impose themselves. This overlay could then be developed by the judges with full constitutional legitimacy. It is not the content of that provision which matters so much as the signposting that will be provided by it: hence it is referred to as a principle and not a rule.7 With such a legislative provision in place there would be a clear indication from the legislature that the courts were entitled to go further than the ordinary rules of statutory construction permitted in negating artificial tax avoidance schemes which abused the wording of the legislation. Once that overlay had been created, there would be better scope

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2 For further discussion of disciplinary and interdisciplinary approaches to tax law research see M. Lamb, A. Lymer, J. Freedman and S. James, Taxation—An Interdisciplinary Approach to Research (OUP, Oxford, 2004).

3 This is also well illustrated by other articles in this issue, especially that of Professor John Tiley, whose very title makes this point, and of Edwin Simpson, who relies on arguments derived from administrative and constitutional law.


5 See T. Endicott, Vagueness in Law (OUP, Oxford, 2000)—this idea is discussed further below.


7 The meaning of this distinction in this context is discussed further below.
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than at present for the judiciary, the revenue authorities and the taxpaying community to manage any uncertainty within a sensible regulatory framework.

Morality, risk and reputation

The duty of the taxpayer

It is inevitable that there will be fundamental tensions between the essential need of governments to raise revenue and the lack of desire of taxpayers to pay for this. Quite apart from differences about the size and role of the state, which are obviously to be decided in the ballot box in a democratic society, each taxpayer will consider that he should pay only his “fair share”. What is his fair share may be a matter for argument, but what is clear is that the taxpayer himself is “not the proper person to decide what it should be”.9

Such evidence as there is suggests that whilst individual citizens do not like taxes, the majority do accept that they are both necessary and inevitable.10 This does not prevent even that majority from wishing to minimise their tax in legal ways and politicians frequently attempt to utilise the tax system to manage behaviour, providing tax incentives to operate in one way or another, thus exploiting this rational desire. In the case of corporations there is an added dimension: it could be argued that corporations pay their share of tax through payroll taxes, taxes on distributions and other payments to other parties and that there is no need for a further specific tax levied on corporations.11 In practice, however, corporation tax clearly plays an important role in revenue collection in most tax systems, and corporations are expected by the public and by governments to make a further contribution directly through corporation tax as well as indirectly through the other taxes they pay. Listed corporations will expect to pay the tax required by law. How far they will go in adopting legal avoidance techniques may take account of public opinion, if only because, as we shall see below, there is increasing pressure from various quarters for corporations to demonstrate some level of social responsibility in relation to taxation. Nevertheless, directors may consider that they owe their primary duties to shareholders, some of whom may be based in states other than those in which the corporation is subject to tax. The views of stakeholders on the contribution to be paid to different fiscs may vary. It is clear that some well known companies pay a low rate of tax on their profits by means of various techniques for international and domestic tax planning, carefully designed to fall within the letter of the law.12 Sometimes this is achieved by what all would agree to be planning or mitigation, and sometimes by complex, artificial methods with no commercial purpose other than tax reduction, which some would consider “aggressive” tax avoidance and which risk being struck down by the courts. Whether this behaviour will be curbed in some way by stakeholder pressure will depend not only upon

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the views of other stakeholders but upon the impact of that pressure on the directors’ perceptions of their duties and of risk, and also on the way in which the law frames those duties and permits social norms to be fed into consideration of them.

There is therefore a relationship between morality in the sense of social norms and taxpayer behaviour, but it is a complex one. Morality may in part be shaped by the law.13

The case law position

The debate about whether morality has a place in the arena of tax avoidance is nothing new.14 In an article in the Modern Law Review in 1955, Wheatcroft discussed references to morality in the decided cases,15 but concluded that “whatever may be the personal sympathies of a judge who tries a revenue case, his decision has to be based on purely legal and technical grounds, and Parliament can expect no discretion or elasticity from the courts in enforcing taxation law”. Even though case law has been moving away from the strict and literal approach found in some of those early cases to the “new approach” in Ramsay,16 as developed by Furniss v Dawson,17 the latest pronouncements of the House of Lords suggest that the judges do not see themselves as having authority to create a judicial anti-avoidance rule or to impose an overlay upon tax legislation but only to interpret parliamentary intention.18 This has not been universally accepted and awaits further explanation in the Barclays Mercantile19 case expected to reach the House of Lords shortly and discussed further below. Even in Lord Hoffmann’s view, it seems that this power of interpretation extends to correcting badly drawn legislation. In the Carreras20 case it became clear that Jamaica had adopted wording from the UK capital gains legislation to govern their transfer tax in circumstances where the different types of taxation made the consequences for capital gains tax inappropriate for a transfer tax. Lord Hoffmann, leading the Privy Council, was prepared to decide in that case that a restricted interpretation would not result in a rational system of taxation, and therefore it could not have been what was intended by the legislature. The Privy Council therefore applied what looked very like “Ramsay principle” reasoning to look at the various steps taken together and treat them as a whole, ignoring a step taken for no commercial purpose. This is a chink in the armour—if the courts can consider whether tax legislation is rational this may take us a long way, but whilst rationality within fairly narrow confines might be something the courts feel happy with considering, morality is a far wider and more amorphous concept and, as discussed in the next section of this article, could not alone sensibly guide judicial decision-making in the tax area.

For many tax advisers and taxpayers, the line that is seen to matter is that to be drawn between avoidance and evasion, with only evasion being illegal. All forms of avoidance, be

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12 For a discussion of views by economists see The Institute of Economic Affairs, Tax Avoidance (IEA, London, 1979) where Arthur Seldon argues that the economic distinction between avoidance and evasion is almost non-existent (whilst recognising the legal and moral differences).
16 Lord Hoffmann in MacNiven v Westmoreland Investments, n.6 supra.
they described as aggressive, acceptable or unacceptable, are legal and for the adviser the question is whether or not they work technically and can happily be fully disclosed to the authorities. The terminology of acceptable and unacceptable avoidance, tax planning and mitigation as opposed to aggressive avoidance, and so on, has been analysed in detail in the cases and elsewhere, but the elaboration of different types of avoidance using judgmental wording can be unhelpful.\footnote{21} As Lord Hoffmann has pointed out, unless the statutory provisions:

\begin{quotation}
“contain words like ‘avoidance’ or ‘mitigation’, I do not think that it helps to introduce them. The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory language to the facts of the case. It is not a test for deciding whether it applies or not.”\footnote{22}
\end{quotation}

Consequently, throughout this article, unless otherwise specified, tax avoidance is used in its widest sense, comprising all arrangements to reduce, eliminate or defer tax liability that are not illegal.

\textit{Beyond the law}

The attitude of the judges to the correct development of the case law does not, of course, address the question of whether there is a morality against which taxpayers and their advisers should not offend, regardless of what the legislation or case law states. Recent comments from the tax collection agencies in the UK\footnote{23} and elsewhere, from politicians\footnote{24} and the media\footnote{25} all suggest that there is some kind of overriding moral duty to pay the “right” or “fair” amount of tax and to exercise self-restraint which goes beyond complying with the law. It is worth quoting in detail from the address of the Deputy Chairman of the Inland Revenue at the 2003 Wyman debate on this point.

\begin{quote}
“So what does morality in tax mean for business, their advisers and the Revenue
\end{quote}

\begin{itemize}
\item \footnote{21} For judicial attempts at definition see especially \textit{Challenge v IRC}[1986] STC 548 and \textit{IRC v Willoughby} [1997] STC 995 at p.1004—“tax avoidance is a course of action designed to conflict with or defeat the evident intention of Parliament” (per Nolan L.J.). The article by James Kessler in this issue contains an account of the development of the terminology and a justification of the distinction between avoidance and mitigation. In the context of his discussion of TA 1988, s.741, where the legislation uses the concept of avoidance, Lord Hoffmann’s comment does not, of course, apply.
\item \footnote{22} \textit{MacNiven v Westmoreland} n.6 supra at 257. On the dangers of over-simplification of the differences between tax avoidance and tax mitigation, see The Rt. Hon. Lord Walker of Gestingthorpe, \textit{Ramsay 25 Years On: Some Reflections on Tax Avoidance} (2004) 120 LQR 412 at 416.
\item \footnote{23} See, for example, Nick Montagu, the then Chairman of the Inland Revenue (now retired) on the link between taxes and social goods, calling this the “foundation of tax morality”, Inland Revenue Press Release, January 9, 2003 and the contribution of Dave Hartnett, Deputy Chairman of the Inland Revenue to the Wyman Debate at the Institute of Chartered Accountants on March 15, 2003 (at www.inlandrevenue.gov.uk/news/wyman_debate_05_03.htm). For similar pronouncements from Customs and Excise see for example Chris Tailby, “Combating VAT Avoidance” \textit{The Tax Journal}, December 2, 2002, 6.
\item \footnote{24} For an example, see the exchange between Malcolm Gammie Q.C. and the House of Lords Select Committee on Economic Affairs May 5, 2004, Questions 154 et seq. (www.publications.parliament.uk/pa/lrd200304/ldelect/l109/40505/4050506.htm).
\item \footnote{25} For example, see “Arsenal stars dodge millions in taxes” \textit{The Sunday Times}, July 18, 2004: “The sophisticated tax avoidance plan developed by the accountants is legal but such schemes are widely regarded as unethical”.
\end{itemize}
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Departments? Let me look at business first. What Footsie 250 company does not think about reputation, media coverage, pressure groups and wider stakeholder interest alongside plans to maximise stakeholder value? . . . With increasing numbers of investors taking an interest in the ethical and social policies of companies in which they invest, are we now at a time when corporate responsibility demands a new attitude to tax avoidance? Put differently, is keeping within the black letter of the law enough to be a good corporate citizen? Or does morality matter?

Well, I understand that when a certain newspaper displayed the logos of some mighty companies in the centre of an article suggesting that the Revenue had gone soft on big business a number of chairmen contacted their tax directors early in the morning to find out why their logo was there. That suggests to me that tax reputation matters to them. I am sure it also means that morality in tax matters too.26

What is actually being referred to here is reputational risk and rational reaction to external pressures. Morality comes into the picture, but only indirectly, as filtered by what the public, media and in particular powerful stakeholder groups, especially shareholders, think is good corporate behaviour, and then only to the extent that there are mechanisms to translate these views into pressures on corporations. These mechanisms may be legal (such as through directors’ duties) or they may be economic (such as share price) or some combination.

References by the revenue authorities to morality actually seem to have backfired in some respects. Whilst many tax practitioners and taxpayers assert that they do believe morality is relevant and that they draw their own lines on what they consider acceptable and what not, calls to go beyond the letter of the law, when couched in terms of contributing to social goods and acting “morally”, meet with three main sets of objections.27 First, there are those who argue that morality cuts both ways and that since the Revenue authorities often apply the letter of the law strictly against the taxpayer, there is no reason why the taxpayer should not act likewise. Secondly, some responses to these calls attempt to engage in a debate about whether actual current government expenditure is a good thing; that is, although the revenue authorities talk about education and health, these taxpayers argue that taxes are also being wasted and spent on more contentious activities such as wars. A slightly more sophisticated version of this argument, although no more convincing, is that funds have more social and economic value in the hands of entrepreneurs than if paid over to the government. The fact is that, as discussed above, this second class of responses involves political discussions to be determined by voters and not individual taxpayers or corporate boards.

A rather more sensible response to the morality card, however, is that taxpayers have a guiding principle that they need only pay what has been determined by Parliament through legislation and that, under the Duke of Westminster’s case, they may arrange their affairs in such a way as to pay the lowest amount of tax possible, provided they are within the law. By definition, the law does not extend to a moral code not embodied in legislation or case law. This attitude is deeply embedded in our history and politics, and in our law.28 According to this account, calls on morality, where the law proves inadequate to achieve

26 Wyman debate, n.23 supra.
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what government intends, are unreasonable, unfair and incomprehensible since taxpayers are entitled to be able to rely on the law as it is written. If this does not accord with the intention of Parliament, it is for Parliament to make its intention clearer. The Duke of Westminster principle has not been overruled although statutory construction is now more purposive than it was when that case was decided. Directors have a duty to their shareholders to maximise profits and must therefore undertake tax planning within the current state of the statute and case law at least to the same level as their competitors (at home and abroad).

Morality alone, without legal backing, does indeed seem inadequate as a guide to the duty to pay tax. A leading legal philosopher has used tax as an example of an area where morality cannot provide adequate guidance without legal content. Professor Honoré has explained that in complex societies morality is dependent on law. Morality is like an outline from which details are missing. Laws, along with conventions, fill many of these in. In his view, taxation affords a good example of this point:

“According to most people's moral outlook members of a community should make a contribution to the expense of meeting collective needs. ... So members of a community have in principle a moral obligation to pay taxes. But this obligation is incomplete or, if one prefers inchoate, apart from law. It has no real content until the amount or rate of tax is fixed by an institutional decision, by law. What amounts to a reasonable contribution is not otherwise determinable, since what is required is a co-ordinated scheme which can be defended as fair not merely in the aggregate amount it raises but in its distribution. Taxpayers cannot settle it for themselves, as people can within limits settle for themselves, say, the proper way of showing respect for the feelings of others. Apart from law no one has a moral obligation to pay any particular amount of tax. An obligation to pay an indeterminate amount is not an effective obligation; it requires only a disposition, not an action. So, apart from law no one has an effective obligation to pay tax.”

Honoré admits, of course, that a tax may be open to criticism on grounds of justice, but even so there is no way of fulfilling the obligation to help support the community apart from paying the tax. This is the way in which morality has been given content. He agrees that to do what is legally required is not always to be morally in the clear but his contention is that morality and law intermesh in complex ways. The systems are separate in some ways but interact in others.

In the context of taxation, the legislature must set out the total amount of tax to be paid by the community, and the way in which liability is to be allocated. Some gaps in the legislation might be decided by judicial intervention by relying on constitutional type principles such as rejection of retrospectivity and issues of interpretation such as the meaning of profit or trading. This might even extend to assuming a Parliamentary intention to be rational within the confines of the framework of a piece of legislation as in Carreras. But the UK judges have declined to create law which imposes taxation simply

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29 On the accuracy of this view of directors’ duties see the section on corporate responsibility below.
30 T. Honoré, n.13 supra.
31 Honoré ibid. at p.5.
32 See Simpson in his article in this issue. His argument is that the judges can and should go further than they do.
33 See n.20 supra.
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because in their view taxed should be levied on some basis of fairness (unless the statutory language permits such a construction). In addition the UK has no Constitution or General Taxes Act which sets out tax principles upon which the judges can build, such as ability to pay and progressiveness (unlike, for example, Spain).34 In any event, if the judges were to fill the gaps by reference to fairness this would be a form of recognition which would immediately be embodied in the law, so that the requirement would no longer be to behave morally, going beyond the law, but would have become legally binding.

The only other source by which general principles or “morality” can enter the equation is through the application of social norms by taxpayers to decide whether to enter tax-related schemes. This is bound to fail as a systemic way of preventing avoidance because taxation is a topic where there will be genuine moral disagreement, which cannot be resolved by appeal to generally agreed values.35 The only moral norm commanding a sufficiently wide agreement is that citizens should pay their share of the tax lawfully collected by governments, but, even discounting personal views on what is fair, what is their “fair” share takes us back to a consideration of what Parliament has said it should be. In the case of directors or trustees, moreover, the exercise of personal morality going beyond what the law requires might conflict with their duties to their beneficiaries or stakeholders under the law, so the only question is one of how to interpret what the law does require. To ensure an adequate process for controlling this question of interpretation and thus of tax avoidance, a political consensus has to be reached and needs to be translated into law either by legislation or by judicial interpretation of legislation. This could be achieved by a legislative instruction about the approach to interpretation in a general anti-avoidance provision.

Corporate social responsibility

It has been shown that simply talking about morality does not progress the debate about taxpayer duties very far because, once we step beyond legal duty, the responsibility to pay any given amount of tax is too inchoate to be a widely accepted moral duty. It might be argued, however, that extra-legal morality could be enforced by some mechanism other than the law if a consensus about taxpaying duty could be built. One possible mechanism in the case of corporate taxpayers could be corporate social responsibility.

It seems that corporate responsibility is beginning to have a role to play in controlling taxpayer behaviour and introducing aspects of “morality” into taxpaying considerations, indirectly at least, but that the ideas behind this movement and the enforcement mechanisms remain too broad and lacking in focus and general agreement to be effective. Backing for corporate social responsibility may be derived in part from clarification of directors’ duties, reporting requirements and codes of corporate governance, but this still gives very little real guidance and a legislative general anti-avoidance provision is the framework within which corporate responsibility dynamics could really operate effectively and fairly.

Until recently, tax had appeared as an issue surprisingly little in the formal corporate

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34 And this is precisely why Raz argues (contrary to Dworkin) that these community values are not part of the law unless they become so by legislation or judicial decision: J. Raz, “Legal Principles and the Limits of Law” (1971–1972) 81 Yale Law Journal 823.
social responsibility debates, but this is changing in the United States following the Enron and WorldCom cases which have led to the Sarbanes-Oxley Act 2002. The new internal reporting requirements under section 404 of that Act require management to assess its internal controls and the independent auditors to report on this assessment. This includes internal controls related to tax accounts when they are significant to financial reporting and will comprise all risks relating to tax so will need to include examination of schemes entered into for tax avoidance and mitigation purposes. In the UK, the structures for reporting and accountability are continually being enhanced by corporate governance codes and by developments such as the Operating and Financial Review which is about to become a requirement for UK quoted companies. These exercises in internal control will at the very least require managers to consider tax more closely than they have in the past and it is likely that tax strategies will need to become more formally defined. This extended scrutiny will in itself tighten control over tax departments and ensure that they are required to justify tax avoidance schemes within an overall corporate strategy. These developments do not themselves determine that strategy, but it is likely to be a strategy built on risk assessment. In assessing risk, and in particular reputational risk, the attitude of stakeholders will be taken into account, so that any swing of public opinion against tax avoidance—current social norms or morality—could have an impact in this indirect way, but the motivation is purely economic. As Power has stated,

"... the current interest in Corporate Social Responsibility (CSR) can be argued to be a defensive strategy: CSR is simply subsumed within reputation risk management."

Previous failure to develop taxpaying as part of the corporate social responsibility debate to date may be in part ascribed to negative attitudes to taxpaying by stakeholders generally. It is more obviously attractive to mobilise support for expenditure by a company to help preserve the environment than to assert that companies should pay their taxes in full in order to make a general contribution to government coffers. This reflects the point made above that tax will be an issue about which there will be much genuine moral disagreement. This is not to suggest that everyone will agree on environmental issues, but there will be much clearer groupings of views than on whether engaging in a certain scheme is acceptable or not. There may be stronger support, however, for more focused tax issues such as ensuring that a reasonable level of tax is paid in developing countries where resources and labour are based, although a failure to pay any significant level of tax at all in the UK and other developed countries may also come under fire as government spending

36 On tax in this connection see especially the Report of the Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues and Policy Recommendations, prepared by the Staff of the Joint Committee on Taxation at the request of Senators Baucus and Grassley of the Senate Committee on Finance (JCS-3–03, US Senate, February 2003). This has contributed to the pressure in the US for legislation to combat tax shelters and the Sarbanes-Oxley Act of 2002 has imposed some limits on the provision of tax advice for publicly held audit clients as well as the reporting requirements referred to here.

37 For example see Ernst & Young Tax Services, November 2003.

38 Although the DTI’s consultation paper on the Draft Regulations on the Operating and Financial Review and Directors’ Report (May 2004) makes no direct mention of taxation, there is little doubt that tax issues would fall within the purview of such a report in some cases, since large companies will be required to report on all factors relevant to the understanding of the business and this includes reporting on risk, including tax risk.

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is squeezed and especially if higher personal taxes are portrayed as being necessary as a result of lower tax take from companies. Various recent developments suggest moves to put tax on the corporate governance agenda. The Tax Justice Network promoted in the UK by War on Want calls for, *inter alia*, public disclosure of turnover and tax paid for all significant business entities with a break down by tax jurisdiction. The Global Reporting Initiative (GRI) and the Publish What You Pay campaign seek to enhance transparency about the contribution made to different jurisdictions, especially developing countries, by tax payments. The latter campaign has been picked up by the UK government which has launched a voluntary Extractive Industries Transparency Initiative. These movements are in their infancy, but combined with increased reporting under wider corporate governance initiatives as outlined above, could start to make corporate boards think about tax paying as more than a straightforward cost to be kept as low as possible in all circumstances. Instead, the contribution made to the fiscs could be seen as a positive point for corporate reports.

In the past, pronouncements from the UK Government on corporate social responsibility have sometimes been couched in terms of tax breaks for rewarding good corporate behaviour, which may give the wrong message in terms of taxpaying itself being good behaviour. The idea that taxpaying should be connected with good citizenship has to be treated carefully, as discussed above, otherwise some will attempt to argue against paying on the basis of the way in which revenues are spent. Properly harnessed with proposed company law developments, presenting taxpaying as a corporate governance issue could have a role to play, however and if the issue is in part one of directors’ duties, these duties must be understood in the context of modern company law.

The proposed Company Law Bill which has emerged from the Company Law Review in the UK is intended to ensure that regard has to be paid by directors to the long term as well as the short term. This is not intended to change the law but the Government intends to clarify the responsibilities of directors by making statutory provisions setting out their duties. The draft bill requires directors to promote the success of the company for the benefit of its members and, in deciding what would be most likely to promote that

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41 www.taxjustice.net/e/about/index.php.
42 www.globaleporting.org/. Started in 1997, GRI became independent in 2002, and is an official collaborating centre of the United Nations Environment Programme (UNEP) and works in cooperation with UN Secretary-General Kofi Annan’s Global Compact. UK organisations using the guidelines in whole or in part include Allied Domecq, Anglo American plc, AstraZeneca, ICI, Barclays and Johnson Matthey to name but some examples.
43 www.publishwhatyoupay.org/. This campaign was launched by George Soros and calls for the mandatory disclosure of payments made by oil, gas and mining companies to governments for the extraction of natural resources. This is designed to ensure that transparency comes from both private and state oil companies and has the support of oil companies including Shell as well as the World Bank.
44 See Shell’s 2003 report “With the co-operation of the Nigerian Government, we have been reporting the taxes and royalties paid by Shell-run operations in Nigeria since 2002 (approximately $1.8 billion in 2003) and will continue to do so.”
46 What the Company Law Review Committee call “Enlightened Shareholder Value”.
47 DTI website (www.dti.gov.uk/cld/review.htm).
success, to take into account all the material factors that it is “practicable in the circumstances for [the directors] to identify”. These factors expressly include the need to maintain a reputation of high standards of business conduct.

In this way, morality may feed into decisions about tax strategy and the belief that there is a duty to minimise tax at all costs might begin to be modified. As can be seen from the wording of the draft bill, however, the proposed statement of directors’ duties imposes only a duty to take reputation into account and then only when practicable. It has to be balanced by the directors with other matters such as, no doubt, profits. To the extent that a tax avoidance scheme is legal it will continue to be the case that directors will have a clear duty to organise the company’s affairs in the least costly way in terms of tax, to set against this, rather less clear, consideration of reputation. What is more, if any tax avoidance in which they engage is legal, it will be hard for them to assess what the reputational effects of entering into it might be, if its consequence is to reduce the company’s tax rate substantially and this is then publicised. This again argues for clear legislative signposting in the form of a general anti-avoidance provision rather than leaving the matter to public opinion and the media.

In Australia, the Australian Tax Office (ATO) has for some time played the corporate governance card. In June 2003 it issued a booklet entitled Large business and tax compliance, which raised the role of boards of directors and good governance in relation to taxation. This was followed up in January 2004 by a letter from the Commissioner of Taxation sent to all listed companies focusing on the importance of identifying tax risk. Having been asked to give practical advice to boards on how to achieve this, he provided a list of questions for boards to address to their tax advisers, covering issues such as the likelihood of success, the likelihood of dispute with the ATO and the costs involved should there be an investigation, whether the advice is based on the actual transaction or an expectation of how it will be implemented and how appropriate it would be to be upfront with the ATO in identifying the issues before or when lodging the tax return in the interests of managing any risk.

This advice, couched in terms of risk levels and corporate governance, is of considerably more practical assistance to companies than broad comments about morality. It does not help to define what will or will not succeed, nor discuss reputational issues, and thus does not help with the central problem discussed here of whether Boards should look beyond the law, but, subject to that central problem, it does provide a mechanism for Boards to use in considering concrete schemes put before them and weighing the costs and benefits and chances of success and, to this extent, this approach is to be welcomed. Of course in Australia there is a general anti-avoidance rule\[^49\]: this letter indicates that such a rule is not the end of the regulatory conversation\[^50\] but a valuable backdrop.\[^51\]

**Culture of Artificiality**

The artificiality and complexity of the tax system is often cited as a reason for the

\[^49\] For a discussion of which, see the article by Orow in this issue. For the ATO booklet see www.ato.gov.au.


\[^51\] Orow in this issue argues that the Australian general anti-avoidance provision inhibits financial innovation but as a deterrent it is clearly successful: see Tiley in this issue. Anecdotal evidence gathered by the author from various conversations with tax advisers suggests that the Australian legislation has changed the mind-set of tax planners. The author does not seek to judge at this point whether the
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frequency of tax avoidance. To some extent complexity is unavoidable when the tax system has to attach itself to complex underlying legal and economic circumstances. We might think that we should tax on a basis approaching something as near to reality as possible but, as Lord Hoffmann has pointed out, there are dangers in talking about reality in this context.\(^5\)\(^2\) As he states, “Something may be real for one purpose but not for another.” This may not sound very helpful in practical terms but it takes us to a central problem of dealing with tax avoidance. The tax system is not founded purely on economic reality, even if we were to know what that was. It has to be about legal reality—(when is there a disposal of land, when and whether expenditure is incurred, and when and whether a payment is made?)—because that is the only practical and operable way to construct a tax system. What we decide to tax may be something quite artificial; income, for example, is an artificial construct. In the business context it bears some relation to the accounting concept of profit but how real is that? Accounting profit is based on a set of standards designed to give a true and fair view of the profits, but it is one view, seen from one perspective: just one other version of “reality.”\(^5\)\(^3\) We could decide to use an entirely different tax base if we wished, and many have argued we should.

Legal reality may often be trying to reflect some sort of commercial or economic reality but it will not achieve this in every case. This does not mean that the legal distinctions created are unreasonable and that taxpayers relying upon them are acting reprehensibly, since the entire system is based on legal distinctions and needs to be in order to operate. Sometimes this seems to operate in favour of the Revenue and sometimes the taxpayer, but since it is the foundation of the tax system, it cannot be eliminated. Artificiality alone cannot be said to be a hallmark of avoidance when so much about tax is artificial.

Sometimes, moreover, governments use tax systems to try to achieve multiple objectives—macro- and micro-economic and social management. Arguably this overloads the system and it certainly creates its own complexities. It is entirely predictable that incentives created through the tax system with one group in mind will be used by others if they find a way to do so. The government has invited a response to its tax incentives and taxpayers are merely taking up the invitation. If tax avoidance is a course of action designed to conflict with or defeat the evident intention of Parliament,\(^5\)\(^4\) situations in which Parliament has deliberately devised a tax incentive but failed to delineate its beneficiaries with care cannot be dealt with by a simple principle of statutory interpretation, since Parliament clearly does intend to create a tax advantage.\(^5\)\(^5\)

Many examples could be given but the one referred to here is that of small businesses. It epitomises the way in which poor policy-making can create a chain of events which indicates to ordinary taxpayers that the tax system is artificial and is there to be manipulated and why the government reaction to that activity, which is to clamp down on it, is met by anger which will then lead to further avoidance activity as taxpayers come to believe that they have been unfairly treated. Giving companies with small profits a nil rate...
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of corporation tax not available to unincorporated firms\textsuperscript{56} has, entirely predictably, led to a rush to incorporate. Government argues that those who have done this are not only the entrepreneurs that they wished to encourage but others who are simply taking advantage of the tax incentive, “often as a result of marketed tax-avoidance schemes”.\textsuperscript{57} Maybe, but why not? It is impossible to distinguish entrepreneurs from other small business owners \textit{ab initio} by any objective criteria and the legislation does not attempt to do so, so there is no sign in the legislation at all that the government intended to restrict these benefits to any particular group of incorporators. The introduction of differential rates \textit{unnecessarily} exacerbated the necessary distinctions between tax treatment of different legal forms in an area where the legal rules often do not reflect economic reality.\textsuperscript{58} Combined with differences between the tax treatment of earned income and dividend income this led to the Exchequer losing large amounts of money as a result of this poorly thought out tax policy. Attempts to counter some of its effects include the use of settlements provisions\textsuperscript{59} and now the introduction of the non-corporate distribution rate in the Finance Act 2004, adding another eight pages of complexity to the Taxes Act. The small business taxation system is further convoluted by the so-called IR 35 provisions\textsuperscript{60} which seek to deny certain taxpayers who have set up personal service companies some of the benefits of incorporation. In each case the government action taken to counter the tax advantages it has itself created has been couched in terms of preventing abuse and unacceptable avoidance. Yet those who have used the tax advantages so created are left bemused. They have often been advised by accountants to act as they have done. It is true that they do not require incorporation for any commercial reason and that their behaviour is tax driven. But they have been told that this is the way to set up a business in a tax efficient way and if they find it odd, they simply believe this is one of the mysterious things about the way the tax system works. In any event they often perceive themselves to be entrepreneurs, even if they are not the growth businesses the government has in mind. Their angry reaction to being told they are behaving in an unacceptable way and will be deprived of the tax benefits can be seen in the press and on websites.\textsuperscript{61}

What message are such people being given by the tax system? Are they to think of tax in terms of economic reality, fairness and rationality when it at first appears that incorporation will legitimately save tax and they then find that some of those benefits have been negated in a complex way that will probably cost them considerable amounts in professional fees? The law has real substance here because it has consequences in terms of rights and obligations. A company is a legal person, not a fiction. So the business owner

\textsuperscript{56} FA 2002, and before that a reduced rate of 10 per cent from 2000.
\textsuperscript{57} Financial Statement 2004, [2004] STI 655 at para.5.93.
\textsuperscript{58} For further detail on the make up of the small business sector in the UK and generally on this area see J. Freedman, “Small Business Taxation: Policy Issues and the UK” in N. Warren (ed) \textit{Taxing Small Business} (Australian Tax Research Foundation, Sydney, 2003).
\textsuperscript{59} “Businesses, Individuals and the Settlements Legislation” Inland Revenue Tax Bulletin Issue 64 April 2003. This led to an angry response from a combination of tax representative bodies CIOT, ICAEW, ICAS, ACCA, ATT, FSB and Working Together, Section 660A: Commentary on Tax Bulletin Article, September 2003 (www.tax.org.uk). A test case has now been heard by the Special Commissioners and the result is awaited at the time of writing this article.
\textsuperscript{60} FA 2000, s.60 and Sched.12 and see J. Freedman, “Personal Service Companies—“the wrong kind of enterprise”” [2001] BTR 1.
\textsuperscript{61} For example see the site of the Professional Contractors Group, which has been at the forefront in attacking IR35 and the settlements actions (www.pcg.org.uk/).
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who has set up a company has become a director and possibly an employee. His initial actions may have been tax driven but he now has a business which is different in terms of legal, though maybe not economic, substance from an unincorporated business. Right from the start he has been given a signal that it is necessary to take account of taxation when making commercial decisions and that the rules can change. The culture of artificiality is established and so it continues. For example he may find it is efficient to lease rather than buy assets as a result of the tax incentives built into the leasing industry. The Inland Revenue may even bless some complex methods of dealing with problems presented by the tax system which would otherwise prevent commercially valuable activity.\textsuperscript{62} In the light of this, it is not surprising that business owners will soon come to believe that it is perfectly natural to do artificial things for tax purposes and that this impression permeates right up the scale to large companies whose directors, used to tax impacting on all their decisions, consider it fair game to take tax into consideration in all planning and then to go on to undertake tax driven activities.

This is not an attempt to white-wash tax avoidance activity. Of course many taxpayers realise that the schemes they enter into have been engineered and may be entered into solely for tax purposes. But if this seems to be perfectly natural and reasonable commercial activity to them, it is at least in part because they have become used to the need to take artificial steps simply to achieve sensible taxation in some cases and once this has begun it may be hard to draw the line as to where to stop.

Certainty

Much of the discussion of tax avoidance centres on the need to draw boundaries to differentiate types of behaviour; evasion and avoidance; tax avoidance and tax mitigation. It is the contention here that it needs to be considered to what extent, and in what circumstances, the failure to draw bright lines results in a real problem and when it may be not only inevitable but perhaps even helpful to steer away from any attempt to define the line categorically.\textsuperscript{63} In some cases we may need to shift the focus away from trying to create clear lines, which may in any event be an impossibility,\textsuperscript{64} towards how we enable decisions to be made in individual cases fairly and within a legitimate and non-arbitrary framework. Proposals put forward in the past for a general anti-avoidance rule have failed because it could not be shown that they would produce certainty. Similarly, general anti-avoidance provisions in other jurisdictions have been criticised for uncertainty.\textsuperscript{65} Perhaps the proposals were being subjected to the wrong test.

Sometimes it is supposed that if, and to the extent that, the law fails to draw a clear line

\textsuperscript{62} For example, see a letter from Lord Sainsbury to the Financial Times on July 7, 2004 on the problems presented to academic spin-outs by FA 2003. He writes that the Inland Revenue has approved models which can be used to “deliver the commercial aims of spin-outs without producing an early tax charge”. This is presumably considered to be helpful tax planning rather than tax avoidance. Here the activity of the tax advisers to create a scheme designed to help a certain group escape from a tax charge by Parliament is applauded by government. At times such activity is essential to help the tax system operate due to its complexity and multiple objectives.

\textsuperscript{63} See Kessler in this issue who decided that the concept of tax avoidance in s.741 is not too vague or subjective to be operational, “although there are some borderline cases where tax avoidance remains at present a matter of opinion”.

\textsuperscript{64} And which we do not have at present.

\textsuperscript{65} See Orow in this issue, for example.
or is indeterminate, this a deficit in the rule of law. It is agreed here that we do need to have strict rules about what constitutes criminal evasion, even if this means the rules are under-inclusive. Here, what Endicott calls the “rule of law benefits” outweigh the need to catch behaviour at the boundaries. When criminal penalties and even imprisonment are at stake, the taxpayer needs to know whether the law has been broken and tax administrators should not have unfettered discretion to prosecute.66 When it comes to the distinction between tax avoidance which will ultimately be successful and thus acceptable (on Lord Hoffman’s ex post test) on the one hand, and unacceptable avoidance on the other, however, it is contended that the measure of “certainty” achieved by formalism is not desirable since this leads to “creative compliance”67. That is, the production of ever more detailed rules simply encourages avoidance, or creative compliance, as McBarnet has called it, by the manipulation of those rules, using the rules themselves as signposts as to how to achieve the effective avoidance.67 Some uncertainty at the borderline is a price worth paying to prevent this, and may even be desirable, provided that there is a way for the broadly compliant majority68 to establish how their behaviour will be treated and the decision on this will be made in a legitimate and non-arbitrary way.

This leads to the conclusion that, as Avery Jones69 and Braithwaite70 amongst others have argued, what is needed is fewer detailed rules, backed up by principles in accordance with which the rules can be interpreted in a purposive way.71 Further, as propounded by Weisbach, some of these principles need to have fuzzy borders.72 Avery Jones and Braithwaite consider that their prescriptions ultimately will increase certainty, but this is not the case made for a general anti-avoidance principle (GANTIP73): rather it is argued that here, as in other areas of law, lack of certainty is not a defect, since certainty is not the aim of the exercise. It is not as though we have achieved certainty now with our detailed rules and it is hard to point to any jurisdiction which has done so. A GANTIP would not make this more difficult to deal with but easier, not through increased precision but by providing an opportunity to create a sensible regulatory framework for the discussion of what is acceptable and creating an improved climate of understanding without becoming burdened by the futile attempt to draw a boundary. This approach would accept that, as in other areas of law,74 principles are needed which might at times override literal
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interpretation of language. This could go further than statutory interpretation under our current judicial rule if only because the exercise would have statutory legitimacy. It could also assist in reducing the number of detailed rules and thus the complexity of the tax system. This might have an eventual side effect of improving certainty, but that is not the primary purpose of the exercise. The need for clear boundaries at different points is now discussed in more detail.

Evasion

How do these arguments apply to the current position on tax evasion and avoidance in the UK? It has been uncontroversial in the past to describe the boundary between evasion and avoidance as a straightforward one, with evasion being illegal and avoidance being legal. In the past few years there has been a concern in the tax community that in Tiley’s words, tax evasion has developed frayed edges\(^75\) and that the revenue authorities are encouraging this development.\(^76\)

It is understandable that the revenue authorities, concerned by criticism that they are not doing enough to combat revenue loss, are arguing that failed avoidance schemes could become evasion, but this is unhelpful in relation to the complaint majority without giving any teeth to the fight against the non-compliant.\(^77\) Of course,

“if an ‘avoidance’ scheme relies on misrepresentation . . . or concealment of the full facts, then avoidance is a misnomer; the scheme would be more accurately described as fraud.”\(^78\)

Some recent pronouncements from the Inland Revenue, and more so from Customs and Excise, however, seem to be trying to go further than this.\(^79\) For example, the Chairman of Customs and Excise has written that:

“It may be that as the legal principles of avoidance become defined in case law, a business which implements an avoidance scheme which has been held by the courts to be avoidance could be embarking on a course of conduct which amounts to evasion.”\(^80\)

The common thread in all cases of evasion is concealment,\(^81\) but not all evasion is criminal.\(^82\)

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\(^{75}\) Tiley, n.11 supra at p.85.
\(^{76}\) Such blurring by the revenue authorities for deterrent purposes has also been noted in other jurisdictions: G. Cooper, “Analyzing Corporate Tax Evasion” (1994) 50 Tax Law Review 33 n.34.
\(^{77}\) On the importance of focusing regulatory strategy at the non-compliant, see V. Braithwaite, n.68 supra.
\(^{78}\) J. Gribbon (then Director of the IR Compliance Division) “A Sterile Activity” The Tax Journal September 22, 1997.
\(^{79}\) Sir Nicholas Montagu, “Revenue goes after the big tax dodgers” The Sunday Times December 29, 2002. (Inland Revenue Chairman stated, “Some large companies are exploring forms of avoidance that they may think legal but we think illegal”).
\(^{81}\) Introduction, to Report of Committee on Enforcement Powers of the Revenue Departments (Keith Committee) Cmdn.8822 (HMSO 1983).
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As Salter has noted,82 when the offence of fraudulent evasion of income tax was introduced in 2000, the word fraudulent was considered a necessary addition to evasion to make clear the need for dishonest intent. Whether innocent or dishonest, evasion will lead to re-assessment for tax purposes but only dishonesty should result in criminal prosecution.83 Whether the prosecution is for fraudulent evasion or cheating the public revenue, dishonesty must be proved. Some reassurance is available, since the Paymaster General has stated in Parliament that “a failed scheme whose details are not hidden from the Revenue amounts not to tax evasion but to tax planning”.84 The Inland Revenue has indicated that there should be no criminal offence where there is no trace of any concealment of the true facts of arrangements for which there is a “respectable technical case”.85 The problem is, who is to decide whether there is a respectable technical case? The complexity of the tax system is such that there may well be reasonable different views on whether a scheme will work. How definite must advisers be that there is a reasonable case? Barclays Mercantile Business Finance Ltd v Mawson,86 was decided against the taxpayers by the Special Commissioners of Taxes and a very experienced High Court Judge but the decision was reversed by an equally experienced Court of Appeal. How should a company director or even a tax adviser decide whether there is a respectable technical case in these circumstances?87 There have been some high profile cases where individuals, including tax professionals, have been successfully prosecuted for what they claimed were unsuccessful avoidance rather than evasion schemes.88 If avoidance shades into fraud, the consequences of stepping over the line here are very great indeed. It is right that the Inland Revenue should seek to combat tax fraud but taxpayers need to know what will be considered dishonest. Juries who have to decide these issues need to know what the norms of disclosure are and how to assess whether there was a respectable technical case.89 This is not something to be left to fuzzy principles, either from the point of view of the taxpayer, nor the revenue authorities if they wish to be sure to secure convictions.

The test for dishonesty depends on a combination of findings of fact about what the defendant knew and believed and an application of the current standards of ordinary decent people.90 Ashworth91 suggests that this test of dishonesty generally derogates from

84 HC Debs, Standing Committee H, June 29, 2000, cols.1012–3, cited in Salter n.82 supra.
86 n.19 supra.
87 Another example of disagreement between different levels of the judiciary comes from Debenhams Retail Plc v Comrs of C&E [2004] EWHC 1540 where the High Court overturned the Special Commissioners. The latter thought that the scheme relied upon artifice, the former that it merely sought to procure that retailers are treated as receiving no more than they truly receive. The Customs and Excise Press notice issued after they lost the High Court case depicts this as an unfair avoidance scheme stating that ordinary taxpayers will not understand why they should pay their fair share towards public services when big household names do not (despite the finding of the High Court Judge): C&E News Release 29/04. We may need to wait years for the case to reach the ECJ for a final decision.
88 See for example the much criticised R. v Charlton [1996] STC 1418.
89 See the account by R. Venables Q.C. of what he argues was a very unsatisfactory handling of the Charlton case in this respect: “Tax Avoidance: A Practitioner’s Viewpoint” in A. Shipwright (ed) Tax Avoidance and the Law (Key Haven Publications PLC, London, 1997), 33.
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the principle of maximum certainty in the criminal law. He acknowledges that juries may recognise dishonesty easily in some situations, but suggests it is far more difficult in situations with which a jury or magistrates are unfamiliar. Juries are unlikely to be familiar with complex tax schemes. Here, imprecision may lean in favour of the defendant by applying the standards of ordinary people, since polls show mixed attitudes to tax evasion. On the other hand, complex schemes undertaken by wealthy individuals and corporate firms may be seen differently by juries from their own activities. There is a strong argument for providing a jury with more assistance than it currently has if it is to be able to take an informed view about the circumstances necessary for dishonesty in complex tax scheme cases.

A central problem is what level of disclosure is necessary to ensure honesty. As the Tax Law Review Committee has pointed out, engagement in an avoidance scheme can encourage taxpayers to be economical with the truth. It is in the interests of would-be avoiders to maintain secrecy as long as possible because official knowledge may be followed by legislative action. At what point does this behaviour become concealment? Is presentation of the relevant information amid a large volume of detail adequate or must the points at issue be spelt out to the Inland Revenue and highlighted for them?

In the lecture on which this paper was based, this author argued for strengthened disclosure rules to help with this problem. If those rules were breached, the argument was, this would give juries guidance on intent. The disclosure rules introduced in the 2004 Finance Act have been very heavily criticised for being drawn too widely and for a number of other aspects but they do achieve this aim in part. They provide a mechanism for early disclosure for those arrangements caught by the descriptions in the regulations. For those who do not disclose when they should have done so there will not only be penalties but, maybe more importantly, there will be a question raised about their honesty in pursuing the scheme. Clients will need to ask questions of their advisers which they may not have done without the provisions. Advisers and taxpayers may actually feel protected by the mechanism: if they disclose fully under this provision it will be hard for the revenue authorities to argue fraud or dishonestly on the grounds of secrecy. The main problem with the provisions is their conceptual confusion of the disclosure function at the evasion/avoidance border, which did need strengthening, with the definitional function at the avoidance/mitigation border. The direct tax provisions, and some of the indirect ones, require disclosure only where there is a tax advantage (as defined) and, in the case of the direct tax provisions, the arrangements are covered only if the main benefit or one of the main benefits is the obtaining of that advantage. These requirements were supposed to act as filters to prevent the Inland Revenue from being swamped with disclosures, but in fact they confuse the issue by introducing concepts that are hard to interpret and use the

92 Arlidge et al. n.90 supra. at 1–015. If the majority think it is morally acceptable to accept payment in cash to evade taxation, does this become the standard to be applied? The authors of this text argue that if the majority of people think small scale tax evasion is not dishonest (as polls suggest may be the case) then most juries will agree and then, according to Ghosh, this will not be dishonest.


94 Based on the disclosure provisions in the US—see E. Nijenhuis, D. Chung and M. Kulikov, “The New Disclosure and Listing Regulations for Tax Shelters” Tax Notes November 18, 2002 involving disclosure of objectively defined categories of transactions.

95 For a full account of the provisions, see Fraser in this issue. There is a general feeling that discussions with the Inland Revenue and the consequent changes to the regulations have resulted in much improvement, however—S. Edge, “Half-Term Report” The Tax Journal July 26, 2004, 9.
language of tax avoidance. The intent is not to distinguish avoidance and mitigation; the fact that the disclosure provisions applies does not mean that the scheme would necessarily fail. But the use of this avoidance language is unhelpful and might give scope to those operating at the edges of the tax planning industry to get around the disclosure provisions, whilst the compliant will not wish to take the risk and so will disclose whether they consider these requirements are truly satisfied or not. Despite these criticisms, the disclosure provisions may be found to be helpful in clarifying the scope of evasion and reducing the attempts of the revenue authorities to blur this boundary.

The avoidance/mitigation border

The line between evasion and avoidance may not be straightforward but it is considerably more so than that between different types of avoidance. The attempt to divide acceptable avoidance, tax planning or mitigation on the one hand, and unacceptable avoidance on the other, in any general sense has been argued already here to be unhelpful. The judicial law has not developed in such a way as to indicate clearly to taxpayers what will or will not be acceptable. The problem should not be exaggerated—it arises only at the boundaries. But at those boundaries, activities which utilise the strict wording of the legislation to achieve a tax saving may or may not succeed. At one point the case law might have been thought to invoke a general principle which overrode the detailed rules: the so-called Ramsay principle which looked at whether a transaction forming part of a pre-ordained, circular or self-cancelling transaction was undertaken for no commercial purpose other than obtaining the tax advantage in question. If so, the scheme could be looked at as a whole and the legislation might then not apply to achieve the effect the taxpayer was hoping for. The Ramsay principle subsisted alongside, and did not overrule, the Duke of Westminster principle that every taxpayer is entitled to arrange his affairs so that the tax attaching to them is less than it otherwise would be. Principles have the potential to conflict and need to be weighed against each other.

In MacNiven v Westmoreland, however, Lord Hoffmann stated that the so-called Ramsay principle looked like an overriding legal principle superimposed upon the whole of revenue law without regard to the language or the purpose of any particular provision. This sort of principle, said Hoffmann, was one the courts had no constitutional authority to impose. According to his Lordship, there can be only one principle of construction—

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96 WT Ramsay Ltd v IRC n.16 supra per Lord Wilberforce “[The principle of IRC v Duke of Westminster] must not be overstated or over extended. While obliging the Court to accept documents or transactions, found to be genuine, as such, it does not compel the Court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded; to do so is not to prefer form to substance, or substance to form”. See also the formulation by Lord Brightman in Furness v Dawson, [1984] STC 153 “First, there must be a pre-ordained series of transactions or, if one likes, one simple composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end . . . Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of liability to tax—not ‘no business effect’. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The Court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied”. It is not the objective of this article to discuss this case law in detail: for such a discussion see Tiley in this issue.

97 n.6 supra.
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ascertainment of what Parliament meant by using the language of the statute.\textsuperscript{98} In place of the Ramsay principle, Lord Hoffmann put forward his own approach to statutory construction. In his view some legislation can be construed in its commercial context. Other statutes refer to purely legal concepts and then cannot transcend their juristic meaning. How do we know which rule applies to a given word in a statute? Hoffmann’s answer is that a legal concept is one of which a commercial man would say, if asked what it meant, “you had better ask a lawyer”! Lord Hoffmann is far too wise to believe that his test gives certainty. His restatement in Westmoreland appears to have left much open for future development, although within apparently narrow confines, and he himself was subsequently prepared to assume that a statute was concerned with the characterisation of the entirety of a transaction rather than the individual steps as a matter of construction of the language “in its context” in the Carreras case,\textsuperscript{99} showing that even he does not believe that the Ramsay approach is dead.

Following on from MacNiven, in Barclays Mercantile v Mawson,\textsuperscript{100} the Court of Appeal has cast some doubts on Lord Hoffmann’s restatement. Here, the Court of Appeal held that a tax scheme was effective even though it involved circular movements of money and would not have been undertaken had it not been for the tax benefits. The issue was whether expenditure was incurred on a pipeline so as to enable a finance company within the Barclays group to claim capital allowances. The Irish Gas Board, which already owned the pipeline, sold it to the finance company but then leased it back again. The Irish Gas Board did not get its hands on the money for very long because that had to be deposited as security for the rental payments with a company which had a relationship with Barclays. The scheme worked technically because there was a genuine legal sale of the pipe-line on arm’s length terms and, said the Court of Appeal, no artificially inserted steps with no business purpose. There was a business purpose to the payment for the plant: the acquisition of the pipeline. The fact that the only reason for acquiring the plant was for a UK company to obtain capital allowances did not detract from the genuineness of the business purpose.

In the High Court,\textsuperscript{101} Mr Justice Park had not considered this transaction to be standard commercial finance leasing, though he accepted that those devising the scheme would not have seen it as standing apart from the general run of their long standing finance leasing business and he did not regard this as “some sort of unappealing tax avoidance scheme”. The Court of Appeal, on the other hand, thought that the tax advantage obtained was a normal and accepted part of the finance leasing trade, given that the availability of capital allowances provides the bed-rock of that trade. Within this culture of artificiality, how should directors and tax advisers know whether they are being “carried away” as Park J. suggested?\textsuperscript{102} If these eminent judges disagree, it is hard to argue that company directors and tax managers should know whether or not these transactions will be “acceptable” or effective. On what basis are they to decide?

The fact is that the capital allowances legislation is quite deliberately not based on economic reality so that government cannot complain when the leasing industry uses the

\textsuperscript{98} ibid. at p.248. This echoes Lord Steyn in McGuckian [1997] STC 908 at 916, “The new Ramsay principle was not invented on a juristic basis independent of statute”.

\textsuperscript{99} n.20 supra.

\textsuperscript{100} [2003] STC 66.

\textsuperscript{101} [2002] STC 1068.

\textsuperscript{102} ibid. at p.1099.
regime to the full, absent any indication in the legislation that it should not have the advantage of capital allowances in these circumstances. This takes us back to the test of construing legislation according to its parliamentary intention, which is apparently the only one we may apply. In this context, Lord Hoffmann has explained that even where statutory language is to be construed in its commercial sense it is not possible to disregard a transaction simply because it was entered into solely for tax reasons. It was submitted to the Court of Appeal in the Barclays Mercantile case that once a statutory concept had been held to be “commercial” in the sense used by Lord Hoffmann it would be possible to undertake a free-ranging inquiry into a scheme without the constraints of the previous case law. This does not seem to have been Lord Hoffmann’s intention and he engaged in an extensive discussion of the previous cases in MacNiven. Lord Justice Carnwath in Barclays Mercantile rejected the idea that the previous cases could be ignored and reasserted the Ramsay principle, not as a pure rule of statutory interpretation in the normal sense, because it involves “reconstituting” the facts, but perhaps as “statutory interpretation in the broader sense”.

The tax community eagerly awaits the next instalment when the Barclays case reaches the House of Lords but, whatever formulation is delivered, it seems that a central tenet will be the ascertainment of the intention of Parliament. Since this will almost always be in situations which Parliament did not have in mind when passing the legislation in question the key question is how far the court can go in “reconstituting” the facts and making assumptions about what a rational Parliament would have intended had it considered the issue. The case law has not give certainty in answering that question. Judges are used to evolving law but in a tax context in particular because of the historical background and because of the political content they will feel very constrained. No statutory clause could give certainty either: Parliament cannot address every permutation specifically so gaps will remain. But what Parliament could do, and the courts cannot, is to provide a GANTIP which would permit assumptions to be made to fill in the gaps in some situations. Once having been given that permission legislatively, the courts could develop an anti-avoidance strategy which would be based on statutory interpretation in a broader sense. This could legitimately go beyond ordinary statutory interpretation, since the GANTIP would give permission, within limits, so to do. Statutory general anti-avoidance provisions usually introduce purpose tests and concepts of tax avoidance or tax benefit. These concepts are no easier to interpret when contained in a statute than when deriving from case law. But at least when they are contained in statute the concepts are legitimately introduced and the development of them may proceed.

Ingenious though it may be, Lord Hoffmann’s restatement of the judicial approach to tax avoidance is not only short on predictive qualities but also, paradoxically for a rule which purports to be returning to constitutionality as one of statutory construction, potentially more unfettered than the Ramsay principle with its fairly precisely drawn

103 n.6 supra at p.256.
104 n.19 supra at p.91.
105 For example, the Australian, Canadian and New Zealand provisions—see Tax Law Review Committee n.93 supra, Appendix 1.
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perimeters.\textsuperscript{106} This restatement has been widely attacked.\textsuperscript{107} The history of the tax avoidance cases in the UK courts has been a chequered one. Principles have been developed, qualified and possibly dashed to the ground. MacNiven may be qualified to make it more workable in the Barclays Mercantile case but, if left to the courts, it looks likely that there will continue to be movement back and forth without any progressive development of a principle which can sensibly manage tax avoidance activity. This situation, coupled with the new disclosure provisions in the Finance Act 2004, which could produce information about many schemes to the Revenue authorities, could have two possible consequences. First we could see much more specific anti-avoidance legislation to counteract these schemes which the courts are not striking down. Secondly, either in addition or as an alternative, it may be that there will once again be calls for a statutory general anti-avoidance rule, despite the fact that this idea failed to win support from taxpayers, professionals or the Inland Revenue last time it was mooted.

The need for a statutory anti-avoidance principle

Rules and principles

Some would suggest that the only way forward is more specific anti-avoidance legislation. The arguments for this are legitimacy and certainty. Yet certainty will not be achieved in this way. It is self-evident that increased specific provision results in complexity—what the US literature calls hyperlexis\textsuperscript{108}—and the problem of creative compliance.\textsuperscript{109} This produces more litigation and more uncertainty. These observations result in the conclusion that what we need is not more precise and detailed avoidance provisions but a principles or standards approach. Variants of this idea have been suggested by Surrey, Avery Jones, Braithwaite, Weisbach and others.\textsuperscript{110} Some of these writers claim that this approach would result in greater certainty as well as reduced complexity but the claim here is only that the volume of legislation could be reduced and that a more sensible framework for managing tax avoidance could be produced by this route.

There is much jurisprudence on the meaning of principles as opposed to rules and some legal philosophers would deny that there is any logical difference between the two.\textsuperscript{111} For our purposes here the distinction has a valuable role to play provided it is not made to carry

\textsuperscript{106} It is of course these perimeters which threaten to emasculate the Ramsay principle since case law formulations, like statute, can be subject to creative compliance; consequently the judges have repeatedly emphasised that the limits of the principle are not yet known.

\textsuperscript{107} For example, by Lord Templeman “Tax and the Taxpayer” (2001) 117 LQR 575, by Lord Millett in the Hong Kong case of Collector of Stamp Revenue v Arrowtown Assets Ltd, FACV 4 of 2003, December 4, 2003 and by the Court of Appeal in Barclays Mercantile, n.19 supra.


\textsuperscript{109} McBarnet n.67 supra.


\textsuperscript{111} The distinction drawn by R. Dworkin, initially in “The Model of Rules” (1967) 35 University of Chicago Law Review 25, has in any event changed over the years. There is not space here to cite even a small proportion of the literature but a key debate has taken place between Dworkin and J. Raz, n.35 supra. For a comprehensive rejection of principles as defined by Dworkin see A. Marmor, Positive Law and Objective Values (OUP, Oxford, 2001).
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too great a weight of meaning. In particular, the concept of principles is not used here to connote any notion of moral content since it has already been explained that it is not possible for the courts to decide issues of taxation on the basis of morality, without the morality being given legal content.112 In addition, the principle argued for here is a statutory principle, not one derived from case law, although some principles may be derived from case law.113 Braithwaite, looking for the common ground between the various writers rather than the distinctions, defines rules as specific prescriptions, whilst principles are unspecific or vague prescriptions.114 There is debate over whether this is a qualitative difference, or just one of degree. A Dworkonian principle is qualitatively different from a rule: rules are all or nothing, but principles can be weighed against each other. Others have pointed out, however, that rules too may have weight in that one rule may form an exception from another. The term principle is used here, as by Braithwaite, to indicate a provision which is broader than a detailed rule and thus can be used as a guide to interpret the rule.115 In this context, the legislative principle would be a method of signposting; a Parliamentary indication that it was its intention that certain types of gap in its rule making should be filled by judicial decision based on the principles set out.

Ideally, any such general anti-avoidance principle or GANTIP would be accompanied by other gap-filling principles, as suggested by Avery Jones116 and found in other European tax systems.117 In addition, as in those other systems, more liberal use of explanatory memoranda or other descriptive material would be permitted than is the case now in the UK to back up this new approach to tax legislation.118 Expressing the general intention of the legislature in the case of tax legislation is not going to be easy. Prebble has argued that income tax is not based in a priori principle but is a compromise.119 In many cases the aim is simply to raise revenue. But just because the whole of tax law could not be based on high-level principles does not mean that some such principles could not be agreed and it might be an exceptionally good exercise for Parliament and its advisers to at least contemplate whether this was the case. A requirement for a preamble which could be used by judges for the purpose of interpretation might go a long way to clarify parliamentary intention, for example where tax law is being used to provide incentives, as we have seen in connection with the Barclays case. Such a requirement might induce more governmental and Parliamentary reflection on the harmful culture of artificiality described above.

Certainty the wrong test

A general anti-avoidance principle in tax in the UK has not so far been accepted. A major objection has been that such a principle would undermine certainty. Some of the authors discussed here have responded, not unconvincingly, that a system of rules interpreted in accordance with principles could increase certainty. It may be, however, in any event, that certainty is not the right test at the successful/unsuccessful avoidance boundary as

112 This is not, therefore, a true Dworkonian view of principles but is closer to that taken by Raz (Raz n.35 supra 849).
113 Raz, ibid. 852.
115 Raz n.35 supra 839.
117 For example in Spain, see Soler Roch n.34 supra.
118 Going beyond the limited extension of such use in Pepper v Hart [1993] AC 593.
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opposed to the avoidance/evasion boundary, at least if criminal penalties are not involved at the former boundary.\textsuperscript{120} What should take priority is producing a practical system with a fair test which is workable for the compliant majority but not as susceptible to manipulation as would be an entirely certain test, even assuming such a test could be devised.

The Inland Revenue’s proposal for a general anti-avoidance rule (GAAR) in 1998,\textsuperscript{121} which built on a proposal from the Tax Law Review Committee (TLRC) in 1997,\textsuperscript{122} was rejected in some degree for lack of certainty. The TLRC produced a draft clause based on the “evident intention” of Parliament and containing a purpose test as any GAAR or GANTIP would need to do. It also argued that a statutory GAAR would provide a framework in which sensible consequences of the application of the GAAR could be specified in a way that cannot happen with a judicial rule and that proper administrative procedures, such as a clearance mechanism, could be put in place to protect taxpayers. The Inland Revenue’s own proposal tipped the balance away from the careful one constructed by the TLRC, both by redefining the GAAR and by expressing scepticism about clearances. The proposal was abandoned after negative responses from the tax community and when the TLRC could not support the Revenue’s proposal.\textsuperscript{123}

Commenting on the proposals, Philip Gillett, Taxation Controller of ICI, whilst keen to stop the “extreme scheme merchants” thought that unacceptable avoidance was a matter for the courts to determine, “in accordance with the social and political mores of the time”.\textsuperscript{124} Once again, this raises difficult jurisprudential questions of where these mores are to be found. At a practical level, the immediate problem is that the UK courts have not shown themselves willing to evolve a general anti-avoidance principle in a coherent and linear fashion. The majority of judges do not accept that they may do so legitimately and certainly not on the basis of social and political mores. The place for a sensible debate about acceptability and social norms, and how to incorporate them into law, is not in the courts but in Parliament.

Troup, by contrast, objected to the proposed GAAR as shifting responsibility for determination of tax liability away from Parliament and in practice to the Revenue, since it required a body other than Parliament to consider what Parliament would have intended had it considered an issue, which by definition it had not done. In his view a GAAR can never achieve certainty so must always be wrong in principle.\textsuperscript{125} It is for this reason that it may be preferable to talk about a GANTIP, to make clear that certainty is not the claim.

A GANTIP would be drawn up in wide terms and not attempt to define the type of

\textsuperscript{120} See the discussion of certainty above and contrast New Zealand where the \textit{Tax Administration Act 1994} imposes penalties for taking an abusive tax position (one which is based on an unacceptable interpretation of the law) or an unacceptable interpretation (one which, if viewed objectively, fails to meet the standard of being about as likely as not to be correct). Whilst it is understandable that the authorities wish to create a downside and deterrent to tax avoidance activity, here the fuzziness around these concepts may represent a deficit in the law. There is extensive revenue guidance available—which this is an adequate substitute for clear legislative guidance in these circumstances is for discussion. (Thanks to Shelley Griffiths of University of Otago for this information.)


\textsuperscript{122} n.93 \textit{infra}. The author was a member of the TLRC which agreed this report, although she did not work directly on this project as a researcher or writer.

\textsuperscript{123} TLRC, \textit{Response to Inland Revenue} (IFS, London, 1999).

\textsuperscript{124} P. Gillett [1999] BTR 1.

\textsuperscript{125} E. Troup [1999] BTR 5. He accepted, though, that principles must be subject to pragmatism.
transaction that would be struck down in a detailed way. One of the problems with the TLRC illustrative provision and the Inland Revenue’s own version was that they became too detailed and the debate quickly focused on the precise wording rather than deciding on the object of the exercise. The TLRC provision attempted to replicate the Ramsay rule in some respects with a concept of steps that was unnecessarily complex. It is notable that the Australian GAAR does not attempt this level of detail or precision and has met with some success.126 It contains a purpose test and indicia of purpose are listed.127 As Orow explains, one suggestion for an improvement of the Australian GAAR coming from the Ralph Committee was to propose a clause clarifying that the rule should be exercised in a manner consistent with and supportive of the tax policy principles embodied in other provisions of tax law, such as the availability of an election.128 A UK GANTIP might contain a purpose test and a direction to consider what Parliament would have intended within the scheme of the legislation had it considered the scheme before it. This, coupled with use of background papers and improved preambles and statements from Parliament about the rationale of legislation would give guidance to the courts in going beyond the wording of the legislation but always within the rationale of the legislation. Troup says that to look beyond what Parliament actually intended raises constitutional issues but this is the very point of the GANTIP. If we are currently facing a crisis of legitimacy and if the courts cannot or will not counteract the literal meaning of a statute by reference to an overriding legal principle they have created themselves, only a statutory GANTIP could remove this constitutional objection. Under a GANTIP, Parliament gives express permission for its intention to be constructed (within the overall scheme of the legislation) where there is scheme which is carried out for the purpose of obtaining a tax benefit. This is not removing responsibility from Parliament but ensures that Parliamentary will can be carried forward in a practical way and without undue delay. The GANTIP would not permit the Revenue or courts to go beyond what could be justifiably discerned or established would have been the intent of Parliament129 but would provide a legitimate framework in which the courts could operate to work out what Parliament would have intended.

GANTIP: altering norms and a framework for development

By expressly qualifying the current governing principle (that a taxpayer is always free to order his or her affairs so as to reduce the tax payable provided he keeps within the letter of the law, construed according to some level of purposive construction) a statutory GANTIP could begin to alter norms of behaviour and provide the necessary legal backing to the notions of morality now gathering around the corporate social responsibility debate.130 This would assist taxpayers wishing to be compliant to read the signals as required by Parliament and company directors to balance their duties to shareholders and to contribute to revenues.

There will be no deficit in the rule of law if the area of uncertainty is one that does not

126 See Tiley in this issue. The legislation has been extensively criticised in Australia and see Orow in this issue but it would be a reasonable starting point for a feasibility study as it does appear to have altered the mindset of practitioners in that jurisdiction.
127 For the provisions see TLRC n.supra, Appendix 1 (Pt IVA).
128 Orow in this issue at p.420.
129 This is the formulation of the TLRC but with the words in italics added by the author: TLRC n.93 supra, para.5.12.
130 Weisbach n.72 supra, 886. This has not been achieved by the new disclosure rules because they have a different, and possibly somewhat confused, function.
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affect day-to-day transactions and is governed not by arbitrariness131 but rather by procedures that attract the support of the compliant members of the tax community. By being associated with appropriate mechanisms such as clearances and codes of guidance, a statutory GANTIP could provide a legitimating framework to enable inevitable uncertainty to be managed. It would facilitate a debate around the meaning of the difficult concept of tax avoidance which could be pursued between the taxpaying community and revenue authorities in agreeing the guidelines,132 although ultimately it would be for the courts to develop the GANTIP. We have seen excellent co-operation between the taxpaying community and revenue authorities in formulating the 2004 disclosure rules and a similar process could result from a GANTIP. This is what Black has called the development of an interpretative community and the adoption of a conversational model of regulation.133 The advantage to the taxpayers, as well as their reputations and a climate of understanding, would be that those who were not “amoral calculators” could, by working with government and non-governmental organisations, get a competitive advantage over those who were, by participating in the formation of the codes or guidance.134 The advantage to the revenue authorities would be the voluntary compliance of the majority within an area of understanding, leaving them free to tackle the extreme cases.

Conclusion

This suggestion for a broad GANTIP is likely to be greeted by a horrified response as unworkable and contrary to the rule of law but it has been argued here that whilst the boundary between evasion and avoidance should be strengthened, with the revenue authorities resisting the temptation to blur it, the area of tax avoidance would be best dealt with by a broad principle. This principle should provide a counterbalance to the principle in the Duke of Westminster’s case and to that of profit maximisation. It should provide legal content to the corporate social responsibility concerns about tax avoidance which cannot be supported by morality alone.

The current approach to tax avoidance cases may suit those devising schemes at present: many cases have been decided in favour of the taxpayer recently. It is quite unclear where the MacNiven approach will take us, though, so no one can be secure that the present position will last. The new disclosure rules may flush out some information and act as a minor deterrent for a while and they may also provide a protective mechanism for some who consider their activities to be within the bounds of what is acceptable. But if the new disclosure provisions do produce significant information for the revenue authorities about new schemes, further legislation of some kind is to be expected. The question of a general anti-avoidance provision needs revisiting and should not be dismissed simply because it was rejected previously. The wrong tests were applied then. A GANTIP should be considered and judged as a legitimating and regulatory device and not an exercise in precision rule-making.

131 Endicott, n.5 supra, 203.
133 Black, Rules and Regulators n.50 supra.
INTERPRETING TAX STATUTES: TAX AVOIDANCE AND THE INTENTION OF PARLIAMENT

I. INTRODUCTION

There are very few tax cases known to the wider legal community but Ramsay is one of them. In 1982, the Ramsay case seemed to herald the introduction in the United Kingdom of a judicially-developed “new approach” to counteract tax avoidance schemes. For a time it seemed that this new approach was firming up into a judicial doctrine or at least a principle attempting to counter tax avoidance. Now, in a series of cases leading up to and including Barclays Mercantile Business Finance Ltd v Mawson (“BMBF”), doubt has been cast upon whether there is or ever was such a judicial principle in the United Kingdom. Arguably though, as will be discussed below, the House of Lords applied the principle in the Scottish Provident case on the very same day that it denied it.

The first part of this article examines whether there is any content to the Ramsay approach following the decision in BMBF. If it is now nothing more than an application of general rules of statutory interpretation, there must be a serious question about the adequacy of the judicial approach to counter tax avoidance. The development of the UK case law over the last 25 years has not been impressive. It has failed to produce a clear framework for dealing with tax avoidance cases, with the result that an increasing amount of specific anti-avoidance legislation is necessary, coupled with extensive disclosure requirements, which have to be followed up regularly by yet more specific provisions. Distinctions have been introduced into the cases only to be found to be unsustainable. Attempts have been made to distinguish tax avoidance from tax mitigation, but...
subsequently rejected as unhelpful. The judiciary are limited by the tools at their disposal and the poor state and nature of tax legislation. If the only available test is whether specific legislation is effective to achieve the intention of Parliament, then everything rests on the nature and quality of that specific legislation. It is argued here that there is still some life in the Ramsay approach to composite transactions, and even that there is an element of seeking economic substance in this approach, despite denials by the courts to the contrary, but that the lack of transparency about when a composite transaction will be found to exist renders the current law unsatisfactory.

The second part of the article examines the problem of ascertaining the intention of the legislature in tax cases, and observes the striking similarities, but also the differences, in the way in which the issues have developed from different juridical backgrounds in the United Kingdom, Canada, Australia and the European Court of Justice ("ECJ"). In the Halifax case, the ECJ has applied to VAT the principle that Community legislation cannot be extended to cover abusive practices. Some jurisdictions have statutory general anti-avoidance rules ("GAARs") but these have met with varying degrees of success and much criticism. Against this background, this part of the article considers to what extent, if at all, a statutory general anti-avoidance principle, or set of principles, might assist with the problems of statutory interpretation in the United Kingdom. The proper way to ascertain the intention of the legislature is at the heart of the debate on tax avoidance and this is an area which is developing rapidly in the United Kingdom as a result of developments in other areas. Statutory interpretation may be the process of discovering parliamentary intention, but this intention, never a straightforward concept, is especially difficult to ascertain in tax legislation, where complex legal concepts are often used to achieve economic ends. A standard, though not uncontentious, definition of tax avoidance is "a course of action designed to conflict with the evident intention of Parliament". The limits of this

7 Lord Hoffmann stated in Westmoreland, above, fn.2, at [62]: “when statutory provisions do not contain words like ‘avoidance’ or ‘mitigation’ I do not think it helps to introduce them. The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory language to the facts of the case. It is not a test for deciding whether it applies or not”. The language of avoidance and mitigation is discussed and defended in J. Kessler, "Tax Avoidance Purpose and Section 741 of the Taxes Act" [2004] B.T.R. 375.

8 Halifax Plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v Commissioners of Customs and Excise (Case C–255/02) [2006] S.T.C. 919.


definition are apparent immediately. As many commentators have pointed out, if the legislation does not have a coherent policy rationale, judges cannot be expected to remedy the situation and neither can a GAAR do so.\textsuperscript{11} Whilst a GAAR cannot be expected to fill the gaps left by poor policy making, it is argued here that a GAAR which comprises a number of principles, including, but not limited to, directions about the significance of economic substance and of the manner of carrying out a scheme, may be able to operate, in conjunction with new approaches to legislation, to support the judiciary better in their task of statutory interpretation.

The third and concluding part of the article considers whether the difficulties experienced in the United Kingdom and elsewhere in ascertaining the intention of the legislature in a tax context could be mitigated by special legislative mechanisms which could declare or signal principles of taxation law as set out by Parliament. The operation of paramount provisions which overlay other legislation such as those under the Human Rights Act and in European Community Directives, may point the way forward here.\textsuperscript{12} Parliament may need to indicate its intentions by layered legislation, with detailed specific provisions being overlaid with principles. The UK judiciary has shown a recent willingness to embrace this new approach to statutory interpretation. As can be seen from jurisdictions where there is a GAAR, however, the interaction between legislative principles and specific rules has to be spelt out carefully if it is to achieve its intended result.

II. IS RAMSAY DEAD?

Following the decision in \textit{BMBF}, Lord Hoffmann commented that:

“The primacy of the construction of the particular taxing provision and the illegitimacy of rules of general application has been reaffirmed by the recent decision of the House in [\textit{BMBF}]. Indeed it may be said that this case has killed off the Ramsay doctrine as a special theory of revenue law and subsumed it within the general theory of the interpretation of statutes . . .” \textsuperscript{13}

This raises a number of questions. First, was the Ramsay doctrine ever a special theory of revenue law or was it always simply an application of statutory construction? Secondly, if there ever was a special rule for tax statutes, what remains of this? Thirdly, how might the judicial approach

\textsuperscript{11}For a very clear expression of this view see M. Gammie, “\textit{Barclays and Canada Trustco: Further Comment from a U.K. Perspective}” (2005) 53 Can. Tax J. 1047.


to tax avoidance develop in the future in the light of BMBF and other recent case law in the United Kingdom and at ECJ level?

An analysis of the voluminous literature spawned by the Ramsay line of cases, much of it written by those who were also arguing or deciding the case law, reveals deep concerns, not a little disingenuous reasoning, and very little progress over the years.\(^{14}\) Many problems were encountered as the case law unfolded: all predictable and predicted.\(^{15}\) Whilst the problems were predictable, the outcome of cases involving tax avoidance schemes remains unpredictable at the margins.

\(\text{(a) The uneasy creation of a new approach.}\)

The description of Ramsay as a new approach was not an invention of the commentators. Whilst Lord Wilberforce was clear in the House of Lords in Ramsay that he was not introducing a new principle he did not hide his view that the judicial approach to tax avoidance was developing. He linked this development specifically to the requirements of dealing with new tax avoidance techniques, stating, “While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still.”\(^{16}\)

Lord Wilberforce was explicit that the new approach respected established principles. He emphasised, in particular, that a subject is to be taxed only on clear words and not on “intendment” or on the “equity” of an Act. What are clear words, however, is to be ascertained on normal principles and these do not confine the courts to a literal interpretation. Further he reiterated the well-known Duke of Westminster\(^{17}\) “principle” that a subject is entitled to arrange his affairs so the tax attaching under the appropriate Acts is less than it otherwise would be. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. Lord Wilberforce also stressed that the fact-based distinction between a sham and a genuine transaction remained unchanged after the Ramsay decision.\(^{18}\) Most significantly for


\(^{15}\)Tiley, fn.14 above; Millet, fn.14 above.

\(^{16}\)Ramsay, fn.1 above, at S.T.C. 181.


the purposes of the discussion in this article, Lord Wilberforce relied upon previous case law, such as *Chinn v Collins*,¹⁹ to justify the application of the legislation to a series or combination of transactions, intended to operate as such.²⁰ In *Chinn v Collins* the Special Commissioners had decided that there was never any possibility that the appellant taxpayers would not proceed from one step to another of a multi-step scheme. Based on these findings and also “its own analysis in law”, the House of Lords in that case reached the conclusion that the court could examine the scheme as a whole and should not be confined to a step-by-step examination. The emphasis that Lord Wilberforce puts on this being a question of law, a point developed in later cases as we shall see, arises from the treatment in *Chinn v Collins* of the construction of the documentation setting out the scheme as a question of law.²¹ It is not the statute that is being construed here, but the nature of the transaction. As Lord Wilberforce states:

> “It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or tax consequence and if that emerges from a series or a combination of transactions, intended to operate as such, it is that series which may be regarded.”

In this approach to construction of documents lies the seed of what might be thought to be a judicial doctrine going beyond statutory construction.

Subsequently, in *IRC v Burmah Oil Co Ltd*, Lord Diplock confirmed the judicial view that a development of the jurisprudence was taking place, stating that *Ramsay*’s case marked a significant change in the approach adopted by the House of Lords to a pre-ordained series of transactions, a process which continued with the decision in *Furniss v Dawson*.²²

At this point there appeared to be a *Ramsay* “approach” which required the court to ascertain the legal nature of the transaction to which it sought to attach tax or a tax consequence by looking at a series or combination of transactions intended to operate as such rather than in isolation from each other (known as a “composite transaction”). The statute in question was applied to this new type of analysis of the transaction or series of transactions (this analysis itself being a question of law). The net result depended upon this combination of statutory construction and the special analysis of the composite transaction. This seems to be a judicially-created

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²⁰The other cases relied upon were *Floor v Davis* [1978] Ch. 295 (dissenting judgment of Eveleigh L.J. in the Court of Appeal); *IRC v Plummer* [1980] A.C. 896.
²¹See particularly Lord Russell in *Chinn v Collins*, fn.19 above, at [8]. For further discussion of whether the nature of a contract is a question of law see *Moore v Garwood* (1849) 4 Exch. 681 discussed by Lord Hoffmann in *Carmichael v National Power Plc* [1999] 1 W.L.R. 2042, HL; and see also the further discussion at fn.74 below.
rule of construction that requires the analysis of the transaction as an indivisible whole in given circumstances. Generally,

“the meaning of a word within a statute is a question of law which it is for the judge to determine, but how that word applies to a particular situation may simply be a matter of common sense or ordinary usage which the courts will treat as a question of fact.”

In the Ramsay cases, however, according to Lord Wilberforce, the meaning of the word is bound up with its application to the facts in a way that makes that application a question of law also. This might have been derived initially from the construction of the documentation as a matter of law but seems then to take on the look of a more independent principle, related to the nature of multiple-step transactions rather than to the particular documentation in question. It does not seem to be “anchored in the meaning of the statute”. The alternative view, which, as we shall see, is expounded by the House of Lords in the most recent cases, is that the Ramsay approach was never anything more than an application of the normal rules of statutory construction.

Whether or not Ramsay ever did contain some elements of an independent rule, it is correct to say that Ramsay did not develop into a business-purpose doctrine along the lines of the US doctrine and was not intended to do so by its creators—counsel or judiciary. Such a doctrine requires that taxpayers have a reason other than the avoidance of taxes for undertaking a transaction or a series of transactions if their actions are to be tax effective. In an article published in this Review shortly after the decision in Ramsay, Mr Peter Millett Q.C. (now Lord Millett), who had appeared as counsel for the Crown in that case, claimed that the fact that the transactions in question were entered into with the sole motive of obtaining a tax advantage formed no part of the ratio of the American cases cited to the House of Lords in Ramsay—these were not business-purpose doctrine cases. In any event, he explained, these

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25 A phrase taken from Lord Hoffmann, who argues that the US “business-purpose rule” is not anchored in the meaning of the statute: above, fn.13, at 199.

26 See McGuckian, Westmoreland and BMBF, above, fn.2.

27 A.G.J. Berg, “Avoidance Schemes after Craven v White” (1989) I.B.L. 45 wrote 16 years ago that the so-called Ramsay principle was nothing but one of statutory interpretation and, as such, was as relevant to legislation in other fields as it was to tax law.


30 Above, fn.14. The cases were especially Knoetsch v United States 364 U.S. 361 (1960) (the sham transaction doctrine, which differs substantially from the UK notion of sham) and Gilbert v Commissioner (2007) 123 L.Q.R., JANUARY © SWEET & MAXWELL AND CONTRIBUTORS
US cases were not cited as binding or persuasive authority but only for the purpose of demonstrating the kind of reasoning that might be applied “from principles accepted in England.”

Ramsay was also not intended to introduce a substance over form doctrine, enabling the courts to bypass the language of the statute to look at the economic consequences of a transaction, despite the fact that such a doctrine exists in the United States, but the case illustrates the confusion that can be created by referencing cases from other jurisdictions in the context of our rather different system. The dangers seem even greater when there is neither comprehensive discussion nor explanation of the extent to which they are supposed to apply, as was the position here. Mr Millett knew that the hare he had set running might not go in quite the direction he had expected. He argued that the ratio decidendi of Ramsay was that

“where the taxpayer claims to have entered into a transaction which is incapable of appreciably affecting his financial position except to give rise to a reduction of his tax liability, it is to be disregarded.”

In his view, this ratio was reached through statutory construction. Following the American Gilbert case, upon a fair construction of the taxing statutes “we cannot suppose that it was part of the purpose of the Act to provide an escape from the liabilities it sought to impose”. This suggested ratio was, perhaps, an expression of hope rather than actuality and proposes a wide view of statutory construction which others can be forgiven for having read as an overriding principle. Mr Millett was aware of the dangers of this and was open about his concern that the House of Lords had actually gone further than he had proposed they should, and “in doing so created difficulties which are likely to perplex taxpayers, their advisers and the courts for some time to come”. This should not have surprised him, given the route he had taken in argument. In Ramsay, both Lord Wilberforce and Lord Fraser of Tulleybelton expressly approved the dissenting view of Eveleigh L.J. in the earlier case of Internal Revenue 248 F 2d 399 (1957) (economic substance doctrine). In addition to these two doctrines, the courts use the business-purpose doctrine, the substance over form doctrine and the step-transaction doctrine. These are not always treated as distinct doctrines. For a detailed discussion of the current US case law, see “IRS Audit Technique Guide on Abusive Tax Shelters and Transactions” (2005) TNT 102-14; for recent developments, see K.C. Burke, “Black & Decker in the Fourth Circuit: Tax Shelters and Textualism” (2006) TNT 74-28; C. Tandon, “Senior IRS Officials Tout Tax Shelter Victories” (2006) TNT 179-1.

31 Gregory v Helvering 293 U.S.465 (1935), which, according to Streng and Yoder, above, fn.29, was probably the origin of the business-purpose doctrine in the United States, was not referred to in the opinions in Ramsay.


33 Above, fn.14, at 222.

34 Gilbert, above, fn.30.
Floor v Davis, 35 which could be argued to be based on the American step-transaction doctrine. 36 Mr Millett considered it unsatisfactory that their Lordships did not give their reasons for denying all legal effect to the intermediate steps within the Ramsay arrangements, as distinct from merely construing them in their context as part of an indivisible whole. So, having opened Pandora’s box, Mr Millett wanted to close it again. This may have happened now, but not before causing considerable confusion.

Subsequently, Lord Brightman, in Furniss v Dawson, 37 developed his well-known formulation of the Ramsay principle, which referred to business purpose, although not on the same lines as the American business-purpose doctrine. For the principle to apply, he stated:

"First, there must be a pre-ordained series of transactions or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end . . . Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of liability to tax—not ‘no business effect’. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied."

It should be noted that even in this strong formulation of the “principle”, lack of business purpose alone was not enough to remove the effectiveness of a tax avoidance scheme and all was said to depend upon the wording of the statute. The precision with which this formula is spelt out, however, does suggest the existence of some kind of judicial rule going beyond statutory construction. Lord Oliver recognised this extra-judicially. 38 In his view Ramsay and Furniss did introduce a principle, imported from the United States, and it was a dangerous and insidious type of fiction

"for it poses as an exercise in statutory construction, when in fact it is nothing of the sort. The construction of the statute is not in doubt. The court construes it according to its terms and finds that, so construed, it enables tax to be saved or minimized. It then assumes a parliamentary intention that the steps which Parliament has enjoined or authorized for the saving or minimizing of tax shall not be effective if they are carried out for that purpose but are only to be effective if carried out for some other ‘legitimate’ business purpose. This is not construction. It is legislation in an area in which Parliament itself has

35 Above, fn.20.
36 Above, fn.30.
37 Above, fn.22.
38 Lord Oliver, above, fn.14.
not thought it right to legislate and thus, in my view, it steps outside the judicial function.”

Lord Oliver had done his best on the bench in Craven v White\textsuperscript{39} to limit this principle and to declare that it was in truth a rule of statutory construction, but in this article, written some five years later, he was still clearly concerned that this was not really the case. The constitutional propriety of a judge-made rule was his primary objection. Ironically, Lord Oliver’s attempt to limit the principle, by adding further conditions to what was required to constitute a single indivisible composite transaction, made the principle look even less like a rule of construction and more like a judicial doctrine than previously, especially when it is remembered that the House of Lords in Ramsay had said that what amounts to a composite transaction is a question of law.\textsuperscript{40} Subsequently, though, further judicial voices were added arguing that there is no Ramsay principle beyond a doctrine of statutory construction. This path has led us to BMBF.\textsuperscript{41}

(b) The destruction of the new approach?

The reinterpretation of some of the older cases as being based purely on statutory construction involves a certain amount of revisionism.\textsuperscript{42} In his extra-judicial writing, Lord Hoffmann has admitted, with characteristic frankness, that:

“In choosing the constructional approach rather than the Furniss v Dawson formula, the House had to rewrite history in a way that struck some people as a little disingenuous.”\textsuperscript{43}

Lord Hoffmann admitted that in Furniss v Dawson Lord Brightman stated “the principle in general terms which contain no mention of the statutory language”,\textsuperscript{44} although, as we have seen above, Lord Brightman did make reference immediately after his formulation of the principle to the terms of the taxing statute. As Lord Hoffmann noted himself in Westmoreland, the spelling out of conditions requiring a pre-ordained, circular, self-cancelling transaction with a step or steps having no commercial purpose other than the obtaining of a tax advantage looks very much like an overriding legal principle superimposed on revenue law.\textsuperscript{45} The Law Lords in Westmoreland rejected this as a principle and described it as “no

\textsuperscript{40}As discussed above.
\textsuperscript{41}IRC v McGuckian, above, fn.2; Westmoreland, above, fn.2.
\textsuperscript{42}Ballard and Davison, above, fn.28, at 578.
\textsuperscript{43}Lord Hoffmann, above, fn.13. For a response to Lord Hoffmann, highlighting where there has been some “re-interpretation” of the basis of case law, see B. Staveley, “The Quest for the Allowable Loss: Reflections on Lord Hoffmann’s Approach to Ramsay” [2005] B.T.R. 609.
\textsuperscript{44}Lord Hoffmann, above, fn.13, at 200.
\textsuperscript{45}Westmoreland, above, fn.2, at [29].
more than a useful aid", 46 much to the chagrin of the by now retired Lord Templeman, who responded in this Review that the “considered pronouncements of an eminent generation of modern Law Lords applying principles to tax avoidance schemes” could not be so downgraded. 47

In Westmoreland, having used his impressive powers of analysis to explain away the previous cases on the basis of statutory construction, Lord Hoffmann then arguably fell into the same temptation to state general rules as had some of his predecessors. He rejected the Brightman formula but appeared to be creating a new legal principle: a distinction between commercial and juristic concepts. Any attempt to apply this as a method of classification a priori would have been the very negation of purposive construction, as was “explained” in BMBF, and the distinction was soon abandoned. 48 In practice this was simply a way of stating that in some circumstances, economic substance should override legal form, but given that their Lordships have never considered themselves to have the power to introduce such a rule, it could not survive and Lord Hoffmann’s formulation contained insufficient guidance to be workable in any event.

The latest instalment of the long-running tax avoidance saga in the House of Lords contains a somewhat exasperated expression of annoyance with revenue lawyers from their Lordships. The Appellate Committee of the House of Lords in BMBF, delivering a joint opinion, complained that all attempts at clarification of the “principles of construction” applied in Ramsay appear only to have raised fresh doubts and further appeals. 49 The Committee accepted that it was not going to be able to remove all difficulties in the application of these principles, because it is in the nature of questions of construction that there will be borderline cases about which people will have different views, but it expressed the hope that it would achieve some clarity about “basic principles”. 50

It is questionable whether their Lordships have achieved their expressed aim of clarification in BMBF and in the accompanying opinion in Scottish Provident. Despite their intention of producing clarity it should be noted that their Lordships do not purport to be aiming at certainty. For obvious reasons, certainty, in the sense of a precise road map for those designing tax avoidance schemes, would not be desirable. 51 What is needed is clarity

46 ibid., per Lord Nicholls at [8].
47 Lord Templeman, above, fn.14, at p.582.
48 BMBF, above, fn. 2, at [38]. Lord Templeman, thought this distinction reflected “ingenuity but no principle” (above, fn.14, at p.584) whilst in Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] HKCFI 46; (2004) 1 H.K.L.R.D. 77, Lord Millett observed that the attempted introduction of these concepts had led to an “arid debate”.
49 At [26].
50 At [27].
in the sense of knowing the principles to be applied and their constitutional source and authority.

The central claim of the House of Lords in BMBF was that the Ramsay case simply rescued tax law from “some island of literal interpretation” and brought it within generally-applicable principles.52 According to this view, the “new approach”, introduced with such a fanfare by the House of Lords in Ramsay, was merely the process of bringing tax law into the fold and aligning it with other areas of the law. The implication of this is that the area of taxation requires no special treatment, and can be dealt with by the legislature and the courts in the same way as any other topic of legislation. This is a questionable assumption in view of the complexity and artificiality of the tax system itself, its use for a multiplicity of objectives and the amount of financial advantage that can be at stake in tax cases.53 Tax law also combines the use of legal and economic concepts in a way that makes interpretation very difficult. Given the layers of conceptual difficulty in the area of tax legislation and the problems with ascertaining the objectives of this legislation, the burden placed on normal rules of statutory interpretation, and the challenge posed to the Parliamentary draftsman, are very great indeed if there are no special rules or doctrines to assist the courts.54

The issue in BMBF was whether expenditure was incurred on a pipeline so as to enable a finance company within the Barclays group (“BMBF”) to claim capital allowances for tax purposes. This highlights the question of whether the legislation was intended to reflect economic substance or whether there had been expenditure merely in a narrower sense of money paid out. Lord Hoffmann might have described this latter as the legal sense of the word had he not had to retract his analysis in Westmoreland in the face of criticism. The conclusion of the House of Lords was not altered by this change of approach, however. The facts were complex and the degree to which this complexity was the result of commercial considerations, and how far it was for tax planning purposes was disputed.55 The taxpayer lost both before the Special Commissioners and in the High Court56 but won decisively in the Court of Appeal and House of Lords. The facts given here are of necessity a simplified version. The Irish Gas Board, which already owned the pipeline, sold it to BMBF but then leased it back back

52 BMBF, HL, above, fn.2, at [33] citing Lord Steyn in McGuckian, above, fn.2, S.T.C. at 915. The Ramsay approach was indeed applied in non-tax cases, for example, Gisborne v Burton [1989] Q.B. 390 (Ralph Gibson L.J. dissenting).
54 For an example of the problems encountered see below, fn.96.

again. The Irish Gas Board did not have control of the purchase money because the agreement required that sum to be deposited as security for the rental payments with a company that had a relationship with Barclays. There was a genuine (not sham) legal sale of the pipeline between arm’s length parties.57

In the Court of Appeal it was held that the fact that the essential purpose of the arrangement was to obtain a tax advantage in the form of capital allowances did not detract from the genuiness of BMBF’s trading purpose as a leading finance company.58 Although finding for the taxpayer, Carnwath L.J. made it clear that he viewed the Ramsay principle as something more than a “pure rule of statutory interpretation in the normal sense” because, in his view, under Ramsay the transactions are “reconstituted” for fiscal purposes (though not for other purposes).59 This takes us back to Mr Millett’s complaint about the Ramsay decision. He did not wish the House of Lords to reconstitute the facts in this way, but this did not prevent them from doing so in Ramsay and other cases, and it takes a sleight of hand to explain this away as the consequence of statutory construction. It is the legal analysis of the facts that is key to the final determination in these cases. Like Lord Oliver, Carnwath L.J. interpreted Ramsay as a principle in order to give it a narrow, rather than a wide, application. The House of Lords achieved the same practical result but by the different route of arguing that to apply Ramsay was to apply normal rules of statutory construction.

When BMBF reached the House of Lords, their Lordships, in a single opinion delivered on their behalf by Lord Nicholls of Birkenhead, commented that it was going too far to suggest that transactions or elements of transactions with no commercial purpose were always to be disregarded for tax purposes. There are two steps to the question: first, on a purposive construction, what transaction will answer to the statutory description? Secondly, does the transaction in question do so? This is a very interesting difference in reasoning from that of the Court of Appeal. There was in the opinion of the House of Lords in BMBF no attempt to justify the inserted steps in terms of policy, they are simply said not to be relevant to the application of the capital allowances provisions in this case.60 This is wholly dependent on the way in which the transaction is analysed. Here, the analysis of the House of Lords was that the relevant legislation was concerned entirely with acts of the lessor. The Act said nothing about what the lessee should do with the purchase price or how he should find the money to pay the rent. All that mattered here was that there

57See above, fn.18.
58BMBF, CA, above, fn.23, at [54].
59Ibid., at [65].
60Contrast [32] in the CA with [42] in the HL.
was expenditure by BMBF on the pipeline, and all the other payments and steps were “happenances” and not necessarily elements in creating the entitlement to the capital allowances. That these other elements introduced a circularity into the arrangements was therefore irrelevant. They were not included in the “scheme” so as to enable the statute to apply to the overall result rather than the expenditure itself. The legislation applied and the capital allowances were available. This was based on an analysis of the transaction on which the House of Lords felt able to overturn the Commissioners. It was a question of law, as in Ramsay, how the facts should be interpreted, but it was a view based not only on documentation but also on the view taken of the surrounding circumstances which, on the facts here, the House of Lords took to mean that the expenditure in question should be viewed in isolation and not as part of a composite transaction.

(c) The re-emergence of a principle?

Although the decision in BMBF is presented as being entirely a decision on statutory interpretation, it is arguable that the decision-making process involved more than that. Crucial to the decision was a question of law, unrelated to the wording of the statute: whether there was a composite transaction. This is more readily appreciated by reviewing the contrast between the approach of the House of Lords in BMBF and in IRC v Scottish Provident Institution (hereafter Scottish Provident)61 in which an Appellate Committee of the House of Lords of exactly the same composition gave its opinion on the same day. The House of Lords considered that the proper interpretation of the transactions in question was a question of law in each case and thus reversible by the higher courts. They decided to reverse the court of first instance (the Special Commissioners) in each of these cases. Whilst in Ramsay, based on Chinn v Collins,62 the question was treated as one of law because it was an issue about the proper construction of documents, in these two later cases, as will be explored further below, the House of Lords take the view that it is the characteristics of a composite transaction that are a question of law and these characteristics must be viewed “realistically”. On one interpretation, this comes close to being a decision to examine substance and not form in certain circumstances but not others. Their Lordships, however, presented the case as being purely one of statutory construction in the sense of how the statute should apply to this composite transaction, once it was held to exist.

The line drawn by the House of Lords between BMBF and Scottish Provident in holding that in one case there was a composite transaction

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61 Above, fn.3.
62 Above, fn.19.
to which the statute applied, whilst in the other there was not, has been regarded as obviously “correct” by most practitioners and other commentators, but it is worth noting that this view of the correctness was not so obvious to the experienced Special Commissioners of taxation in each case and to the High Court judge in BMBF, Mr Justice Andrew Park, who was a highly respected member of the tax Bar throughout his career as a barrister, all of whom decided these cases differently from the House of Lords. In practice, it was critical to the success of the taxpayers in BMBF at both Court of Appeal and House of Lords level that capital allowances were widely known to be key drivers of the finance leasing industry. This made it more difficult to argue that the result for which the taxpayer contended was outside the policy and intention of the legislation, although it is interesting that Park J. thought that the “overall transaction was not ‘standard commercial finance leasing’ at all”.

The Court of Appeal in BMBF linked its line of policy reasoning to whether there was a commercial purpose to the transaction as a whole. The House of Lords, on the face of it, took a much narrower view of the policy aspects, looking only at “what the statute actually requires” through its wording—that is that capital expenditure “be incurred”. This, however, depended entirely on deciding that the surrounding events were not relevant because they were not necessary elements in creating the entitlement to the capital allowances. These surrounding events could have been construed differently. Park J. said in the High Court that expenditure was not incurred on a pipeline but rather on the creation of a complex network of agreements. In practice what resulted in the House of Lords analysing the transactions as they did was their view of the broader background policy. Had they believed that the circularity of the scheme was relevant, they would have analysed the transaction as a composite whole. The reason they did not do so related to the nature of the scheme, not the statute. This goes further than pure statutory construction, even of a purposive nature, since the outcome of the application of the statutory words depends upon this special style of transaction analysis and not just a reading of the wording in the statute. Whatever they might have said

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63See for example M Gammie, above, fn.18, writes, “In BMBF, the question was did the taxpayer incur expenditure to acquire these assets? The answer was obviously yes; where he got the money to acquire them and what the vendor did with it afterwards was irrelevant to the statutory questions. In Scottish Provident, the question was whether these were the type of contracts that parliament had in mind? The answer was no.” It is easy to state the question so that the answer is “obvious”, but much depends upon the way the question is posed.

64Significant changes have been introduced in s.81 of and Sch.8 to the Finance Act 2006. In effect, this legislation looks at substance rather than form; something that the House of Lords considered would run counter to the intention of the previous legislation. The new disclosure provisions, above, fn.4, specify leasing to be a hallmark that requires disclosure in some circumstances.

65BMBF, HC above, fn.56, at [47].

66BMBF, above, fn.2, at [39].

67BMBF, HC above, fn.56, at [58].
about the need for a closer analysis of what the statute actually requires, it was a close analysis of the transaction that gave them the result they reached. They admitted as much in quoting Ribeiro P.J. in Arrowtown, who stated:

“The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.”

Viewing the transaction “realistically” allowed the House of Lords to bring in wide policy considerations in deciding whether to look at economic substance. This meant looking beyond the wording of the statute and accepting the evidence of the taxpayer about what constituted “the ordinary trade of finance leasing.”

That this approach amounts to more than purposive construction can be seen even more clearly in Scottish Provident, where the House of Lords found that a scheme entered into by the taxpayer (“SP”) was ineffective for tax purposes. The taxpayers were attempting to use the transition to a new legislative regime, which was being introduced to tax derivative contracts based on gilts and bonds on which gains and losses had previously not been taxable. The scheme was designed to take advantage of this transition and had no other purpose. If effective, it would achieve a non-taxable gain and an allowable income loss. Under the scheme, SP granted to Citibank (the bank which devised the scheme) an option to buy gilts at a price representing a heavy discount from market price in return for a correspondingly large premium. This was not taxable as a gain under the old system. After the new tax regime came into force, Citibank exercised the option and SP had to sell the gilts at a loss, which under the new system was allowable for tax purposes. Commercially the transactions would cancel each other out, subject to price movements in between the times of the two transactions. In tax terms there was a loss and no gain. Had the parties been content with that, they might well have succeeded in “sailing through the gap”, according to their Lordships.

There remained, however, a commercial risk of a real loss or profit if prices fluctuated during the currency of the option. Thus Citibank’s option was matched by a grant by Citibank to SP of an option to buy the same amount of gilts (the SP option). This was designed to remove the risk of a real gain or loss if prices changed. The figures had to be carefully worked out for the scheme to work; the options could not just match or they would cancel each other out and the purpose of the scheme would

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68 Collector of Stamp Revenue v Arrowtown Assets Ltd, above, fn.48.
69 BMBF, above, fn.2, at [36].
70 ibid., at [41].
71 Scottish Provident, above, fn.3, at [26].
not be achieved. The SP option price was also made close enough to the market price to allow for some possibility that it would not be exercised.

This second option was a form of risk management, much like the deposit in BMBF. It could have been construed as “happenstance”, as was the deposit in BMBF. The operation of the tax scheme was not dependent on the grant of the second option. The Special Commissioners found as a fact that:

“There was a genuine commercial possibility and a real practical likelihood that the two options would be dealt with separately. Likewise, there was a genuine commercial possibility and a real practical likelihood that [the SP option] would not be exercised.”

The House of Lords recognised that it was not entitled to disturb this finding of fact, but said that a question of law existed. There was a contingency arising from the documents that might have prevented the composite transaction from being completed. The Special Commissioners concluded that there was a realistic possibility of this contingency arising. The House of Lords held that the Commissioners had erred in law in concluding that this meant that the scheme could not be a composite transaction, when in fact the contingency had not arisen. This looks very little like a decision about construction of a document and rather more like a principle about the nature of a composite transaction for these purposes. It has nothing to do with the particular wording of the statute before the court and looks very like a judicial ruling about the factors to be taken into account in cases where there are transactions that in fact cancel each other out as a matter of substance. This finding of law clearly sets a precedent about the characteristics of a composite transaction, which would apply where the statute in question was worded completely differently from that in this case.

The central question was said by the House of Lords to be whether the Citibank option gave it an entitlement to gilts so that this would be a qualifying contract as defined in the legislation. Only then would there be an income loss for tax purposes. If the option was part of a larger

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74There seems to have been no attempt in Scottish Provident to link this to the documentation rather than the surrounding facts: contrast, for example, Lord Templeman in Ensign Tankers v Stokes [1992] S.T.C. 226 at 232 where the analysis of the transaction as a composite transactions was based on a reading of the documents in question as being interdependent and so read as a whole. Arguably, if what was at issue was not a document but a “series of acts and things done”, then its proper construction was a question of fact and not law at all: see Lord Hoffmann in Carmichael, above, fn.21 citing Moore v Garwood, above, fn.21.

75The relevant wording is from s.154(1), Finance Act 1994 as amended by the Finance Act 1996; see Scottish Provident, above, fn.3, at [18].

scheme, by which the rights to the gilts were bound to be cancelled by SP’s rights to the same gilts, then it could be said that there was no such entitlement and so no income loss. The statutory language was given a “wide practical meaning” and it was found that there was no entitlement. Their Lordships held that:

“Since the decision of this House in [Ramsay] it has been accepted that the language of a taxing statute will often have to be given a wide practical meaning of this sort which allows (and indeed requires) the court to have regard to the whole of a series of transactions which were intended to have a commercial unity.”

In this sense, there was emphasis on the language of the legislation, but it was the application of this legislation to the facts, subject to the judicial rule on composite transactions described above, that was important in reaching this conclusion. If what amounts to a composite transaction is a question of law, it seems inevitable that the precedents will build again and that the Brightman formula, or something like it, will re-emerge. What is this, if not a judicial principle? The House of Lords stated that it would destroy the value of the Ramsay principle of construing provisions as referring to composite transactions if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. This focus on the transaction, rather than the statute, takes this “principle” beyond ordinary purposive statutory interpretation. Arguably, the Scottish Provident elaboration marks an important development of Ramsay-style thinking, so heralding the development of a new style Ramsay principle. Given that the detailed characteristics of a composite transaction are a question of law, and that it is the existence of such a transaction that affects the tax outcome, rather than merely the purposively construed wording of the legislation, the Ramsay approach does not appear to be dead, only transmogrified.

To the extent that one can discern a distinction between the legal analysis in BMBF on the one hand, and Scottish Provident on the other, from the wording of the Appellate Committee’s opinions in these two cases, it rests on whether the court was prepared to look at the wider transactions involved in each as a composite transaction or as a happenstance. The focus was on their Lordships’ understanding of the policy of the legislation, but going beyond purposive construction by combining this with a view of the surrounding circumstances of the particular transaction in question. In Scottish Provident there was a gap, which looked very much as if it had arisen from legislative oversight. In BMBF the taxpayer was relying on a deliberately created tax incentive: some would say not in the way the Parliament intended, but others would
disagree. The line drawn between these two cases is based on the judicial view of the intention of Parliament, but that view does tacitly include the issue of whether the legislation can have imposed upon it an intention to look at legal concepts only or whether it can be applied to the transaction in question so as to take account of economic substance. The approach here is wider than a normal purposive construction. It is arrived at partly by looking at the legislation in context, in the normal way, but in part by a review of the nature of and manner of carrying out the scheme in question so as to reach an assessment of its economic substance.

As we shall see, this is the very same process as is created by the Australian statutory GAAR. If the court is to apply such wider policy perspectives then, it is argued in the next section of this article, it would be preferable for these to be derived from a GAAR which had itself been enacted by Parliament and therefore explicitly represented its intention. This process would have the advantage of providing a transparent framework for this decision-making. This proposal requires further discussion of the meaning of the intention of Parliament and an examination of experiences in other jurisdictions that have GAARs.

III. ASCERTAINING THE INTENTION OF THE LEGISLATURE: UNITED KINGDOM AND OTHER EXPERIENCES

(a) The meaning of Parliamentary intention

In the past, Lord Templeman attempted to draw a bright line between tax avoidance, on the one hand and tax mitigation or tax planning on the other.\(^7\)\(^6\) Other descriptions of avoidance thought to encompass activities that should not be effective include unacceptable,\(^7\)\(^7\) impermissible,\(^7\)\(^8\) aggressive and abusive.\(^7\)\(^9\) One widely-used definition is that of Lord Nolan in Willoughby, that tax avoidance is a course of action designed to conflict with or defeat the evident intention of Parliament; although it should be noted that he was discussing tax avoidance in the context of a particular statutory provision providing for a clearance mechanism if the taxpayer could show that his purpose was not tax avoidance but not purporting to give a general definition.\(^8\)\(^0\) The phrase may also be used more widely in opposition to evasion, to cover all legal tax activity which reduces the liability to tax that would arise if another route were followed. This wide use includes what is known as mitigation, which does not defeat the

\(^{76}\)See Lord Templeman, above, fn.14 and in CIR \textit{v} Challenge Corp Ltd, above, fn.6.

\(^{77}\)Criticised by Lord Hoffmann in Westmoreland, above, fn.2.


\(^{79}\)Halifax, above, fn.8. For a detailed examination of terminology and its origins see Kessler, above, fn.7.

\(^{80}\)Income and Corporation Taxes Act 1988, s.741; see Willoughby, above, fn.10.
intention of Parliament, as well as avoidance in the narrow sense, which, under this definition, does. Lord Nolan’s classification suggests that there is a clear line between avoidance in its narrow, pejorative, sense and mitigation, but if this distinction does depend upon the “evident intention of Parliament” then we are back to asking what that is, and to whom it must be evident, and that is not a simple dividing line.

Lord Hoffmann has dealt with the problem by stating that

“. . . tax avoidance in the sense of transactions successfully structured to avoid a tax which Parliament intended to impose should be a contradiction in terms. The only way in which Parliament can express an intention to impose a tax is by a statute that means that such a tax is to be imposed. If that is what Parliament means, the courts should be trusted to give effect to its intention. Any other approach will lead us into dangerous and unpredictable territory.”

According to this view, successful tax avoidance cannot exist, since any scheme that is held by the supreme tribunal to be effective is, by definition, not avoidance. This relies on a very particular view of Parliamentary intention, of course, and one that can only be ascertained once the highest court has heard a case. A more commonly-held view is that expressed in the Institute for Fiscal Studies Green Budget in 2006:

“There will have been no avoidance if the judges decide that Parliament misfired, so that arrangements fall within the letter of the law—however much it may appear that Parliament may not have intended its language to cover the particular arrangements entered into by the taxpayer. As a matter of law, that is what Parliament has prescribed and a taxpayer does not avoid tax by limiting his or her liability to what the law prescribes.”

These commentators assume that actual parliamentary intention may differ from that which the language states and the courts decide it to be. This depends upon what is meant by parliamentary intention. The tax debate is often distracted by the notion that individual members of Parliament have not considered, or do not understand, the tax issues before them or that the legislature as a whole has not considered a particular matter. This is often the case, and parliamentary procedure for the passing of tax legislation could be much improved if it could be removed rather more from the political arena of the annual budget and given more time for

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81Above, fn.13.
reflection\textsuperscript{84}; but these comments misunderstand the role of legislation as an expression of the intention of Parliament as an institution rather than as a collection of individuals. As Waldron puts it, “an institution has no occurrent thoughts”. He writes:

“This means abandoning all talk of legislative intentions apart from the intentionality that is part and parcel of the linguistic meaning . . . of the legislative text itself.”\textsuperscript{85}

It is helpful to think about parliamentary intention in this way. The debate is not then sidetracked into questions of majority and minority views, or the views of Government as opposed to the legislature as a whole. Understood in this way, the intention of Parliament is not a fiction.\textsuperscript{86} The legislative intention is the product of the process that produces the text.\textsuperscript{87}

This is an argument for the authoritativeness of the text. But it is not an argument for exclusion from consideration of all other types of material. Certain types of statement by members of the legislature, “made in a canonical form established by the practice of legislative history, should be treated as themselves acts of the state personified.”\textsuperscript{88} As Waldron puts it:

“the judges are developing a practice of recognizing such statements as acts of the legislature and the legislators are responding to that recognition by producing statements that are intended to be taken in that way.”\textsuperscript{89}

Thus the argument about the role of \textit{Pepper v Hart} statements or explanatory memoranda can take place within this framework because these may or may not come to be recognised as acts of the legislature, as a matter of policy.\textsuperscript{90}

Nor is this approach to parliamentary intention an argument for literalism. Although Lord Hoffmann’s view places great weight on the words used to express the intention of Parliament, his is certainly not a literalist view. He argues for the courts to be trusted to give effect to the intention of Parliament, so, very definitely, he sees a role for the judges. What he criticises is the unwillingness of Her Majesty’s Revenue & Customs (“HMRC”), which issues instructions to the parliamentary draftsman, to legislate by reference to substance rather than form. In his

\textsuperscript{84}TLRC Working Party (Chair, Sir Alan Budd) \textit{Making Tax Law} (2003).
\textsuperscript{85}J. Waldron, \textit{Law and Disagreement} (1999), at p.142.
\textsuperscript{87}“In seeking for the intention of Parliament we are seeking not what Parliament meant but the true meaning of what they said”; \textit{per} Lord Reid in \textit{Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG} [1975] A.C. 591 at 613 cited in Cross, above, fn.24, at p.26.
\textsuperscript{89}ibid., at pp.342–343; Waldron, above, fn.85, at p.146.
\textsuperscript{90}See above, fn.9.
view, this denies the courts the opportunity to recognise the economic effect of transactions.\(^91\) Although, in practice, as argued above, the effect of the approach of the House of Lords in cases falling within the revised *Ramsay* "principle of construction" may be to take account of economic substance, this is not explicit or openly acknowledged by the courts, since it would be considered to go beyond the powers of the judiciary.

Much has been made, from *Ramsay* onwards, of tax being created to operate in the real world, not that of make-belief.\(^92\) The true position, however, as Lord Hoffmann recognises here, is that the tax system is often not based on economic reality, and this would make it difficult to apply any kind of economic substance test in such cases. Some taxes, of which capital gains tax is a good example, are based on legal concepts of property or contract and are of their essence a matter of legal form rather than economic substance. Other areas of taxation are based on business or accounting concepts, but these may be modified for tax purposes. "Reality" is an unhelpful notion in this context since, as Lord Hoffmann has pointed out himself elsewhere, "something may be real for one purpose but not for another".\(^93\) Legal substance has its own reality, but economics is not its basis. It is where these legal concepts clash with economic substance that problems often arise. Indeed, successful tax schemes work with the legal concepts and precise wording of the statute, complying with these concepts very precisely, which is why it is so difficult to combat them. As Lord Hoffmann suggests, this can be dealt with only by the legislature spelling out its intention more clearly.

Ideally this would be done in the specific legislation, but for cases where this has not been achieved, a general parliamentary intention to give effect to economic substance could be made explicit in a GAAR: a general legislative provision intended to apply certain principles, presumptions or overriding tests to the interpretation of specific tax legislation.\(^94\) For the reasons explained above, there are instances where it may not be reasonable or even possible to apply an economic substance test. If the basis of the specific tax legislation in question differs conceptually from economic reality, this will need to be taken into account as now, but the examination of whether economic substance could and should be relevant would be sanctioned clearly by Parliament. This would not remove all problem cases, particularly in respect of legislation passed prior to the GAAR; but the existence of such a principle would assist in focusing the

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91 Above, fn.13, at p.206.
92 See Lord Wilberforce in *Ramsay*, above, fn.1, at 82: “The capital gains tax was created to operate in the real world, not that of make-belief”; but see too the discussion in Staveley above, fn.43 and above, fn.54 and text thereto.
93 Westmoreland, above, fn.2, at [40]. This was in the context of Lord Hoffmann’s now-abandoned distinction between juristic and commercial meaning but the point itself remains valid. See also the discussion in Staveley, above, fn.43.
94 For examples of GAARs in other jurisdictions see below.
minds of legislators in the course of introducing new specific legislation on the basis of the tax in question. In this way, the concept of economic substance could become a useful tool, as Lord Hoffmann would like to see happen; but if economic substance is to override legal concepts then this needs to be clearly understood and integrated into the legislative process, and the GAAR must also give further guidance as to when it is to apply.

This suggests that the way forward, for future legislation at least, is not more detailed drafting but policy-based, principles-based drafting together with a GAAR applying an economic substance test, unless this is expressly excluded. The detailed mass of rules we currently have nevertheless leaves holes in the net that the courts cannot plug by referring to economic substance at a higher level of generality since there is no direction to them to do so. Indeed, at present it may be inappropriate for them to do so since this has not been considered as an option by the legislators. As Lord Hoffmann puts it:

“It is one thing to give the statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there.”

It is not the function of a GAAR, any more than of the judiciary, to fill gaps left by the failure to set out parliamentary intention. Parliamentary intention can, however, be expressed at a number of levels. A general

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55 For a similar suggestion in the US context, see M.A. Chirelstein and L.A. Zelenak, “Tax Shelters and the Search for a Silver Bullet” (2005) 105 Col. L.R. 1939. The authors propose a “silver bullet (or perhaps a broad-spectrum antibiotic) that would kill a variety of tax shelters, and do so in such a way that the government would no longer always be playing catch up.” Their proposal focuses on non-economic losses and deferrals; it was written before a number of Inland Revenue Service wins in tax shelter cases under the judge made US economic substance rule (see Burke, above, fn.30 and below, fn.124), but proposes something more specific than that rule, though not narrowly tailored to a particular scheme.

56 Lord Hoffmann specifically refers to Ingram v IRC [2000] 1 A.C. 293 in his B.T.R. article. This is a good example of the clash between economic and legal reality. Many commentators and the revenue authorities considered the court did not give effect to the “obvious” intention of Parliament but Lord Hoffmann considered that he was giving effect to that intention by applying the concepts of what he called “highly sophisticated English land law”. The issue was what amounted to a separate interest in property. If Parliament had wanted to override legal substance by looking at economic substance, it would have needed to do so explicitly. Tax law must operate in the “real world”, but it is a very special real world of legal rules, as discussed below. The particular scheme in Ingram was the subject of highly complex, specific anti-avoidance legislation (Finance Act 1986, s.102A). Taxpayers continued to find ways around the legislation, resulting in another anti-avoidance provision (Finance Act 2004, Sch.15).


58 Lord Hoffmann, above, fn.13, at p.205.
anti-avoidance principle or set of principles\textsuperscript{99} could set out references to economic substance, to the manner of creation and implementation of the scheme in question and to other objective factors that would reveal the motive for the scheme and whether it was consistent with the legislation. This would have a double function of reminding the legislator to consider and spell out the basis of new legislation as well as supplying direction to the courts to enable them to apply the specific legislation before them in the way intended by Parliament. It seems probable that a statutory GAAR will achieve something more than a normal rule of statutory construction only if it has sufficient power and content. This means that it needs to be based on express principles and criteria, rather than on a broad instruction to look at whether the purpose of the legislation has been abused, or merely at the motive of the taxpayer. If the principles are to modify the meaning of a specific statute they must do more than simply direct the court back to that statute. This is not to say that the specific statute is to be ignored; rather that it will be modified by the GAAR explicitly subjecting it to an overriding principle or principles. A broad GAAR that merely applies a purpose test and refers to abusive or impermissible actions will simply be read by the court as an instruction to look at what is impermissible or abusive under the normal rules of statutory construction. Something more is needed. The judiciary will be very reluctant to create such principles for fear of overstepping their jurisdiction but, if properly directed by the legislation, will be well able to develop the principles provided by the legislature. This is well illustrated by contrasting the outcome of recent cases on the GAARs in Canada and Australia.

(b) Experience in other jurisdictions

No jurisdiction has yet managed to produce a definition of activities that fall on the “unacceptable”, “impermissible” or “aggressive” side of the line, although some have attempted to draw up objective factors or characteristics that might indicate the existence of such an activity, either in their GAAR (as is the case with Australia\textsuperscript{100} and as is proposed in South Africa)\textsuperscript{101} or in a non-legislative document.\textsuperscript{102} For a lawyer, the difficulty

\textsuperscript{99}See Freedman, above, fn.97. The description “GANTIP” was used in this earlier article to differentiate the general anti-avoidance principle from a general anti-avoidance rule—for the purposes of the present article GAAR is used to describe a general principle-based provision since GAAR is the more familiar term.


\textsuperscript{101}SARS, above, fn.78 and see also South African Revenue Service, Tax Avoidance and Section 103 of the Income Tax Act, 1962, Revised Proposals, September 2006 (“SARS 2”).

\textsuperscript{102}In Israel, the term “aggressive tax planning” has not been defined but a commission has detailed its characteristics: A. Lapidoth, “New Legislative Measures in Israel to Counter ‘Aggressive Tax Planning’” (2007) 123 L.Q.R., JANUARY © SWEET & MAXWELL AND CONTRIBUTORS
is that the line in question is not between legal and illegal activity. None of these activities amounts to evasion provided they are fully disclosed, but if they are on the “wrong side” of the line they simply may not save tax as intended. The characteristics used to distinguish the ineffective from the effective transactions \textit{ex ante} tend to rely on artificiality, circularity, abnormality and a discrepancy between economic substance and legal form. As we have seen above, these characteristics are not explicitly at the forefront of the UK case law since \textit{BMBF}; although they are present in the background in terms of the configuration of the facts. In \textit{BMBF}, all these issues are simply folded into a blanket of “statutory construction”, although unfolded a little by the discussion of composite transactions in \textit{Scottish Provident}, which does, tangentially at least, recognise the significance of circularity.

(i) Canada: back to statutory interpretation?

In Canada, the statutory GAAR in s.245 of the Federal Income Tax Act 1985 operates to deny a “tax benefit” that would otherwise result from an “avoidance transaction” or a “series of transactions” of which the avoidance transaction is a part, provided that the transaction, or series of transactions, result in a misuse of provisions of the Act or other regulations, or is an abuse having regard to those provisions read as a whole.\footnote{\texttt{s.245 of the Federal Income Tax Act RSC 1985, c.1 (5th Supp.), as amended. This summary of the provision is taken from B. Alarie, S. Bhaitia and D. Duff, “Symposium on Tax Avoidance after \textit{Canada Trustco} and \textit{Mathew}: Summary of Proceedings” (2005) 53 Can. Tax J. 1010.}} Two recent cases, \textit{Canada Trustco} and \textit{Mathew}, have highlighted the problems with this legislation.\footnote{\texttt{Canada Trustco Mortgage Co v Canada [2005] 2 S.C.R. 601; 2005 S.C.C. 54, Mathew v Canada [2005] 2 S.C.R. 643; 2005 S.C.C. 55. For a full discussion see J. Freedman, Converging Tracks? Recent Developments in Canadian and U.K. Approaches to Tax Avoidance (2005) 53 Can. Tax J. 1038.}} The taxpayer won in \textit{Canada Trustco}, which related to financial leasing and was very similar on its facts to \textit{BMBF}, but was defeated in \textit{Mathew}, which was decided at the same time. A leading commentator has suggested that the decision in \textit{Canada Trustco} may render the GAAR largely meaningless.\footnote{\texttt{See B. Arnold, “Confusion Worse Confounded: the Supreme Court’s GAAR Decisions” (2006) 54 Can. Tax J. 167.}} The parallels with \textit{BMBF} and \textit{Scottish Provident} are clear. The Canadian cases would almost certainly have been decided in the same way in the United Kingdom without a GAAR. This has been used as ammunition by opponents of a GAAR, who argue that the policy of the specific legislation was unclear in \textit{Canada Trustco}, so that no other outcome could be expected.\footnote{\texttt{Alarie et al., above, fn.103; Gammie, above, fn.11.}} Supporters of the GAAR criticise the Supreme Court for not looking at the economic substance of the transaction, but the problem

\texttt{(2006) Bul. for Int. Tax 255. The United Kingdom has “hallmarked tax schemes” as part of its disclosure regime (above, fn.4), but these hallmarks determine the liability to disclose rather than the existence of a particular type of avoidance.}


\texttt{106 Alarie et al., above, fn.103; Gammie, above, fn.11.}
is that the GAAR is not explicit that this is its function, whilst the specific legislation in relation to which the court is being asked to apply the GAAR was not drafted in an environment where economic substance had been highlighted as an issue by the GAAR.\textsuperscript{107} This is an indictment of the value of the Canadian GAAR as it stands now, but it does not necessarily mean that a GAAR is doomed to failure: rather it suggests that an improved GAAR is needed, with a clearer relationship to the specific legislation and an express policy on economic substance as well as other criteria.

The key problem is that the Canadian GAAR, in s.245, does not provide directions to the courts on the meaning of “abusive”. A business-purpose test was rejected in the case of \textit{Stubart}\textsuperscript{108} in 1984 and this was what led to the introduction of the GAAR. The GAAR was clearly intended to go beyond normal purposive statutory interpretation, since principles of construction that allowed the courts to look at the object and spirit of legislation had already been endorsed by \textit{Stubart}. Unfortunately the \textit{Stubart} principles of construction were not robust enough to ensure that strict statutory interpretation would not return.\textsuperscript{109} Even so, to give the current GAAR some meaning it must be required to go beyond the guidelines in \textit{Stubart}. But how far and to what effect is not explained by the Supreme Court, which unhelpfully states\textsuperscript{110}:

“The GAAR’s purpose is to deny the tax benefits of certain arrangements that comply with a literal interpretation of the provisions of the Act, but amount to an abuse of the provisions of the Act. But precisely what constitutes abusive tax avoidance remains the subject of debate.”\textsuperscript{111}

The requirement is that there should be an abuse of the provisions of the Act or the Act read as a whole,\textsuperscript{112} but the Supreme Court rejected a two-stage interpretation of s.245(4) on the basis that there is no way one could abuse the Act as a whole without abusing its provisions. Thus the court was forced back to a simple rule of statutory interpretation. It stated that s.245

\textsuperscript{107}For an argument that the Canadian GAAR was intended to be based on economic substance, as indicated in the explanatory notes to the provision, see J. Li, “Economic Substance: Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance” (2006) 54 Can. Tax J. 23.

\textsuperscript{108}\textit{Stubart Investments Ltd v The Queen} [1984] 1 S.C.R. 536. The case rejected the \textit{Ramsay} “new approach” as then understood.


\textsuperscript{110}One of the problems here is that the extent of the \textit{Stubart} guidelines was the subject of debate in subsequent cases (Duff, \textit{ibid.}). This does not detract from the point that, given the reasons for enacting the GAAR, the court should feel obliged to give the GAAR some meaning which takes it beyond the guidelines in the \textit{Stubart} case.

\textsuperscript{111}\textit{Canada Trustco}, above, fn.104, at [16].

\textsuperscript{112}s.245(4).
“does not rewrite the provisions of the Income Tax Act; it only requires that a tax benefit be consistent with the object, spirit and purpose of the provisions that are relied upon”.

Given that this takes us no further than ordinary purposive construction, it puts the situations in the United Kingdom and Canada on exactly the same footing. Unlike the House of Lords in *Scottish Provident*, however, the Supreme Court was at pains to stress that, once the provisions of the Income Tax Act have been interpreted, it is a question of fact, not law, whether the minister (on whom the burden rests) has established abusive tax avoidance under the section. This gives the curious result that in the United Kingdom, where there is no GAAR, the question of what amounts to a composite transaction is a question of law, but in Canada, with its GAAR, the question of what is an abusive transaction is one of fact. Section 245 does not spell out any criteria that could be used to assist in deciding what is abusive. In particular it does not spell out that artificiality, or economic substance, are pertinent considerations. Although the Explanatory Notes to the section state that “subsection 245(4) recognizes that the provisions of the Act are intended to apply to transactions with real economic substance”, the Supreme Court rejects

“... any analysis under s.245(4) that depends entirely on ‘substance’ viewed in isolation from the proper interpretation of specific provisions of the Income Tax Act or the relevant factual context of the case.”

In *Canada Trustco*, “cost” in the context of a claim for a capital cost allowance was given what Lord Hoffmann might have called in *Westmoreland* a “legal” meaning, and the mere fact that an economic or commercial purpose was not present was held to be insufficient to show that the transaction resulted in abusive tax avoidance. It was held that economic substance must be considered in relation to the proper interpretation of specific provisions. Here the relevant provisions did not refer to economic risk but to cost, which in the context of the relevant legislation is a well-understood legal concept. In *Mathew*, on the other hand, textual, contextual and purposive interpretation of the specific provisions in question resulted in the conclusion that Parliament could not have intended the scheme there used to be effective.

The Canadian courts in *Canada Trustco* came up against the same problem as was encountered by in the United Kingdom in *BMBF* and

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113 *Canada Trustco*, above, fn.104, at [54].

114 *ibid.*, at [46].

115 *ibid.*, at [60]. discussed further in Arnold, above, fn.105. S.245(5) does permit recharacterisation of the nature of a payment or other amount, but only in determining the tax consequences of the section applying and not to determine whether it applies.

116 *ibid.*, at [75].
indeed in Ingram. The revenue authorities argued for the application of an economic substance test, but the court considered that the specific legislation was based on purely legal concepts. In Canada Trustco, the Canadian Supreme Court took the view that although the purpose of the GAAR was to prohibit tax avoidance, this must be done without jeopardising consistency, predictability and fairness in tax law.

“These three latter purposes would be frustrated if the Minister and/or the courts override the provisions of the Income Tax Act without any basis in a textual, contextual and purposive interpretation of those provisions.”

The problem is that the court in Canada Trustco did not consider whether its approach frustrated the purpose of the GAAR, and the intention of Parliament in passing s.245, which must have been to go further than the previous case law, was not given full consideration. The legislature must take some of the blame for this itself for not spelling out the principles sufficiently in the body of the GAAR, despite referring to economic substance in the explanatory notes to the legislation. The relationship between the GAAR and the specific legislation and the basis of the specific legislation requires greater consideration to ensure that the interaction between the two is effective. Stating this does not remove the difficulties inherent in integrating an economic substance rule with provisions based on legal concepts, but an express statement about economic substance in the GAAR would mean that this could be considered fully without undermining consistency, predictability or fairness. There would be transitional problems with specific legislation enacted prior to the GAAR, but ultimately, since all future legislation would have been enacted with the GAAR in the background, very clear words would be needed to displace its presumption that the courts could look at economic substance in the context of other criteria, criteria which should be listed in the GAAR.

(ii) New Zealand

The New Zealand GAAR legislation has encountered similar problems: this legislation can be mentioned only briefly, but it is worth reflecting that the picture is a familiar one. A key issue is the thin dividing line between attempting to override a specific statutory purpose through the GAAR, that is gap-filling, which is not permitted, and employing the GAAR as a tool to protect the specific legislation from frustration, which is. Another is the difficulty of applying a GAAR where the concepts in the specific

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117 Above, fn.96.
118 Canada Trustco, above, fn.104, at [42].
119 New Zealand Income Tax Act of 2004, ss.BG1 and GB1, although based on much older legislation.
legislation seem to be pure tax concepts, with little relation to commercial reality.  

The New Zealand legislation does not attempt to spell out what amounts to tax avoidance in the sense used by the legislation and this gives rise to difficulties, as is seen in Peterson v Commissioner of Inland Revenue in the Privy Council.121 Here, in another case on finance leasing, the majority, led by Lord Millett, found that it was entirely consistent with the specific legislation for the taxpayer to depreciate its costs, despite the surrounding facts which shifted risk away from the taxpayer. Given the facts as found by the lower courts, the taxpayers were simply relying on a tax incentive provided by Parliament. Reference was made to BMBF with which there are clear similarities. The strong dissent from Lord Bingham of Cornhill and Lord Scott of Foscote criticised the application by the majority of jurisprudential principles developed in the U.K. context, where there is no GAAR, and was prepared to look at the surrounding circumstances more widely than the majority (just as in BMBF the central question was whether the surrounding facts were part of what was to be considered or was mere “happenstance”). It is not clear as yet how significant the Peterson case will be for the development of the New Zealand GAAR, particularly as it was the last New Zealand tax case that will be heard by the Privy Council. Much depended on the way in which the facts had been dealt with in the lower courts and concessions made by the Commissioner, and Lord Millett indicated that the majority would have decided the case differently had it been differently argued.122 Nevertheless, it does indicate the difficulties encountered by the judiciary where they are given insufficient guidance about the relationship between the GAAR and the relevant specific legislation.123

(iii) Objective tests: Australia and the ECJ

By contrast, recently the ECJ in a VAT context in Halifax124 and the High Court of Australia have both shown a willingness to develop

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122ibid., at [4].
123For a more thorough review of the New Zealand cases see Dunbar, above, fn.120.
124Halifax, above fn.8. This section of this article mainly examines jurisdictions that have a statutory GAAR, but the contrast with the approach in other European countries is worth drawing, since the latter is now having an impact on the United Kingdom. The United States is not covered here, but is the prime example of a jurisdiction where effective genuine judicial doctrines have emerged without a statutory GAAR: Streng et al., above, fn.29. Recently, there have been calls in the United States for codification of its judicial rules, largely due to a number of cases lost by the Inland Revenue Service (“IRS”) on the basis of a textualist approach to statutes and a narrow view of the doctrine of economic substance. This tide may be turning as the IRS has now had major victories under the economic substance doctrine (e.g. Coltec Industries Inc v United States 454 F. 3d 1340 (2006); Black and Decker v United States, 436 F. 3d 431 (4th Cir. 2006)), but the scope of the judicial economic substance doctrine remains unclear. Calls for codification remain. See D. Hariton, “How to Fix Economic Substance” Tax Notes, April 28, 2003;
objective criteria for evaluating whether their general anti-avoidance principles should apply. In the case of the ECJ this is a judicial rule; in Australia there is a statutory GAAR, known as Pt IV A, which gives the courts the authority to pursue this path. The Australian GAAR has been drafted specifically to deal with the problems encountered by the revenue authorities in trying to operate the jurisdiction’s previous, less explicit, GAAR, which was emasculated by a narrow interpretation given by the courts. Thus, Australia can be said to have moved on a stage ahead of Canada, although some commentators would now say that it has gone too far. South Africa is also proposing to strengthen its GAAR. Following consultation, and heavily influenced by the Australian and Canadian experiences, it proposes, inter alia, to list five so-called abnormality factors as objective indicators of lack of commercial substance. The Australian legislation already refers expressly to the economic substance of the arrangement as being a relevant factor for the courts to consider.

In Australia, the GAAR applies to a scheme through which the taxpayer derives a tax benefit, as defined, and the scheme must have been entered into for the sole or dominant purpose of obtaining a tax benefit. This purpose is tested by applying an objective determination using eight factors set out in the legislation. These are: the manner in which the scheme was entered into or carried out, the form and substance of the scheme, timing and length of period during which the scheme was carried out, the result that would be achieved apart from Pt IV A, any change in the financial position of the taxpayer and persons connected with him and any other consequence for the taxpayer and such persons and the nature of the said connection. Whilst these factors may seem very obvious and might be matters which the courts might develop for themselves, the point is that the courts did not do this in Australia, and have not felt able to do so expressly in the United Kingdom or Canada either. Listing the factors in this way gives the judges the tools they need to go beyond normal rules of statutory construction to construe the specific legislation before them, not contrary to its purpose but according to these broader principles.

Chirelstein and Zelenak, above, fn.95; Burke, above, fn.30. Familiar key issues are whether the economic substance doctrine is an objective test and the problem of the weakness of statutory interpretation of specific legislation as a method of controlling avoidance. As in the United Kingdom, the US revenue authorities currently prefer disclosure requirements and adviser regulation to the idea of a GAAR.

125 Above, fn.100.
126 There is a vast Australian literature on the failure of the previous provision and much criticism of the new GAAR. For a starting point see C. J. Taylor, “Australia”, in Cahiers, above, fn.28, p.95; R. Woellner, S. Barkocz, S. Murphy and C. Evans, Australian Taxation Law (16th edn, 2006), paras 25.500-25.800; Cassidy, above, fn.100; Cooper, above, fn.100.
127 SARS, above, fn.78.
128 SARS 2, above, fn.101.
129 Pt IV A, above, fn.100, s.177D.
Problems may occur if these principles are applied too rigidly and on a checklist basis. They must all be considered, and are apparently exhaustive; but the courts have held that they do not need to be “unbundled from a global consideration of purpose and slavishly ticked off”. This is valuable, since a more rigid approach could start to remove the nature of the GAAR as a broad principle and turn it into a detailed set of rules which could damage its essence. Used as principles, however, the value of these factors as directives to the courts about the factors to be taken into account when assessing the taxpayer’s purpose can be understood. The list declares that these purposes are relevant when assessing the applicability of the specific legislation to the scheme in question. As such they give content to the GAAR and enhance the ability of the judiciary to apply the specific legislation in accordance with Parliamentary intention, taking the specific legislation and the GAAR together. Moreover, since these are objective criteria, they exclude any inquiry into the subjective motives of taxpayers. Subjective motive tests are generally too easy to manipulate to be valuable in tax cases.

It is interesting to compare with this the judgment of the ECJ in *Halifax*, which sets an objective test for determining whether the essential aim of the transaction is to obtain a tax advantage. In this case on the Sixth VAT Directive, the ECJ applied the concept of abusive practice, developed by the court in non-tax cases. So, the right to deduct input VAT will be denied where the transactions from which the right derives constitute an abusive practice; that is, where there is a tax advantage which would be contrary to the purpose of the provisions in question. It must be apparent from objective factors that the essential aim is to obtain a tax advantage. The ECJ uses similar language to the Australian legislation in directing the national court to look at the artificial nature of transactions and the links of a legal, economic and/or personal nature between those involved in the scheme in order to assess this. How this decision will be translated into law in the United Kingdom remains to be seen. HMRC seem inclined to leave it to the courts, which may feel able to develop such tests within a European context where they could not do so as a matter of purely UK law. Many civil systems of law have general anti-avoidance provisions but some also have general theories of abuse of law.

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130 FC of T v Consolidated Press Holdings Ltd (No.1) (1999) A.T.C. 4945 cited in Woellner et al., above, fn.126. See J. Dabner, An Old Methodology in a New World: a Comment on our Current System of Judicial Decision Making in Tax Cases (Australian Tax Teachers Association Conference (“ATTA”), 2006), http://pandora.nla.gov.au/tep/23524, arguing that the factors amount to no more than a “smell” test. For the reasons given here this author believes they have a greater value than this.


133 Halifax, above, fn.8.


135 Halifax, above, fn.8, at [81].
which overlap these specific tax provisions. These doctrines seem to go beyond pure statutory interpretation. In the Netherlands, for example, the *fraus legis* doctrine, which is of general application:

“can only be considered after interpretation and characterisation according to the normal interpretation methods have been fully utilised without this leading to an outcome that can be regarded as consistent for the purpose and intent of the law.”

The concept of abuse of law has been rejected in UK tax law in the past but may now be entering into UK jurisprudence through this and other decisions of the ECJ. It is possible that the development of this jurisprudence in a European context could even have an influence on the development of the UK direct tax case law, although it is more likely that it will be confined to indirect tax. It could be that legislation will be needed to clarify the full effect of the *Halifax* case, although at present there is no sign of any intention to legislate. If, however, legislation was found to be necessary to give full effect to the ECJ case law, the opportunity might be taken to deal with direct and indirect taxes in a single GAAR.

The question of the characteristics to be sought in determining whether there has been abuse cannot be separated from the question of what constitutes the scheme or transaction to which these test are to be applied. Is it enough that there is an overall commercial purpose for what is done, even if steps are added which are not commercial? Is a commercial activity negated because it forms part of a wider scheme that vitiates its commerciality? This will depend on what is to be included in the scheme. As we have seen in the discussion of *BMBF* and *Scottish Provident*, in the United Kingdom the courts pose this as a question of law by asking what is part of the composite transaction, and the answer to this question is vital to the outcome of the case. In Australia, what is the scheme for the purpose of Pt IVA has also been central to the robust approach of the courts to the application of the GAAR.


137There is also a specific tax GAAR, *richtige heffing*. This can only be used with authorisation of the Secretary of State for Finance and has not been used since 1987 since the *fraus legis* has been developed to serve the purpose (Robert Ijzerman, Netherlands in *Cahiers*, above, fn.28).


141For current HMRC thinking on a GAAR see below, fn.153.

142Cooper, above, fn.100, describes how the “size of the scheme” is significant to the inter-relationships with other parts of the Pt IVA test such as the tax benefit and the dominant purpose.
This question of what amounts to a scheme was discussed in the recent Australian decision in Hart143 where there was a mortgage arrangement, the overall commercial aim of which was to finance the purchase of two properties, one a home and one an investment. But the terms on which the loan was made (allowing for repayment in two unequal portions where interest on the investment loan part was tax deductible and on the home loan part it was not) were explicable only by the taxation consequences for the respondent. On one view, since the wider scheme had a clear non-tax purpose—to borrow money—it was not caught by the GAAR. This was the view of the Full Federal Court of Australia but when the matter came to the High Court it was rejected on the basis that the presence of a discernible commercial end does not determine the answer to the question posed by the eight factors set out in s.177D. Thus these factors were rolled into the decision about what constitutes a scheme. Here, the High Court was satisfied that the scheme could be defined in such a way that the dominant purpose under s.177D was that of obtaining a tax benefit. The application of the eight factors to a case like BMBF or Canada Trustco could have led to different decisions from those reached in Canada and the United Kingdom, since the manner of implementing the scheme would have been significant as well as the commercial objective of the borrowing.

There are commentators and members of the judiciary in Australia who argue that the Hart case has taken them a step too far, since the overall commercial objective should have been enough to permit the taxpayer to take advantage of a tax deduction provided in the specific legislation.144 On the other hand, this was a marketed scheme, organised and sold quite blatantly as a tax-driven plan. If the presence of a commercial end result were to validate a tax scheme it would be much too easy for tax planners to escape the GAAR. Thus it is not enough for a GAAR to specify an economic substance test: the judges must also be given the tools to ascertain how to apply that test. As Hart shows, the manner in which the scheme was carried out (another of the eight factors) was also highly relevant. In this way the Australian GAAR gives the courts explicit authority to look at matters which the UK courts do in practice take into account, but under the awkward and not very convincing guise of statutory construction.

It is not claimed that a GAAR can solve all problems or that it means that no modifying legislation will ever be needed. There is no doubt a need in Australia also to pay more attention to the relationship between the GAAR and specific legislation, and the controversies surrounding tax avoidance are certainly not at an end.145 The Australian experience does

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143 Above, fn.131.
145 Hence the Australian principles based drafting project: see above, fn.97.
suggest, however, that those who argue that a GAAR can do nothing more than a normal rule of statutory construction are mistaken.

IV. SIGNALS, DIRECTIONS AND PRINCIPLES

The principles behind tax legislation are not always clear. Policies are confused and objectives are obscure. The position is complicated by the use of the tax system made by governments to fulfil social and economic goals, even though taxation may not always be the best vehicle for this purpose. In addition, tax legislation is based on an uneasy combination of legal concepts and economic outcomes, which do not always mesh well together. Tax systems for a modern, sophisticated economy and complex legal system will inevitably reflect that complexity, but we have now reached a position where the length and intricacy of tax legislation is constantly under criticism from business and the professions.\textsuperscript{146} Superimposed over the existing vast amount of statute law there is a constant flow of new legislation, much of it specific anti-avoidance provisions that can themselves create opportunities for avoidance through “creative compliance”.\textsuperscript{147} Despite this, such evidence as there is suggests that there is still much avoidance activity, which is reducing the revenues that the state expects and needs in order to pursue its objectives.\textsuperscript{148}

There are some who argue that we should leave the judiciary to adjudicate at the margins through case law; that, in fact, the courts draw an appropriate line, and that in most cases taxpayers are aware of their position. A more sophisticated and persuasive version of this view is articulated by Edwin Simpson, who argues that the judges have the authority to overlay their own guiding constitutional principles in tax law and that \textit{Ramsay} represents such a principle, though it may only be applied where the underlying principle of a body of tax law is tolerably clear.\textsuperscript{149} The problem with this argument is that the judiciary have not yet succeeded in establishing such a constitutional principle, nor have they created a stable framework for their decisions. If the argument made above, that \textit{Ramsay} lives on through the \textit{Scottish Provident} decision, is correct, it is possible that guiding principles will yet emerge from the case law. But, as against this, the House of Lords has explicitly renounced the

\begin{footnotesize}
\textsuperscript{146}See, for example, the Chartered Institute of Taxation, \textit{Budget 2006 Representations} (2005): “All parties involved must surely acknowledge that the ever-growing accretion of tax law is not sustainable”; Tax Faculty of the Institute of Chartered Accountants in England and Wales, \textit{Towards a Better Tax System} (1999); Institute of Directors, \textit{Tax Avoidance} (2006): “The current approach is leading to an impossibly complex tax system.”
\textsuperscript{147}For the concept of “creative compliance” using the anti-avoidance legislation, see McBarnet and Whelan, above, fn.51.
\textsuperscript{148}For example, House of Lords Select Committee on Economic Affairs, \textit{The Finance Bill 2005}, HL Paper 13-4 (2005), at para.5.
\end{footnotesize}
power to create a judicial principle of revenue law and, even if we were to see such a development, we could equally well see it dashed to the ground by a subsequent House of Lords decision. Relying on the courts has not given us linear progression over 25 years. A “wait-and-see” policy will not be an adequate response for another quarter of a century.

There are others who argue that, in the corporate field at least, the temptation to indulge in avoidance schemes of a borderline nature can be curbed through pressures to conform to a standard through the activities of HMRC, the media and stakeholders demanding observance of corporate social responsibility principles. There is some evidence that this approach is having an impact, but the idea that the law is incapable of regulating this area is not only a worrying attitude to the role of law, but also leaves taxpayers with no obvious authoritative source of guidance in an area where “morality” will also not always supply widely-agreed answers. This is particularly problematic for taxpayers who have a responsibility to others such as trustees and company directors. Too much discretion is left to the administrators and unelected lobby groups, who can apply pressure based on their views of what Parliament intended, which is not the same as parliamentary intention. The new disclosure rules are also currently changing behaviour and reducing the appetite for tax schemes, but this deterrent effect can only be maintained if there is a readiness to introduce specific legislation whenever a scheme is discovered through this medium. This specific legislation is creating further complexity in tax law and broadly-drafted, motive-based clauses in this legislation are arguably creating as much difficulty for taxpayers who are broadly compliant as would a GAAR. In these circumstances, business and professional groupings might support a GAAR, although only if they felt that ultimately the volume of specific legislation would be reduced in this way, and they would almost certainly then press for a prior clearance mechanism, which HMRC would be likely to resist. The point here is that the longer we wait before introducing a GAAR, the more specific legalisation is introduced. Once there, such legislation will be hard to remove.

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151 Although legal regulation is more likely to change behaviour than the “softer” pressures described: see S. Morse, The How and Why of the New Public Corporation Tax Compliance Norm (May 15, 2006), http://ssrn.com/abstract=905746.

152 See T. Honoré, “The Dependence of Morality on Law” (1993) 13 O.J.L.S. 1. He argues that, whilst there is a moral obligation to pay taxes, this obligation is incomplete apart from law because the law has to fix the amount or rate of tax. He might have added that law has to fix the basis on which tax is payable. For further discussion on this point see Freedman, fn.97 above, 334 et seq.

When a GAAR has been suggested in the United Kingdom it has usually been dismissed as incapable of achieving certainty. This author does not argue that a GAAR would provide certainty, but it could provide clarity as to judicial powers and a framework for judicial development that does not exist at present. It would provide guidance to the judiciary about the way in which Parliament intended tax law to be construed and authority to develop the law in a way that currently occurs only spasmodically because of rightly held concerns about legitimacy.

For such a GAAR to be effective, the evidence from other jurisdictions suggests that two requirements must be fulfilled. First, the GAAR must contain principles that go beyond a normal rule of statutory construction. Thus, a reference to “abuse”, for example, is insufficient. The GAAR should refer to principles that can be applied to transactions in an objective way. The list should include, but not be confined to, economic substance. Secondly, the drafting of specific legislation needs to become more explicit about the underlying principles of the legislation. Arguably, if the second condition were to be fulfilled, a GAAR would not be needed; but in view of the impossibility of drafting to cover all eventualities, and the skill of tax advisers in devising schemes based on the wording of legislation, a combination of better drafting and overriding general principles to which reference can be made seems the best way forward.

It may appear that a GAAR along these lines would require the courts to override the intention of Parliament in relation to the specific legislation in question, something the courts would resist. As the Supreme Court of Canada has stated:

“To send the courts on a search for some overarching policy and then to use such a policy to override the wording of the provisions of the Income Tax Act would inappropriately place the formulation of taxation policy in the hands of the judiciary, requiring judges to perform a task to which they are unaccustomed and for which they are not equipped.”

If, however, the overarching policy is explicitly provided by Parliament itself, the judicial application of that policy does not contravene the judicial function. In fact, the exercise is intended to uphold the intention of Parliament by conforming the interpretation of the specific legislation to

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154 Most notably by the TLRC, who withdrew their support by reason of the response from the Inland Revenue and its unwillingness to provide clearances, above, fn.83, and TLRC, A General Anti-avoidance Rule for Direct Taxes (1999). HMRC are once again examining the possibility of a GAAR through a wide-ranging comparative legal study, but remain wary of offering pre-transaction clearances, which HMRC see as advice to planners on refining their schemes: see House of Lords Select Committee, fn.153 above, at paras 60-65.

155 It would also be important to have an appropriate administrative framework that would filter the cases in which the GAAR was to be applied through a committee, as in Australia.

156 Canada Trustco, above, fn.104, at [41].
the overriding principles which are also an expression of Parliament’s intention. If we doubt the ability and willingness of the judiciary to implement such a scheme where proper directions are given through the legislation providing the principles, we need only look to the Australian experience or to the willingness of the UK courts to apply overriding principles in Human Rights Act and European law cases. As Kavanagh has argued, this modifies the focus on what Parliament intended in the specific legislation, but only to fulfil what in the tax context would simply be a broader principle of taxation.157

The application of this idea in a tax context has already commenced in relation to the Sixth Directive on Value Added Tax in IDT Card Services.158 Relying on the preamble to that directive, Arden L.J. was prepared to construe a provision of the UK Value Added Tax Act 1994 in the light of the wording of the Sixth Directive, to prevent non-taxation. Whilst this remains a rule of interpretation, it is a very special one, permitting the courts to adopt a construction “which is not the natural one”.159 Arden L.J. cited the Human Rights Act case of Ghaidan v Mendoza160 in this context and was explicit that she was able to construe the legislation in this way “even if Parliament did not intend to limit relief in the way for which Customs and Excise now contend”, because there is “no indication that Parliament specifically intended to depart from the Sixth Directive in this respect”.161

If tax principles can be inserted into the law of the United Kingdom in this way then there seems to be less of an objection to a principles-based GAAR. There are of course limits on this approach to interpretation. As Arden L.J. points out in the same paragraph, the provision must not raise policy issues as to its effect which the court cannot, in performance of its role, resolve.162 Thus, this is not an argument that a GAAR can fill gaps, but that it could modify interpretation and introduce a new perspective to construing parliamentary intention. For example, economic substance could become a valid consideration in construing the legislation, openly and without having to resort to formulae about what amounts to a composite transaction. This would not prevent the legislature from abandoning economic substance expressly, but would enhance the ability of the courts to mesh economic substance with legal concepts where there

157Kavanagh, above, fn.12.
158Above, fn.12.
159At [82].
160Above, fn.12.
161At [113].
162In Fleming v Customs and Revenue Commissioners [2006] EWCA Civ 70; [2006] S.T.C. 864 the majority of the Court of Appeal refused to go as far as Arden L.J., who dissented in interpreting legislation to give effect to Community law. The House of Lords are to hear Fleming and may limit the development commenced in IDT Card Services, but this approach to interpretation is unlikely to disappear completely.
was no express indication that Parliament intended to impose purely legal concepts.

It goes without saying that policy issues do need to be made as clear as possible in tax legislation; but, despite argument over many years, there has been little improvement and no thorough review of the underlying principles of tax law. It is not realistic to expect any such overhaul of the entire tax system to take place immediately, though we might continue to call for it, but improvements could be made. The experimental programme in Australia to introduce new legislation under a “coherent principles” approach to drafting is worth watching. To understand what is being proposed here it is important to recognise, as Mr Pinder of the Australian Treasury writes in his paper on the topic:

“A principle is not just a less specific rule; it is a statement about the essence of all outcomes intended within its general field. When the principle works, it does so because the essence it captures appeals to readers at other than an abstract intellectual level; it means something to readers because it relates to their understanding of the real world.”

Pinder gives an example of treatment of shares as continuations of existing shares following a takeover and restructuring of a company. The concept used is of the shares in the old and new company being “reasonably regarded as matching”. The policy objective is made clear. There is a note included about a factor to be taken into account in deciding on reasonable matching, but it does not purport to be exclusive. The provision informs the reader of the intended outcome rather than the mechanisms being used to achieve that outcome. This approach is controversial, with the usual comments being made from Australian academics, practitioners and the judiciary that it will reduce certainty. Difficulties are being encountered in implementation. As Pinder points out, however, black-letter, detailed tax law is itself far from certain. As we have seen above, the courts in the United Kingdom are already engaged on policy analysis in deciding when to apply the judicial tools at their disposal, such as the notion of a composite transaction. Policy-based drafting, coupled with a GAAR, gives a proper framework for this activity and allows it to be developed in a transparent way. One major advantage of a stated policy of principles-based drafting combined with a GAAR could be that HMRC and Parliament could be required to address the interaction between any new scheme of legislation and the principles set out in a GAAR whenever

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163 Pinder, above, fn.97.
164 ibid.
165 Income Tax Assessment Act 1936, s.139DQ(1).
166 For example, the Institute of Chartered Accountants in Australia, Response to Taxation of Financial Arrangements Bill 2006, March 1, 2006.
it introduced a new piece of legislation. This would be of value in itself.\(^{167}\) This would not solve all the difficulties with existing legalisation, but could be a way forward for the future.

V. CONCLUSION

The UK case law has failed to provide coherent guidance for dealing with tax avoidance. The House of Lords has admitted that all attempts at clarification have only raised fresh doubts and further appeals. The latest opinions in *BMBF* and *Scottish Provident* will not have ended this cycle, denying as they do the existence of a judicial doctrine of revenue law but apparently applying a strengthened version of the *Ramsay* principle on the very same day. Under the guise of purposive statutory interpretation the courts are making distinctions based not on the wording of the statute in context, but on external, policy considerations. The judicial approach requires a proper framework, which could be provided by layered legislation, including a principles-based GAAR.

Parliamentary intention can be expressed only through the text of the statute, albeit read in context. Obviously the best way to give effect to parliamentary intention in tax law will be to express policy clearly in the specific legislation and to have a coherent underlying framework for the tax system. Policy-based drafting could assist here. It is, however, unrealistic to suppose that full coherence will be introduced into the tax system in the near future or that legislation can be produced that will offer no opportunities to those skilled at devising tax schemes. A properly-drafted GAAR, referring to principles that included, but were not limited to, economic substance, could give the judiciary the powers it needed to give full effect to parliamentary intention and prevent the frustration of specific legislation. It would not create any greater uncertainty than exists at present, but would increase clarity, transparency and legitimacy. Such a provision would take the courts beyond the normal rules of statutory construction, towards the bolder approaches currently being developed by the UK courts in other contexts, applying layered legislation by reading specific provisions in the context of general principles. This would not override parliamentary intention but would give it full effect.

*JUDITH FREEDMAN.*


* KPMG Professor of Taxation Law, University of Oxford. This article is based on lectures delivered at Sydney University, Tel Aviv University and the Statute Law Society. The author is grateful for assistance she received from many colleagues and the helpful comments received at those lectures.

Abuse of rights; Australia; Canada; Comparative law; EC law; Judicial decision-making; Legislative intention; New Zealand; Statutory interpretation; Tax avoidance

Analysis

GAAR: challenging assumptions

SPEED READ The current ‘informal engagement’ to explore whether there is a case for the GAAR may very well result in no action and this would be a relief for many in the tax community. But before dismissing the idea, it is worth considering what the alternatives might be and whether a carefully crafted GAAR resulting from thorough consultation and with appropriate safeguards might not be preferable. The tax world has changed since 1997. The tax community should engage fully in the GAAR debate which might give it an opportunity for considerable input – an improvement on sitting back and waiting for case law and piecemeal legislation.

Judith Freedman is KPMG Professor of Taxation Law at the Oxford University Faculty of Law and Director of Legal Research at the Oxford University Centre for Business Taxation. She is a member of the Tax Law Review Committee of the IFS. Email: judith.freedman@law.ox.ac.uk; tel: 01865 288337. The views expressed in this article are her own personal views.

Changing times

The Times reported on 13 September 2010 that although policymakers are consulting on a general anti-avoidance rule (GAAR) ‘there is speculation that this plan has frozen.’ There are certainly many tax practitioners and directors who would breathe a sigh of relief if that were the case, and it is well known that there are those in HMRC who are not keen on the idea. Andrew Goodall’s well balanced report in Tax Journal on 12 July 2010 suggested, however, that the debate is not a repeat of that which occupied the tax community in 1997. Since then, case law has moved on in the UK and in other jurisdictions. The economy and politics have changed.

For once the UK could learn from other jurisdictions and come up with an improved version of the GAAR

A scheme for disclosure of tax avoidance schemes (DOTAS) has been introduced and developed – in response there has been much specific anti-avoidance legislation and the tax system has become even more complex than it was in 1997. Increasingly we rely on HMRC guidance to assist us through the maze and yet there is lack of clarity about the extent to which that reliance is safe. These changing circumstances call for a re-examination of the GAAR question.

‘Informal engagement’

The current discussion arises from an undertaking in the Red Book to ‘engage informally with interested parties to explore whether there is a case for developing a general anti-avoidance rule (GAAR).’ This is clearly the result of a political compromise between different parts of the Coalition government. It will be unfortunate if this issue becomes a political football. The idea that a GAAR could bring in vast sums of revenue in the coming year or so to meet the deficit is clearly misconceived.

It too much is claimed for this device it will undoubtedly fail to meet expectations, but that does not mean that tax practitioners might not examine it seriously as a possible tool, to be used in conjunction with other techniques, to improve the workings of the system. Being an ‘engagement’ and not a ‘consultation’, this exercise does not seem to be covered by the formal rules of consultation and it is not clear who decides who are the ‘interested parties’. Nevertheless, the HMRC/HMT team tasked with the engagement has, by all accounts, talked to a large number of people in a short time. They have also held meetings and workshops, the results of which will no doubt be reported in due course.

What follows is based on a short talk I gave at one such workshop (representing my personal views and not those of HMRC). I aimed to move the debate beyond instant dismissal based on outdated arguments.

Reasons why we do not need a GAAR

Commentators give a number of reasons for not having a GAAR. These need fresh examination rather than uncritical repetition.

The courts can deal with avoidance already

The argument here runs: we do not need a statutory rule, since we have the judicial approach in the Ramsay line of cases. But the case law has not developed in a linear direction. While the House of Lords rejected the existence of a judicial doctrine and stated that the ‘new approach’ is no more than a purposive interpretation applied to the facts viewed realistically (Barclays Mercantile Business Finance Ltd v Mawson [2005] STC 1), their Lordships comments on the same day in IRC v Scottish Provident [2005] STC 15 suggest that something remains of the old case law. Subsequent decisions of lower courts use language which derives from this earlier case law. Cases and HMRC guidelines, such as the anti-avoidance signposts, continue to refer to pre-ordained transactions, commercially unnecessary steps and artificiality. Yet other cases indicate that the only thing that has to be looked at is the statute. Whilst practitioners may think they have a good feel for what is and what is not going to work, to suggest that currently we have a clear and predictable judicial approach that can be explained to clients and business people is unduly complacent.
GAARs have not worked in other jurisdictions and our judiciary would be reluctant to apply a GAAR

No jurisdiction has yet developed a perfect solution to tax avoidance and none ever will. That does not mean that a GAAR is worthless, although much depends on how one judges success. The initial failure of the Australian GAAR has now been addressed. Predictions that the revised legislation would suffer ‘judicial castration’ in the same way as its predecessor have not come to pass and the revenue authorities have had successes in the cases of Spotless (1996) 186 CLR 494 and Hart [2004] HCA 26. Criticism continues, of course, but it is a powerful tool which is used only rarely but it is a control on activity. Similarly in Canada, New Zealand and Hong Kong the revenue authorities have had recent victories in GAAR cases (Lipson in Canada [2009 SCC 1]; Ben Nevis and Glenbarrow in New Zealand [2008] NZSC 115 and 116) and HIT Finance and Tai Hung Cotton Mill in Hong Kong (FACV 8/2007, 16/2007 and FCV 2/2007).

Again, these have been subject to extensive criticism by the commentators, but it cannot be said that the GAAR has made no difference or has been destroyed by the judiciary and even the critics agree that in each jurisdiction it is a powerful weapon.

In South Africa, after an extensive study of systems in other jurisdictions, a new provision was introduced based on some of the better elements found in other countries, such as the use of objective and explicit indicia of avoidance. According to the 2010 Large Business Customer Survey conducted on behalf of HMRC most large corporate taxpayers say that they have a clear idea of what HMRC considers avoidance to look like, so why not set out the indicators in the legislation rather than only in guidance?

India is close to introducing its own provision modeled on that of South Africa. In the USA, the judicial economic substance test has been codified in legislation. There are many critics of all this legislation, but for once the UK could learn from other jurisdictions and come up with an improved version of the GAAR, bypassing the worst pitfalls. This requires detailed study of those other systems rather than outright dismissal of their attempts as failures.

One problem that concerned people in 1997 (that a statutory rule could conflict with the judicial rule) should not have been present if we now have no judicial doctrine. A GAAR would simply be another piece of legislation to apply purposively. A GAAR should be drafted in such a way as to show that it is a principle, in accordance with which other legislation should be interpreted. Our judges are adept at handling jurisprudence from the European Court and under the Human Rights Act, both of which involve the application of principles in this way. It is not suggested that the judiciary can be, or should be, removed from the process of interpretation and the attitude of the judiciary to GAAR will be a critical factor. If experience elsewhere were properly applied, however, and clear enough signals were given, the GAAR could be a tool that the judiciary would welcome, and a more constitutionally legitimate way forward than a judicial doctrine.

We have DOTAS and specific anti-avoidance legislation

There are reportedly around 300 anti-avoidance clauses with unallowable purpose tests in our legislation. It is hard to believe that this is simpler to manage than a single GAAR would have been. Moreover, these were introduced often with no framework of clearances or other safeguards. Increasingly practitioners are finding these tests unmanageable and require guidance on their application. The prospect of slightly different jurisprudence growing up around each of them is unpalatable. It would be naive to suppose that these tests and other anti-avoidance legislation would disappear overnight as a result of the introduction of a GAAR. It would take time and a number of successes before HMRC would rely on the GAAR to that extent. But the longer we leave giving the GAAR a chance, the more specific provisions we shall have. Would it not be sensible to put the GAAR in place in the hope that eventually this would reduce the need for new specific legislation? Disclosure has had some success, but this is a process that increases the number of provisions, some of which may then be used as a basis for schemes in the process of creative compliance. The relentless build-up of specific anti-avoidance provisions is a significant cause of complexity in our system.

A GAAR would increase uncertainty and be anti-competitive

In view of all the other current concerns of business in the international tax sphere and indeed the impact of the higher rate of income tax and the proposed bank levy, it seems unlikely that a GAAR would figure high on the list of anti-competitive provisions for most businesses. Most taxpayers are very familiar with GAARs in other countries and with anti-abuse laws in domestic law as well as in treaties and many would probably be surprised to hear that the UK had no statutory rule.

In fact it probably would not loom large at all unless it was highlighted as major problem by their advisers, which seems unnecessary. We lived with a supposed judicial rule for many years after 1981. If anything, a well drafted GAAR
Far from being an excuse for poor drafting, a GAAR should be a stimulus for better legislation

could increase certainty in this area, although anti-avoidance is an area of law that will never be absolutely precise, since if bright lines are drawn they will be manipulated by those devising schemes.

What is important is to have a framework which allows taxpayers who are engaging in normal commercial activity to ascertain their position with certainty. Some argue that a clearance system would be an essential accompaniment to a GAAR; others are concerned that a clearance system might degenerate into de facto requirement to apply for clearance for every transaction and so increase costs. If the tax profession can put aside its antipathy to a GAAR sufficiently to engage in the design of a clearance system and ensure it does not just become an added burden, it could become a useful (and possibly at least partially self-funding) feature of the tax system.

It would be better to improve the underlying legislation

A very real objection to a GAAR is that a sweeping anti-avoidance provision is no substitute for good legislation and a coherent underlying tax system. Were a GAAR to be seen as an excuse for sloppy drafting elsewhere that would be a serious problem.

A GAAR will only work well if the purpose of the underlying legislation is coherent and discernible. Thus a GAAR needs to be backed up by improved legislation and possibly further moves towards principles-based legislation, in the proper meaning of that term, which goes beyond anti-avoidance provisions. Far from being an excuse for poor drafting, a GAAR should be a stimulus for better legislation.

A GAAR would give too much power to HMRC and undermine the rule of law

A widely drafted GAAR would be likely to be backed up with HMRC guidance and there might also be a clearance system. This could be seen as transferring power to the administration. While this is a valid concern, we are not free from administrative guidance under the current system, and this has emerged piecemeal and is not given within a framework of binding statutory clearances. One of the areas in which the tax community could engage if a GAAR were to be formally consulted upon would be the framework for delivery, policing and value of guidance. It might be considered desirable to set up some kind of panel involving the wider tax and business community to assist with these tasks and the decision of when to use the GAAR, as is done in Australia. This might be an opportunity to exert some measure of control over HMRC’s discretion rather than a necessary extension of HMRC power.

Conclusion

The standard objections to a GAAR need to be questioned. Changing conditions mean that now is a good time for a formal consultation on a GAAR and not just an informal engagement. It would not solve every tax avoidance problem and changes emerging from its introduction would be seen gradually, not immediately. Its introduction should not be rushed and we need to learn from the mistakes of other jurisdictions. If, however, the tax community could get past the old arguments and see this discussion as an opportunity rather than dismissing it out of hand, the GAAR could be a vehicle for obtaining a clearer framework for anti-avoidance legislation, explicit statutory indicia of ineffective avoidance, a clearances system and a stimulus for better drafting of tax legislation more generally. The alternative is to continue with the current mish mash of unpredictable case law and piecemeal legislation with yet more unallowable purpose tests being introduced and, no doubt, further ad hoc guidance. It is hard to believe that this is a recipe for the competitiveness and certainty about which the critics of the GAAR seem so concerned.

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