A HISTORY OF TAX AVOIDANCE

ORIGINS

The invitation to speak tends to call forth acceptance without too much thought about the topic.

When I was asked to give this talk, I rather concentrated on the word history in the title but, when I began to write it, I realised that I had not got in mind a definition of the thing of whose history I was to speak: it was, as it were, as if I had agreed to speak about history which strikes me as a somewhat broad topic.

So I think it would be a good idea to begin by defining what, for the purposes of this talk, I shall take to be tax avoidance.

I do not include in the term tax avoidance what is sometimes called tax evasion or, more honestly, fraud: I am excluding from my history those cases where a person has hidden resources from the revenue authority or lied about some material facts; and I do not include, in the concept, cases where by reason of innocent mistake, tax has been underpaid.

But I do include cases where a liability to tax has arisen and an attempt is made to reduce that liability by claiming a relief in circumstances where it might be said that the legislation granting the relief does not intend for it

to be granted; and I think cases of that sort can be called tax avoidance in a strict sense.

I shall also extend my categorisation of tax avoidance to include cases where the attempt is to prevent a liability from arising by doing a transaction in one way rather than in another, which would attract a liability.

If successful, cases of that kind will prevent a liability from arising and in that situation there is no tax at all: it has not been avoided; it is just not there.

The question of whether, in a case like that, there has been avoidance is a difficult one.

If I decide to go from Nice to Monte Carlo by the coast road, it is not a natural use of language to say that I have avoided the Corniche: it is just that I have chosen one route rather than another and doing that may not involve avoidance at all.

But I do not think it is necessary to get into a philosophical debate about what is and what is not tax avoidance or to go into too much further detail on the question: for the purposes of this talk I can perhaps say that tax avoidance is hard to describe but recognisable when we see it in which respect, it is like an elephant.

And on thinking about what I should talk about, it occurred to me that you probably don't want to hear too much about what X did to avoid tax: you probably want to know about the history of the legislative and judicial responses to tax avoidance and that is what I shall focus on in this talk.

But before I get to that, it might be useful to consider the origins of tax because it may illustrate some of the conceptions which it is necessary to have in mind before we can deal with tax avoidance and it may also tell us something about modern attitudes to tax avoidance.

So far as we can tell, taxation began about 5000 years ago and generally consisted of what might be called turnover taxes related to the results of agriculture.

The Bible, for example, talks of a tithe, which was one tenth of the taxpayer's turnover – though around the time when the pyramids were being built, the rate seems to have gone up to 20%.

The legislative codes by which these taxes were introduced were quite short so that there were not many rules about calculation and there are perhaps three points about the early taxes which have some resonance in the modern world.

First, the taxpayer was meant to feel good about paying the tax.

For example, when paying the tithe, the rule was that you had to count

1 to 9 and then give away the 10th part, the idea being that this concentrated the taxpayer's attention on the magnitude of what he had and was keeping, rather than on what was being taken from him.

We do not see much of that type of encouragement nowadays though perhaps it can be seen in Neville Chamberlain's 1937 imposition of the national defence contribution to fund rearmament, the name of which was intended to make us feel good about paying it.

And, in modern Japan, the names of the taxpayers who pay the most tax are published with great praise each year.

One lesson which we may draw from the wish to make people feel good about paying taxes is that there is a level above which the burden of tax becomes unacceptable and, when that level is reached, people do not feel good about paying tax and avoidance and perhaps even evasion then increases.

A state cannot run unless it can collect taxes and, when the tax burden becomes, for whatever reason, unacceptable, the ability to collect tax will reduce.

Secondly, where taxes don't have many rules to define their scope, there is not much room for avoidance but there is plenty of room for evasion which needs to be effectually discouraged.

Under the Shogun regime, again in Japan, if a farmer did not pay his tribute to the relevant ruler, he would be burnt to death and, he didn't evade tax again: I have been told, though I do not know if it is true that, in modern China, tax evasion attracts the death penalty.

The lesson to learn from this is that extortion in some form or another is often part of the collection mechanism for a tax system even if it is dressed up with a veneer of legality: the method of enforcement is one of the things that determines whether the tax system is acceptable or not.

Thirdly, because tax systems need to be enforced, they need to be run by administrators who, in the words of the Bible are discrete and wise: indeed, the integrity of all tax systems and the maintenance of a free society is dependent on those who run a tax system behaving wisely.

Of course, as society changed, so did taxation.

As manufacturing became part of society, so taxes were imposed on the products of manufacture in much the same way as the original taxes applied to agricultural goods; and there were other forms of taxation, such as the window tax, which was relatively easy to avoid but unpopular; I learnt recently that the expression daylight robbery has its origin in popular dislike for the window tax.

On the whole, these taxes did not raise any difficult definitional

questions and, if you wanted not to pay them you could, in a certain sense, avoid them by doing without or your could evade them, at risk of considerable penalties.

Emperor Wang Mang in China introduced a tax of 10% on profits of professionals and skilled labours in 10AD and, for whatever reason, by the end of the 18th Century and the beginning of the 19th, income taxation became the most popular system of taxation.

It can be seen that even a simple income tax system expresses or implies rules which require analysis and so poses questions which need to be answered: taking Emperor Wang Mang's tax, it asks what is a profit?; who is a professional and who is a skilled labourer?

Answering the question what is a profit turns out to be quite difficult and accounting concepts play a large part: there is also a distinction between income receipts and capital receipts; if income can be turned into capital or, more accurately, if receipts can be obtained in capital form rather than income form, there will be no profit and no income tax to pay.

So the coming of income taxation brought with it both definitional questions and, as tax policy became more sophisticated, an increasing number of rules: an obstinate struggle accordingly began between taxpayers and tax collectors, with taxpayers seeking to avoid taxes by using the rules

and tax gatherers seeking to collect taxes by what might be called rule broadening.

AN AUSTRALIAN INTERLUDE

An early example of rule broadening can be found in Australia in s.53 of the Income Tax Assessment Act 1915, which appears to be the first ever legislative example of a general anti avoidance rule.

It provided, in brief "every arrangement…shall, so far as it has…the purpose or effect of…altering the incidence of any income tax….be absolutely void".

An immediate problem which arose was that one of the arrangements which altered the incidence of tax was marriage, so when the rule was enacted everyone in Australia became illegitimate, and the legislation had to be amended to make plain that the arrangements caught by it were only void for tax purposes.

Although the Australian rules had a number of problems attached to them, similar legislation of a kind which renders transactions falling within them void were enacted in several jurisdictions.

However for a number of reasons, voiding rules were not very successful; one of those reasons is that in order to apply rules of this kind it is necessary to define tax avoidance and, as I have mentioned, that is hard to

do. If a taxpayer arranges his her or its affairs so that, according to a literal reading of the rules, there is no longer tax to pay, when a different transaction would have attracted tax, has tax been avoided?

Another problem with voiding rules is that, once you have struck out a transaction, a question arises as to what there is to tax.

Nonetheless, and while the larger economies have, on the whole, not adopted rules of the kind, examples of them can still be found in some places.

ANTI AVOIDANCE LEAVING ASIDE THE AUSTRALIAN INTERLUDE

Modern taxation – that is taxation in the 20th and 21st centuries – has seen a constant endeavour by taxpayers to reduce their tax burden, a see saw approach from the judiciary and an increasingly interventionist approach from the legislature.

At the beginning of the period, courts in common law countries applied a strict construction to tax legislation and to an understanding of the facts and there was relatively little legislative intervention in the field of tax avoidance.

Starting in the 1930s and 1940s, the approaches to tax avoidance in the UK and in the US diverged: the UK maintained its strict constructionist

approach, but introduced legislation to stop the avoidance of income tax by the transfer of assets abroad and by other targeted strategies which were designed to lower the rate of income tax by splitting income up between different taxpayers who used the income given to them to assist the original owner of the income.

In the US, however, the Courts began to adopt a loose construction of legislation to prevent what might be seen as abuse.

From the 1930s to the mid 60s, avoidance in the UK involved some manipulation of basis periods (which could in the right circumstances cause profits to drop out of charge to tax) but was limited chiefly to trying to turn income into capital by, for example, dividend stripping.

Dividend stripping involved selling the shares in a company pregnant with profits to a purchaser who took a dividend and then sold the shares at a loss.

As the law then stood, the share buyer could and did use the loss to get a tax repayment.

The original seller paid no tax on selling the shares, because the sale proceeds were capital and there was no capital gains tax.

Dividend stripping was originally successful but its success was dependent on the original share purchaser being a dealer in shares.

In the first case to reach the House of Lords on the topic, it was held that the purchaser was a dealer but, in the next case, in an apparent policy reversal, it was held that these transactions were not dealing.

We see here the beginnings of a judicial pattern, in which Courts are initially attracted by the intellect which goes into devising a tax plan and uphold it, and then become alarmed at the thought that they have let the tax genie out of the bottle and start to change the rule that they originally applied.

The legislature also intervened with legislation specifically designed to prevent dividend stripping – FA 1960 s.28 – but, in what might be called a bout of interpretation creep, it was later held, in breach of promises made to Parliament when it was enacted, to apply to a much wider range of transactions.

Nonetheless, in this period, while the US was experimenting judicially with ways of countering tax avoidance, the Courts here on the whole maintained a rigorous but classically correct strict constructionist approach.

A fundamental change began with the introduction of capital gains tax by FA 1965.

This new tax was much more rule based than income tax and so examination of the detail of the rules appeared to offer scope for avoidance.

And, at or about the same time, post war tax policy allowed for certain reliefs designed to assist in the obtaining of specific economic objectives; and eager taxpayers, again paying careful attention to what the rules said, sought to obtain these reliefs in situations which the legislature might not have considered fully or at all in granting them.

The result was that a gap developed between the tax collector's expectation of how the provisions would work and the taxpayer's claims as to how they did work.

And the Courts had to resolve the question of whether it was the tax gatherers expectation or the taxpayer's claim which was right.

In general terms, taxpayers expected the taxing acts to be interpreted strictly with significance being attached to each word, and to be applied to the facts as presented.

Again that was a classically correct approach in accordance with the principle that, as Rowlatt J said *in Cape Brandy Syndicate*, "in a taxing act one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in. Nothing is to be implied. One can only look fairly at the language used".

In the 1970s and 1980s the desire to avoid tax led to a number of what

might be called boutique vendors of tax avoidance schemes coming into existence and so, each year, new schemes were developed, schemes which, for example, were designed to create capital losses which could be set against capital gains, or schemes which purportedly generated interest payments which could be set against income and, later in the period, schemes designed to attract relief for apparent investments in films or other things, like research and development, which, it appeared, had attracted government favour.

All of these arrangements involved a taxpayer implementing a pre-planned arrangement by executing a series of documents in a particular order: it was, to use a somewhat outdated phrase, like putting on a gramophone record and playing it through to the end.

Each year, as these schemes came on the market, they were shown to carefully selected tax counsel who, in response to meticulously crafted instructions, would give an opinion saying that they worked to achieve their intended tax purpose.

When I was in pupillage, my pupil master was instructed to advise jointly with the late Mr Stewart Bates QC on one of these schemes, a scheme designed to create capital losses, which my pupil master thought worked.

We went to see Mr Stewart Bates who gave his advice as follows.

"I agree" he said "with every single tree in the wood, but I do not agree with the wood".

My pupil master was furious. "How can you advise like that?" he said to me. "I agree with every single tree in the wood but I do not agree with the wood".

In time, these schemes started to come before the Courts and, in the beginning, they met with some success: Courts were attracted by the schemes; but after a while, the scale and the nature of the avoidance which was being attempted became unattractive and the Courts reacted to it.

Eventually, the first of them got to the House of Lords. It involved the very scheme which my pupil master and Stewart Bates QC had advised on: it is called *Ramsay*.

And the House of Lords held that it did not create capital losses at all.

It was like a nuclear bomb going off in the fiscal world.

It is very difficult to know exactly what the House of Lords actually decided in *Ramsay* but, in broad terms, they endorsed the approach of Mr Bates: broadly, they said that they agreed with every single tree in the wood but that they did not agree with the wood – and, in doing that, they were beginning to adopt an approach similar to that which the US Courts had

been using since the 1930s.

It is, however, fair to say that although US Courts abandoned strict construction in the 1930s, they have not in the near enough a century since then worked out exactly what principle they were applying in tax cases; and as we can see looking back on the last 40 odd years of UK experience, our Courts here were, with *Ramsay*, beginning a similarly uncertain voyage.

For those of us advising on tax the *Ramsay* decision, which was sometimes called an emerging doctrine or a new approach required us to reconsider the basis on which we were giving advice and, to do that, we needed to understand what the House of Lords had actually decided.

As I say, that was quite difficult to discern especially because the House of Lords expressly denied that they were departing from the classical approach to the interpretation of a tax statute.

Eventually, however, we came up with the analysis that the only thing decided by the case was that circular, self cancelling transactions did not work and we got on with our jobs content that *Ramsay* was quite a limited decision.

The case of *Burmah Oil* which followed it did not disturb our analysis.

But the next case to get to the House of Lords was not a circular transaction at all.

It was *Furniss v Dawson*, when a transfer from A to B to C was in effect analysed by the House of Lords as a transfer from A to C.

Again, we needed to understand what the decision stood for and the synthesis generally adopted was that, where there was preordained series of transactions, the intermediate steps could be ignored.

That synthesis recognised some development in judicial thinking since *Ramsay*, but it was not too uncomfortable; it was possible to live with rules which were confined in their effect to ignoring, for tax purposes, circular self cancelling transactions and the intermediate steps in a preordained series.

However, at this stage of the analysis, it is to be noted that it was not year clear whether what was being applied was a rule of statutory construction or a view of the facts.

The Courts insisted that all that they were doing was interpreting the statute in question but, even so, it was hard to reconcile that with the decisions they were reaching which appeared to be particularly fact dependent.

And, it is also to be noted, first that the new doctrines which were being applied in tax cases involve a good deal of judicial activism and, secondly, that there is some judicial flirting, again denied, with the rule that

judges may only declare the law and may not, especially in tax matters, make it.

Following *Furniss v Dawson* there were some judicial attempts better to define the rule that the judges were introducing: in *MacNiven*, for example, it was suggested that the rule that circular self cancelling transactions could be ignored only applied where the legislative concept involved was a commercial rather than a legal one, but that rule did not get much traction.

The next case of significance was *Arrowtown* and that produced a snappy synthesis of the rule which is that you "apply the statute construed purposively to the facts viewed realistically".

Now that is very neat but it is also very elastic and it gives room for much judicial discretion, some of which can be seen in the *Scottish Provident* case, in which it was decided that, where steps were built into an arrangement to prevent its outcome from being preordained, those steps could be ignored.

The cases since then have broadly adopted the snappy synthesis and that has allowed for some quite surprising results in some of the cases – I mention *UBS v HMRC* [2016] STC 934 and *Rossendale BC v Hurstwood Properties (A) Ltd* [2022] AC 690.

Although displaying a somewhat different judicial technique, the *Rangers* case has similar aspects in the sense that it applies a very broad view of what the statute says to a very elastic view of the facts.

In *Rossendale*, which, on a true analysis, does not add anything new to the debate but which some judges see as having done so, the principle was stated like this:

> "In order to ascertain whether a particular statutory provision imposed a charge or granted an exemption from a charge, the Court should
>
> (i) Ascertain the class of facts intended to be affected by the charge or exemption, which was a process of interpretation of the statutory provision in the light of its purpose and
>
> (ii) To discover whether the relevant facts, looked at in the round, fell within the class, which was a process of applying the statutory provision to the facts

On the basis of the case law I have mentioned, various things can be ignored for tax purposes so, for example, shares which definitely exist can disappear: it is rather like a conjuring trick and some of us think it is a conjuring trick.

It is no doubt possible to spend time and effort in trying to achieve an intellectual and logical synthesis of the principle which the Courts say they are applying, but this is no more than to dress a possibly unpalatable truth in fancy clothes.

The truth is that, nowadays, Courts, without thinking about the structure of our tax system and the careful learning which has gone on to

develop it, reach an instinctive conclusion as to whether there should or should not be a tax charge or an exemption, which is not based on the statutory wording but on some self described principle of morality and then interpret the relevant provision or the facts to reach the desired conclusion.

That, I think, is where the law has got to: and it means that, in order to predict the outcome of a case which involves anything which might be called tax avoidance, it is necessary for the lawyer to have a go at predicting whether the Court will regard what has been done as moral or not.

It would be difficult to over emphasise the upending in judicial thinking which has gone on here in a period of less than 50 years.

It used to be necessary for the State to prove that liability to tax existed.

Nowadays it is more nearly true to say that, once HMRC have raised a claim to tax, the taxpayer must prove that tax is not due.

That is certainly the case before the FtT where it is plain that the taxpayer bears the burden of establishing that the claim against which he is appealing is wrong.

Let me now leave the judicial experience and look at the legislative experience.

THE LEGISLATIVE EXPERIENCE

At the same time as judges were changing their attitude to tax avoidance, legislative techniques were also employed to attack tax avoidance more widely than before.

These techniques are generally aimed at specific types of tax avoidance and are, accordingly, known as TAARs or targeted anti avoidance rules, but there are other anti avoidance rules including a general anti abuse rule.

Although we have introduced the GAAR, it is little used, has had very little effect and most advanced economies believe that is not necessary or desirable to have one.

Australia has perhaps the best known example of a GAAR – in Australia it is an anti avoidance, rather than an anti abuse, rule - in Part IV A of the Income Tax Assessment Act 1936, a series of provisions which have been expanded from time to time as taxpayer claims threaten to escape from the scope of this GAAR.

On the whole, the rules to which I am now referring are intended to apply only where a transaction has a main tax avoidance purpose and they have spawned quite a lot of litigation in which judges have again shown themselves to be alert to protect the tax take.

But these decisions and the arguments put by taxpayers, in arguing

them show just how difficult it is to determine what is tax avoidance and what is a tax avoidance purpose.

I do not have the time to make a detailed critique of these provisions or of the decisions on them – that deserves a talk of its own – but the decisions do seem odd, do seem to give too wide an interpretation to the rule being applied.

At the same time as these rules were being introduced, Parliament introduced the DOTAS Rules, requiring persons who suggest tax avoidance schemes to notify HMRC of them in advance.

We have also seen accelerated payment notices and follower notices designed to enforce early collection of tax in relation to marketed tax avoidance schemes; and HMRC have been given greater powers of investigation, all of which has been accompanied by increased penalties; and there is also an enabler's penalty which can in certain circumstances impose a penalty on an adviser for giving what turns out to be wrong advice.

A particularly nasty type of avoidance, which should be sharply distinguished from more principled types of avoidance, was the loan scheme, marketed to people to whom tax avoidance schemes should never have been sold, like NHS nurses, who were told that they could avoid tax

by diverting their pay to a company which would then loan money to them.

The users of these schemes were told that there would be no tax on the money lent to them and they believed it.

These schemes never worked: I have called them avoidance but they were or were close to evasion.

And if there was any doubt about whether they worked, it was laid to rest by the enactment of the disguised remuneration legislation and the loan charge, which had largely to be withdrawn because of the adverse effect it had on many taxpayers who had been quite wrongly lured into these schemes.

Possibly the largest legislative intervention to stop avoidance was SDLT.

When that tax was introduced, it had become the custom to avoid stamp duty on land transactions in a number of relatively straightforward ways.

The price paid was the imposition of SDLT, a tax which is much harder to avoid than stamp duty was and which contains its own form of GAAR.

Another modern feature of tax life is that we have adopted legislation designed by the OECD to prevent what is called BEPS – base erosion and

profit shifting – and we have introduced, in accordance with Pillar 2 of that initiative, a tax called the multi national top up tax which penalises large multinational groups which have successfully reduced their tax bill abroad.

It seems clear that the intention of the MTT is to penalise successful groups which manage their tax affairs efficiently; and this makes no economic or political sense to me.

It makes no economic sense because what detriment does the UK suffer if, say, a Canadian subsidiary of a UK group pays a low rate of tax?

And it makes no political sense because it surrenders much in relation to the tax to the OECD, so allowing foreigners to meddle in our affairs when, by voting for Brexit, the country showed itself unwilling to do that.

WHERE WE ARE NOW

The increase in legislative and judicial activism in relation to tax avoidance, coupled with the economic collapse in 2008 which created, in many large businesses, losses which provided their own form of tax reduction, has all had the result that fewer people than before 2008 have any appetite for tax avoidance: I do not say that it does not happen but there is less of it than there used to be.

But, even so, the legislative and judicial activism to which I have

referred has changed the culture of our tax system, has taken us away from what might be regarded as the wholesome attitude explained by Rowlatt J in *Cape Brandy Syndicate* to something much more flexible, to an attitude where it is regarded as almost a duty to pay tax without making any attempt to reduce it.

The result of this combination of legislation and judicial activism is that we have a tax system which appears to be highly rule based.

But, because of the way our judges are interpreting the legislation in truth, we have a system which, like the earlier and simpler agricultural taxes, is largely based on conceptions of what the answer "ought" to be.

We have, accordingly ended up with a system which appears to be modern but which in reality is curiously old fashioned.

And, oddly, like an old fashioned tax system, it is supported by an enforcement regime which, every time I look at it, appears brutal, especially as Courts, in their zeal to do down tax avoidance, have shredded many of the protections which taxpayers were supposed to have under the system of self assessment.

As a result the tax system imposes not only a financial burden but also an administrative burden on those who bear the obligation of complying with it than I believe is fair, moral or right in a system which

extracts money from people and must need some degree of consent from those who pay the tax.

Is that satisfactory or not?

My answer is that it is unsatisfactory, that it strikes at the essence of a free society and that it is inimical to the proper functioning of a democracy.

Will the situation improve soon?

That seems unlikely.