

TAX AVOIDANCE IN PRACTICE¹

by David Goldberg

What reasons did you have for becoming a lawyer? Perhaps you had dreams of inheriting the gown of Erskine. Perhaps you hoped, one day, to heal, through the balm of compensation, the economic or physical harm caused by a tortfeasor or to do battle for an oppressed minority shareholder. Some of you may have become lawyers to have, one day, the privilege of doing just this: to plead before a jury for the life of an innocent man. It is, I suppose, just possible that you might now hope to spend your life dealing with the drama of ships that go bump in the night in the Arabian Gulf or, as that is sometimes called, commercial law. I doubt if any of you became a lawyer because you had dreams of going to the Tax Bar.

For myself, I became a lawyer partly out of family tradition and partly because I admired the bravery and apparent integrity of men like Chief Justice Coke and like Sir Thomas More, whose Inn I chose to join and for whom I had the deepest admiration, though later reading suggests that he may have been a bit of a hypocrite. Nonetheless, I admired – and still admire – the guts of these men, and I looked, I suppose, for the opportunity to ply my craft despite the antipathy of an overwhelming executive power, and looked to have the opportunity to remain true to myself, when every instinct of self-preservation said, “Bend to the wind!” And yet, for all these high-sounding dreams, I ended up practising at the Tax Bar, knowing by heart large chunks of the five volumes which now make up the Yellow and Orange Books, knowing them even better than the perhaps more memorable and certainly more beautiful prose and poetry of Shakespeare or Virgil, which I learnt long before there even was a Yellow Book. But, believe it or not, life at the Tax Bar has measured up to the hopes which I had; and what I shall do this evening is to explain why and to link that to a discussion of the attitude of the Courts to tax avoidance, which may yet prove to be a field of dreams for the aspirational lawyer.

In his book *The Worker and the Law*, Lord Wedderburn made the remark that “most people want nothing more from the law than that it should leave them alone”. The phrase is striking; and I believe it to be true. We live in a country sewn thick with laws, and – for the most part – we are at once glad that they are there and completely unaffected by them. There is, however, one area of the law which affects virtually every adult person in this country and probably almost anyone in any modern economy in the world. It is the law of tax: if you work, it is inevitable that you will have something to do with the law of tax and something to do with the people who administer it. If you do not work, the probability is that you will be entitled to benefits, and – again – you will have something to do with the persons who administer tax. So here’s the thing: you can go through life without having anything to do with the criminal law, without having anything to do with the law of tort and without having anything to do with commercial or company law or the law of trusts; you can even go through life without being aware that you have had anything to do with the law of contract. But you cannot go through life having nothing to do with the law of tax, unless you completely divorce yourself from the society in which you live.

Having something to do with the law of tax does not just impact on the relationships which one individual has with other individuals; it inevitably brings every taxpayer or benefit-seeker into contact with the State. When you deal with tax,

the administrator can (and very often will) assert an unlimited power – the unlimited power of the State or, as we used to say before we became quite so European, of the Crown – to get involved with the detail of your life. It is improbable – not wholly impossible, but improbable – that you will regard the tax administrator as your friend; but many people will and do regard the taxman as an enemy, and, while that is undoubtedly unfortunate and regrettable, it is also – given the nature of the tax collector’s job – almost inevitable that that will be how he or she is often regarded. This may make a life dealing with tax sound a little bit gritty, a bit like a Cold War stand-off or a black and white movie scripted by John le Carré – say *The Spy who came in from the Cold*. So let me see if I can add a little bit of colour.

Life at the Tax Bar has not been entirely without glamour. At the moment, the remittance basis is very much in the news. In my early days at the Bar, anybody who was employed by a non-resident and worked, under that employment, wholly abroad was on the remittance basis in respect of his or her salary. Moreover, once the employment had ceased, the foreign emoluments could be brought here entirely free of tax, a significant benefit when the marginal rate of tax for even relatively modest earners was 83%. The arrangement, by which what might have been regarded as one job was divided between two employments – one wholly onshore and one wholly offshore, was known as a Split Schedule E, (this schedule being the one under which employment income was taxed). Many of the people who used this Split Schedule E arrangement were film stars and pop stars; and an advantage of the arrangement was that some of them remained resident and spending money here, when – without it – they would (as they very easily could) have become resident in a lower-rate jurisdiction such as the USA. The knowledge needed to put this arrangement into effect was not very great and the technology needed to implement it was not very difficult, so it was the sort of thing about which a relatively young barrister could advise. So I got to meet many well-known faces, who came as clients for advice as to just how to enter into and to operate their Split Schedule E arrangements.

The magic of Split Schedule E was available not only to actors, actresses and pop stars: it was available to anybody who worked outside the United Kingdom; and one of the people who availed himself of the benefits of the arrangement was a well-known politician called Mr Duncan Sandys. Mr Sandys was employed by what was then a high-profile company called Lonrho, which was managed by the buccaneering figure of Tiny Rowland – who was called “Tiny” for the same reason as Little John was called “Little”, though I’m not entirely sure that they were taking and giving to the same groups of people. The arrangements involving Mr Sandys became public, and the Prime Minister of the day, Mr Edward Heath, who was not particularly noted as a phrase-maker, said that they represented the “unacceptable and unpleasant face of capitalism”. The only other remark of Mr Heath’s which I can remember was about Saddam Hussein, of whom he said that “he was not the sort of man you would want to have to dinner; not even to lunch actually”. That remark, of course, had nothing at all to do with tax, but the remark about capitalism did; and Split Schedule E was restricted, so that it was only available for non-domiciled taxpayers although, for some time, other reliefs remained available for domiciled employees working abroad. This trip down memory lane began with a grim tale of confrontation between the individual and the State and seems now to have strayed into the hedonistic and

perhaps even selfish world of film stars, and – as we would now regard them – sleazy politicians on the take. The one seems rather far from the other, but is that really so?

Before I answer that question, let me ask another: what does it mean to be free? Do you consider yourselves free men and women? You do not have the freedom to stand up in a theatre and shout “fire” when there is no fire: you do not have the freedom to commit murder or theft. You do not have the freedom to open a bank account without going through the most ludicrous amount of regulation required by the money laundering legislation; and you do not have the freedom to travel through this land without being photographed over and over. And yet I suspect that each of you considers yourself free. Why? What do you mean by “being free”? Let me suggest that the essence of freedom lies in knowing what it is you are allowed to do and what it is that you are not allowed to do. When we say that we are free, we mean that we can do any of the things that are permitted; and we might add that there is here – it may be different in Continental jurisdictions – a presumption that everything is permitted unless it is prohibited. The essence of the British concept of freedom, then, lies both in the assumption that you may do whatever is not prohibited and in the knowledge of what is prohibited.

In 1981 the House of Lords decided *Ramsay*² and they followed that up in 1984 with *Furniss v. Dawson*³. It was originally not entirely clear whether these were decisions based upon an analysis of the facts or upon a method of statutory construction; but in *Craven v White*⁴ the Court strongly declared that it was just construing the statute and not doing anything special in relation to the facts. Over time, this encouraged the Revenue to think that there was a special rule of construction that tax avoidance does not work; and that was the argument they put to the Court in *MacNiven*⁵. The Court rejected the proposition that there was a special rule about tax avoidance; it said that it was conducting an ordinary exercise in statutory construction and attempted to set out an approach to statutory construction which, among other things, made a distinction between legal and commercial terms – a distinction which then got overblown by commentators.

What was going on here was something that is, in some respects, quite conventional; and it happens in all areas of the law. Judges perceive a problem and then set about trying to solve it: they attempt a solution, and if it works – that is, if it seems satisfactory as a solution in other cases, it becomes more or less fixed, and is used over and over again. However, if, in a later case, it seems that the solution is not satisfactory, then it is adjusted.

Up until *MacNiven*, I rather suspect that the House of Lords was indeed trying, as the Revenue thought they were, to create a general rule against the perceived problem of tax avoidance. However, when that proposition was put boldly to the judicial committee in *MacNiven*, the judges felt that it was too broad to be workable. Not everyone was happy with the process of reasoning by which the result in *MacNiven* was achieved, and the whole area was reviewed later, first in the *Arrowtown*⁶ case in Hong Kong. According to the judgments in that case, the Courts in tax cases were doing no more than applying orthodox cannons of statutory construction to a realistic view of the facts of each case. In the jargon of the day, we

call this purposive construction.

The science – or is it really an art? – of modern construction was pithily summed up by Mr Justice Ribeiro in the Hong Kong Court of Final Appeal in the case of *Arrowtown*. He said that “the ultimate question is whether the relevant statutory provision, construed purposively, was intended to apply to the transaction, viewed realistically”. That was the first clear statement in any of the tax cases that the approach of the Courts to tax avoidance involved a large factual element; and it is to be welcomed for that degree of honesty.

But let us examine that sentence, which may – perhaps – properly be designated as an aphorism and which has been approved by the House of Lords in *Barclays Mercantile*⁷ and in *Scottish Provident*⁸, so that it now represents the law here as well as in Hong Kong. What Mr Justice Ribeiro does not say is that you apply the statute to the facts. He says that you apply the statute, construed purposively, to the facts which are viewed realistically. What the Court is doing has been adjectivally expanded. It is not just applying the statute to the facts: it is construing the statute purposively, viewing the facts realistically, and then applying the purposively construed statute to the realistically viewed facts. That is, presumably, to do more than just to apply the statute to the facts because, if it is simply applying the statute to the facts, the adjectival phrases add nothing – indeed, mean nothing. Since, in our legal tradition, we attribute weight to everything that a Judge says, we must assume that these adjectival phrases do not mean nothing. Construing purposively is not the same thing as applying the statute. Indeed, when a Judge says that he is construing something purposively, it is inevitable that he is going to construe it to mean something that it does not say: if he is not going to construe something to mean what it does not say, he does not have to construe purposively.

The approach summed up by Mr Justice Ribeiro has its roots, as far as the English legal tradition is concerned, in *Ramsay*, but the decision in *Ramsay* is the inheritor of a tradition begun in the 1930s in America by the charismatically named Mr Justice Learned Hand, who wrote the most beautiful English. The beauty of his prose perhaps hides a lack of rigour in his analysis. I have not looked up the precise quote, but somewhere he makes a remark along the lines that the meaning of a statutory provision differs from the meaning of the words in it in the same way as a melody is different from the single notes which go to make it up. Lord Hoffmann has, of course, rejected the idea that a statute carries with it some kind of penumbral spirit, and, although he is now one of the arch proponents of purposive construction, I doubt if he would altogether accept the idea inherent in Learned Hand’s notion of melody. I protest at the suggestion that words and music can be analogised in the way that Learned Hand did: words convey meaning and the statutory draughtsman is careful in the way in which he or she puts words together. Music, on the other hand, sets free the mind, so that emotions can take over: the combination of words does not achieve the same sort of thing as the combination of notes; and I do not find it any easier to swallow what Mr Justice Learned Hand says, given my knowledge that he was thrown out of his glee club at college because he could not sing.

By 1984 or, perhaps a bit later, and no matter what or where its origins were, the

House of Lords seemed to have crafted a rule – or, at least, sent a message – that, if a statute had to be applied to something that was tax avoidance, it would be construed so that it did not permit the tax avoidance to happen. Now, of course, the House of Lords has, apparently, been running away from that proposition in the recent cases or, at any rate, has been running away from that way of putting the matter. But you will, I am sure, have noted the extraordinary contradiction between the remark made by the House of Lords in *Barclays* that there was no special rule applicable to tax cases and the remark made by the very same judicial committee on the same day in *Scottish Provident*, that the rule in *Ramsay* had a beneficial effect in tax cases. Wherever we are now in our thinking about our approach to tax avoidance, we are a very long way from the sort of thinking which prevailed in the *Duke of Westminster's* case⁹, with its insistence that form and substance were the same thing and that the question of whether what was done was acceptable or not was irrelevant. It seems to me that a very flexible rule of statutory construction has been crafted, a rule which allows the Court to arrive at the result which it thinks sensible, even if the wording of the statute does not actually easily lend itself to the interpretation adopted.

Some of you might respond to me that that is not what a rule of purposive construction does: you might say that that rule does not allow a sensible result, but only a result mandated by a meticulous analysis of the underlying purpose of the legislation. I wish I could agree with such a halcyon view. Unfortunately, however, I cannot find any meticulous examination of purpose in any of the authorities, but only assertion.

I know, for certain sure, that the purpose of the stamp duty group relief legislation in its original form here, and in the form it was in, in Hong Kong, when it was considered in *Arrowtown*, was to impose a formalistic test for the existence of a group, even though the CFA in Hong Kong purported to find some more substance related purpose in the legislation. What is actually happening in all these cases about purposive construction is that where a tax planner has discovered something which has not been dealt with by the legislature, the highest level of the Courts is filling the gap with the solution which they believe would have been adopted by the legislature if it had thought about the matter. That is not really construing purposively but legislative guessing: it has not generally been done in the past at the High Court or Court of Appeal level, as the recent *Bank of Ireland*¹⁰ case shows; but it is done at the House of Lords level and, now increasingly, in the High Court and the Court of Appeal, as the recent *Harding*¹¹ and *Prizedome*¹² cases demonstrate. What is perhaps most (or at least, very) concerning is that the approach adopted in a case is very dependent on the particular judge or judges hearing it. Some judges will look to the words of the statute; others will fill a gap in what the words provide for by guessing at the purpose. In tax cases, when a judge of a particular sort is presented with a legislative gap as a result of which no tax appears to be payable, he or she will fill the gap with tax even in a situation where it is plain that Parliament just did not think about the matter at all. That is not finding the intention of the legislature but, rather, stipulating what the intention would have been if Parliament had thought about the situation, which it didn't.

I have no doubt whatever that all of us can find cases – they may not be the

same cases for each of us, but all of us will be able to find cases – where we applaud the result reached, even if we have doubts about whether the law, as we understood it before the case, really supports the decision. Let us, however, bear in mind that if we have a rule which allows us to reach a sensible result in spite of the language of the statute, the same rule can be adapted, so that it allows us to reach a politically convenient result: it might even be that “sensible” and “politically convenient” are synonyms. At any rate, once a Court has decided that it can interpret a statute to mean what it does not say, a little of our democracy has been lost: a little of our knowledge as to where the boundary, between the permitted and the prohibited, lies, has been eroded.

Our response to a Court’s decision is, of course, not wholly influenced by reason: to some extent it is influenced by whether we approve of the result. I work, more or less every day, with the authorities about tax avoidance constantly in mind. I have become used to them: they are familiar friends, part of an everyday patchwork. But, as I have been preparing this talk, trying to look at these cases with a fresh eye so as not to say something too dull to you, one point has struck me: and it has, as it struck me, shocked me. In some, at least, of the familiar list of tax avoidance authorities, the legislation was absolutely clear, without any trace of ambiguity and mandated a result in favour of the taxpayer. Yet the taxpayer lost, because clear legislation had a different meaning from that appearing from its words when it was construed purposively. If that does not shock, surely it at least surprises; and I suggest that it should shock. There is a difference here between cases where it is possible to regard the facts in different ways and those where the facts are absolutely clear and the only issue is whether the statute applies to them. The shocking cases are those of the latter kind and examples of them are on the increase, as lower Courts get used to the idea that they may construe purposively. What the House of Lords has been doing is to look for a satisfactory response to what I shall, for the moment, call “the problem of tax avoidance”.

There are, however, logically prior issues here. First, is tax avoidance a problem? If so, what is the problem? Does it stop the government from achieving the revenues to match its budget? The answer is, by the way, No. If it does not have that adverse result, what other problem is it causing? Is it all types of tax avoidance or only some that are a problem? I shall need to come back to these issues in a moment. For the time being, I shall note that the present response of the Courts to the problem of tax avoidance is extremely flexible. As an aside, I might note that the most ancient sorts of law – those that have been tested by experience for much longer than ours - do not permit this sort of latitude: they are extremely formalistic so, for example, many ancient systems (including Sharia law, which has shaped the form of some financial instruments and so is something one might have to deal with while practising UK tax law) prohibit lending at interest, but do not prohibit the economically equivalent discount. That does not, of course, mean that ancient systems have never flirted with rules that put substance above form, but it does mean that, having tried them, they rejected them. I venture to suggest that that is because experience has demonstrated that a degree of certainty is needed in a legal system and that the necessary degree of certainty can only be achieved when regard is paid to form.

In theory, of course, Parliament can remedy any wrong decision by a Court, but the prospect is that it will not: while it may remedy a decision that says black is white, it will not remedy a decision that, although the words seem to say “A” they actually mean “B”, especially if nobody actually gave a lot of thought to whether they meant “A” or “B” when they wrote down “A”. So Courts have taken for themselves a very flexible power and, to my mind, flexibility lies at the heart of what our present generation of judges is seeking to achieve. At any rate, whenever I have, as an advocate, advanced a bright line rule as a solution to a case, the Court has rejected it; and my feeling is that it has been rejected because it fetters the ability of the Court to reach its own conclusion as to the right result. An element of flexibility has been inserted into the rather rigid statutory structure of our tax code.

We may see that development as a bit akin to the amelioration of rigid common law rules by equity; and we all regard equity as a good thing. There is, however, a difference between equity and a rule of purposive construction. Equity is, itself, a form of customary law, changing another form of customary law. A rule of purposive construction is a rule of customary law which affects a statute; and it may at least be asked whether it is appropriate to have a customary law, even if it is comfortably called a rule of construction, which permits the meaning of a statute to be changed. The question of whether that sort of rule is appropriate becomes even more acute if one considers that the operation of the rule is not going to be well policed or controlled by the institutions of democracy other than the Courts.

Now let me turn to consider how all this theory interacts with the everyday practice of tax law. I cannot now remember exactly when, but, at some time during the late 1970s or the early 1980s, the Revenue set up a series of what they called “Special Offices”, which were supposed to deal with complex cases of avoidance. Since these offices were first set up, the name has been changed on a number of occasions: I think the current title is Special Compliance Office, though, no matter what version there has been, the word “special” – am I alone in thinking it has slightly sinister connotations? – has been retained. What the Special Offices used to do – I am sure things are a good deal better now – but what they used to do was to take a taxpayer who had done any form of planning and say “that planning does not work: you owe us some more tax. If you are willing to pay something – not necessarily the full amount we say is due – we shall go away; but if you say you are not willing to pay anything, we shall use our wide range of investigatory powers and continue investigating you until we have worn you down and you pay us the lot”. The lawyer’s response to this was to say, “You cannot behave like that: it is not law; in particular, the tax planning works”. The official response was along the lines of “that’s what the taxpayer said in *Furniss v. Dawson*”. So you can see that a rule which appears to be about statutory construction of detailed technical provisions actually transfers power to the administrator: he has been given the power – or, at least, more power – to harass, by the enhanced flexibility created by this sort of rule of statutory construction.

In the early 1980s one of the Revenue’s supposedly star investigators was a man called Mr Michael Allcock, and he used to style himself as the Revenue’s specialist on Schedule E and Iraq: what the Inland Revenue had to do with Iraq I am not entirely

sure, but I think that, among those whom the Revenue regard as their customers, there were a number of Iraqi individuals with oil wealth; and I think Mr Allcock may have been their chief customer liaison officer. Because Mr Allcock was the Revenue's specialist on Schedule E, I had a number of meetings with him about non-domiciled salaried individuals who were still using Split Schedule E arrangements. It was Mr Allcock's tactic to say that these arrangements did not work: the basis for the assertion was not terribly well made out, but it seemed to have something to do with *Ramsay* and *Furniss v. Dawson*. At any rate the message came over loud and clear that, if money was paid, Mr Allcock would go away, and if it wasn't paid, well, the Revenue would go on making a nuisance of themselves, requiring more and more information and using their powers under the Taxes Management Act 1970, including – especially – section 20, to get it. Many taxpayers could not bear the burden of the investigation: the psychology of most taxpayers is such that being investigated by the Revenue causes astonishing trauma, and many of them paid money just to get rid of the inquiry, and not because they believed it to be due. That way of running a tax system was not very likeable: it smacked of extortion, and, although there is some element of extortion inherent in every tax system, the extent of the extortion element seemed to cross the line. It was not only Mr Allcock who, in those days behaved in this way: there were others. To my way of thinking, a tax system should be run in an entirely rational way and should not have any elements of emotional bullying such as was often then found in the conduct of the Special Offices.

Happily, we seem to have made some progress towards a more rational way of administering the tax system; and three developments may have assisted to that end. First, some taxpayers proved themselves willing to stand up to Revenue bullying: the taxpayers who were willing to do this were relatively few, but there were enough to make a difference. The initial stand was over the Revenue's power to obtain information under section 20; and there were a number of administrative law grounds on which the use of the power could be and was challenged. So, here, the tax lawyer had also to be an administrative lawyer, demonstrating the width of tax practice.

The next thing that happened was that it turned out that some of the money which Mr Allcock had been collecting from taxpayers had been kept by him for himself. Everybody was astonished at this, and, I suppose, given that we have a Civil Service that we regard as sea green incorruptible, it was a very shocking thing to happen. However, when you stand back and think about it, if your business plan is to collect money even in cases where it is doubtful whether the law properly empowers you to collect it, this sort of thing is all too likely to happen. Mr Allcock was tried and convicted: the evidence established that very many taxpayers were only too willing to pay him and that made what he was doing a bit too easy for him. There were, however, some of us whose clients did not pay up like lambs to the slaughter: there were a few of us who, as it was put to him at his trial, used "to put him through the wringer". The way we were behaving was regarded by the majority of tax practitioners as vaguely shocking. You were, apparently, not supposed to answer back to the Revenue. But there is not much doubt that the only thing which curbed Mr Allcock's ability to help himself in the way that he did was the stand that a few taxpayers and the lawyers or accountants acting on their behalf took against him.

The last thing that happened – and the thing which really improved things – was that the Revenue raided a firm of accountants called Kingston Smith: the raid was not because of any suspicion that Kingston Smith had done anything wrong, but was part of an investigation into one client of the firm. Nonetheless, the Revenue, in exercise of their powers under section 20C wanted to take away the hard disk from the firm's computer. An injunction was obtained stopping the raid. Quite astonishingly, the Revenue breached the injunction, and, eventually, that led to a wide-ranging internal review of their procedures, which has had the most beneficial effects. So now we have a tax system which, no doubt, is not being run perfectly, but is, I think, being administered much more carefully than it was 20 or so years ago; and the efforts of the Tax Bar have certainly done something to help bring that about.

Nonetheless, we still have a culture in which Revenue officials can, and sometimes do, seek to challenge an arrangement made by a taxpayer on the grounds that it constitutes tax avoidance. Although the Courts now deny that there is any special rule about tax avoidance, there is, nonetheless, a general trend in every type of case – not just tax cases, but in all areas of the law in which a question of construction arises – to interpret the instrument before the Court in a way which leads to a sensible result. But this does rather beg a question. What is a sensible result? It seems that, in tax cases at any rate, the sensible result is assumed to be the one which prevents tax avoidance, and examples of that sort of approach are to be found in both *Arrowtown* and *Carreras*¹³, which are both cases where the statutory language was, if not ignored, at least added to by implications not drawn from the legislation itself. So, in advising a client about what transactions he can safely do or not do, in advising a client whether to appeal an assessment, and in deciding how to present a case, the question of whether what was done or is to be done is tax avoidance now looms quite large. And that is not, here, because of any specific statutory language (or not usually because of any specific statutory language) but because of a concern that a Court will be willing to apply purposive construction to strike down tax avoidance even more widely than it would be willing to in other cases, and that the Revenue, being aware of that possibility, will assert claims to tax which are not supported by the express wording of the statute.

A tax practice involves almost every aspect of human and, so far as it is a different thing, commercial life. You might find yourself advising a farmer or an entrepreneur whether to put assets into a trust or to make an outright gift of his assets to a member of the family. You will need to consider not only the effect that transaction will have for tax, but also what impact the gift will have on the donor's ability to live; and potentially the impact which it will have on family life. Or you might have to advise a person who is about to take up employment on his remuneration package, or whether – as for example in the case of private equity partnerships – it might be fiscally more advantageous for him to become a partner: in that context, you will need to know something of the liability risks to which you are exposing him by the suggestion. It was, indeed, tax and liability considerations which led to the development – originally in the USA – of Limited Liability Partnerships, in the form of a body corporate which is treated as fiscally transparent.

Matters which are less involved with the human side of things but which are,

nonetheless, intellectually most challenging relate to what is, in the jargon of the City, called structured financing. In the end, all structured financing is a form of straightforward lending dressed up with a whole load of different financial instruments such as swaps or options and other complex derivatives. A cynic would say that many of these different structures have a tax purpose: they seek to generate reliefs greater than those which would be available if interest were simply paid on a straightforward loan. A greater cynic might take the view that the whole purpose of derivatives is to persuade fools to part with their money; and they certainly seem to have been very successful in achieving that result recently, with the consequence that we are now having to unwind many of these structures because of the credit crunch. Sometimes you get involved with ships and oil rigs and things like that; and that is especially so when capital allowances are involved.

Then there are takeovers and mergers and corporate reconstructions: and many of these will have an international cross-border element, so that questions of how EU law, other tax systems and double tax relief impact on them will need to be considered. In all of these cases the desire is to keep tax to a minimum and in all of them you will need to consider how the Court will react to what has been done in the light of its approach to tax avoidance.

One issue which arises here is whether the Court has adopted a different approach to the imposing of charges to tax on the one hand and the granting of reliefs from tax on the other. Many of the cases in which the Courts have talked about tax avoidance have involved cases where a taxpayer is seeking to bring himself within the scope of a relief. There is a difference between that sort of case and the sort of case where the taxpayer seeks to keep himself outside the scope of the charge to tax. The difference is that, where the taxpayer is seeking a relief, he is attempting to say “this specific relieving provision applies to me” but, where he is saying that he is not within the charge, the matter is the other way round: he is there saying “this provision does not apply to me”. In litigation generally, the presumption is that he who asserts must prove so that, in a way, the burden is different in the two cases.

In actual practice – I think it is not so when you are learning law or thinking about it in theory – the question of burden becomes very important. “What do I have to prove?” and “What do I have to do to prove it?” are questions which loom very large when you are preparing a case for trial, and here tax litigation is no different from any other sort of litigation. When a taxpayer is seeking a relief, he carries the burden of establishing that it applies to him: if he says, “I am not within the charge”, he does – of course – carry a burden, but there is also a burden on the Revenue to establish that the charge does apply. There ought, accordingly, to be a difference of approach in the one case and in the other. It does, however, have to be said that the cases in this area do not actually establish that the Courts will adopt wholly different approaches in the two different types of case.

A synthesis or attempted synthesis of the case law so far means that foremost in the mind of the adviser is the question: “Will the Court consider this to be tax avoidance?” The reason why the adviser has to consider this question is that, as I have said, the Courts have devised a very flexible rule of purposive statutory construction

which they appear to use, most particularly to strike down tax avoidance by finding a legislative purpose which fills any gap which has been left in the tax net. So it becomes very important to know whether something is tax avoidance or not.

Many jurisdictions – though, dare I say it, on the whole not those with the largest economies – have attempted to deal with questions of tax avoidance by enacting a general anti-avoidance rule or, as it is known in the jargon of the trade, a GAAR, and these rules – with some exceptions – bear a strong family resemblance to each other. The provisions attempt to define, in one form or another, what tax avoidance is. In Australia, the definition goes on and on, and it contains, in some instances, the need to make a comparison between what actually happened and some other reasonable hypothesis. In Hong Kong, the GAAR operates by reference to the concept of “tax benefit” and the definition of “tax benefit” is very much shorter than in the Australian code: it is defined as “the avoidance or postponement of the liability to tax or a reduction in the amount thereof”. In a recent Hong Kong case, Lord Hoffmann has said that this definition, too, requires a comparison (not specifically required by the wording of the legislation – Lord Hoffmann has divined the need to make this precise sort of comparison) between what actually happened and some other appropriate alternative hypothesis: he was not, however, very clear as to what would constitute an appropriate alternative hypothesis.

For example, a moment ago, I gave you a list of the sort of things a tax adviser might have to advise on and, at the head of that list, I put advising on gifts to a member of the family. A gift like that, if made seven years before a death, means that the donor’s estate will be less than it would have been and, on his death, his estate will bear less inheritance tax than would have been the case if the gift had not been made. It may also be that the gift will shift the burden of income tax. If we seek to apply Lord Hoffmann’s definition here, there is, undoubtedly, tax avoidance; but I am not sure that everybody would call that tax avoidance or, if they would, that they would call it objectionable tax avoidance. In the late 1980s and the early 1990s, Lord Templeman, in the middle of speeches which quite often seemed like a rant, drew a distinction between what he called tax avoidance and acceptable tax mitigation. The difference between them was, he said, that one had real economic consequences and the other did not. That does rather beg the question as to what is a real economic consequence but it does seem to me that it provides at least some indication of the way in which the Court will approach an arrangement which it perceives to be fiscally driven. I rather think that, if a Court believes that a fiscally driven arrangement has a real economic effect, then it will not regard the matter as tax avoidance, but that if it regards what has happened as wholly artificial, then it will identify tax avoidance and seek to stop it. I cannot say that that is a precise guide: Lord Hoffmann has been at particular pains to say that circularity is not, in itself, a vice. But real things can be achieved by circular transactions in the sense that even something circular can effect permanent changes in, for example, group indebtedness; and other apparently permanent things may not have any real effect.

I was recently asked to advise on a structure which was intended to result in a profit being realised in a way which was outside the charge to tax. It seemed to me that the charging provisions, read literally, clearly did not attach to the profit, but in

my heart, I knew that the Court would feel that the charge ought to attach; and that it would feel that way, even though the way the profit was realised involved a transaction between genuine third parties acting at arm's length which, undoubtedly, had real economic consequences. I wanted to advise that the Court would strike this arrangement down: after all, in the context of the relief being sought in *Arrowtown*, the Court did strike down an arrangement which obviously fell precisely within the wording of the statute. My heart said "tell them not to do it", but my head could not find any rational basis for imposing the charge other than that the legislature had not thought at all about the situation being created. One should, in that situation, be able to advise with clarity and vigour, but experience, bought with grief, teaches. In the end, I advised that the charge should not attach but, I was nearly reduced to the drivelling three handed lawyer by the concern that the Court, faced with a legislative gap, would fill it with a tax charge, relying on some supposed purpose to impose a charge in this unthought about transaction.

One of the difficulties here is that nobody actually knows what they mean by tax avoidance: I shall be interested to hear how you define it, but I doubt if we shall all agree on what it is, and I also expect that, however you define it, you will be unable to do it by reference to factors which, if we examine them with sufficient rigour, will prove to be wholly objective, so that somewhere or another in your definitions there will be a subjective element. My study of GAARs suggests that, in the end, the subjective element is always present, so that a decision that the GAAR applies is essentially an expression of a view that the Court does not like what was done in the case. The same is, of course, true when the Court says that tax is payable on a purposive (but not a literal construction) of the legislation.

And if we do not agree on what tax avoidance is, we may also not agree on whether tax avoidance is a good thing or a bad thing. The mantra of the day is that tax avoidance is a problem. However, a thing about mantras is that they are meaningless phrases designed to provide comfort; and that is just as true of this mantra as any other. I raised earlier a number of issues related to the question of whether tax avoidance is a problem. Essentially I asked what, exactly, the problem is. If you have spent any time thinking about that question I expect you will have some sort of answer to it. Before we consider what that answer might be, let me put another proposition to you. Let me suggest to you that tax avoidance might be a good thing.

Suppose you were asked to sit down with a blank sheet of paper and devise a tax system for the 21st century, ignoring all the political complications that would be involved in moving from our current system to another. How would you go about structuring that system? I venture to suggest that, given the first place accorded in our everyday life to the market economy, the first thing you would do is to try to devise a tax system which least distorted economic decision making. You might, for example, not have an income tax because, at least at certain rates, that discourages people from working and so on: one of the reasons doctors don't work at night now is that the inconvenience of it is not compensated for by keeping 60% only of your gross pay. Most tax avoidance of the kind which is perceived by taxing authorities as really objectionable is done by companies and by large companies at that: I do not say that all tax avoidance is done by that sort of person, but most of it, the sort that gets taxing

authorities really worked up, is done by large companies. And the reason why they do it is not necessarily selfish: it may be and usually is done by companies to make themselves more competitive; they do it so that they can do the things they want to do without worrying about tax. And if this is not a good thing it may, at least, not be a bad thing: the almost automatic reaction that it must be stopped does not seem to me to have any logical foundation other than the notion that it is somehow unfair for tax to be avoided, and I rather suspect that, if I asked for your answer to the question: “what problem is tax avoidance?”, it would have something to do with fairness.

Indeed, I believe that what our current generation of judges is seeking to do by the use of purposive construction is to introduce some aspect of what they regard as fairness to our tax system in the belief that they are thereby curing something wholly unfair. Notions of fairness are, however, essentially emotional and not rational and one person’s view of fairness is not another person’s view. Suppose, for example, that we live in a community where there is a rule that every family must contribute to the well which provides water for the community. There is one family of five people earning £10,000 a year and the rule is that it must contribute 10% of its income (that is £1,000) to the upkeep of the well. There is a widow, a single person with an income of £100,000 a year and the rule is that she must pay 10% of her income (that is £10,000) towards the upkeep of the well, so that she pays 10 times what the family of five pays while using only one-fifth of the water. Is that fair? Would it be more fair or less fair if the widow had to pay £20,000 towards the well which is what happens with a progressive tax system? How do I measure a company’s ability to employ more people because it has saved tax against the benefits that its tax payment would have purchased? I am not going to provide a definitive answer to these questions, but I think I have demonstrated that a conclusion about whether something is fair or not does not have any logical basis: pure logic would indicate that what is happening in relation to the well is unfair, but that may not be a good guide to how the cost should be shared. Once you permit an emotional conclusion about fairness to influence the result on a question, you have moved very far from the strict lines apparently drawn by a statutory code; and have introduced an element of discretion.

I suspect that I may be alone here in thinking that tax avoidance is not necessarily a bad thing, but I may not be alone in finding a rule which allows a Court an ability to dispense with the black letter of the law objectionable. It seems to me that a rule of purposive construction, which is essentially a rule that says we will interpret the statute to catch you if we do not like what you have done, is not very far from the sort of discretionary rule that we should all find objectionable. Some time ago, when the financial arrangements on divorce were much in the news and a professional tax adviser, Mr McFarlane, was ordered to pay his ex-wife half his income for the rest of his life, a colleague of mine said to me “we should never have allowed the law to get in this mess”. It was a criticism of the divorce practitioners, who have allowed the law to reach a state in which what, to some, seems to be state-sponsored theft is permitted. And all of this has come about from a genuine desire to do good, based on a statute which contains a mandatory rule about reasonableness. The majority view seems to be that the Courts’ no doubt genuine desire to do good in this area has actually created wholly unreasonable results. So my colleague imposed on me, by his casual remark, the feeling that I needed to do whatever I can to stop the

law of tax becoming a mess.

There are, no doubt, lots of ways in which the law of tax may become a mess, and, indeed, the current state of our statutory code may already be described as a ghastly mess. However, putting that right falls mainly in the political field. What the tax lawyer needs to be doing is to stop the Courts from creating a mess or adding to an existing mess, and that means, in particular, confining the rule about purposive construction so that a degree of certainty is restored to our tax system. We may not think that a discretionary element in the law of tax is a bad thing. Very few people will stand up and say tax avoidance is a good thing or that the opportunity to do it should be permitted. That makes the law of tax an easy area in which to introduce rules which gather a wide measure of public acceptance.

But consider where a rule introduced acceptably and easily in an unpopular area like tax may go. Both tax law and crime are considered by international convention to be penal. If a discretion gets built into the tax system might the discretionary rule be spread to the criminal area? If so, how comfortable do we feel about that, at a time when the tone of government is more authoritarian and more Tudor-like than I can ever recall? How comfortable would we feel if there were a rule that an action would be criminal if the Court thought it ought to be criminal? And if we feel uncomfortable with that, why would we allow that sort of rule as a rule of tax law, and how different is it, really, from a rule of purposive construction?

Here is an extract from Robert Bolt's play "A Man for all Seasons" which profoundly influenced my thinking. Richard Rich is being courted by Thomas Cromwell, who wants him to betray Sir Thomas More. Rich goes to More and asks for a job.

"RICH (*desperately*): Employ me!

MORE: No!

RICH (*moves swiftly to exist: turns there*): I would be steadfast!

MORE: Richard, you couldn't answer for yourself even so far as tonight.

Exit RICH. All watch him; the others turn to MORE, their faces alert.

ROPER: Arrest him.

MORE: For what?

MARGARET: Father, that man's bad.

MORE: There is no law against that.

ROPER: There is! God's law!

MORE: Then God can arrest him.

ROPER: Sophistication upon sophistication!

MORE: No, sheer simplicity. The law, Roper, the law. I know what's legal not what's right. And I'll stick to what 's legal.

ROPER: Then you set Man's law above God's!

MORE: No far below; but let me draw your attention to a fact – I'm *not* God. The currents and eddies of right and wrong, which you find such plain-sailing, I can't navigate, I'm no voyager. But in the thickets of the law, oh there I'm a forester. I doubt if there's a man alive who could follow me there, thank God ... (*He says this to himself.*)

ALICE (*exasperated, pointing after RICH*): While you talk, he's gone!

MORE: And go he should if he was the devil himself until he broke the law!

ROPER: So now you'd give the Devil benefit of the law!

MORE: Yes. What would you do? Cut a great road through the law to get after the Devil?

ROPER: I'd cut down every law in England to do that!

MORE (*roused and excited*): Oh? (*Advances on ROPER*). And when the last law was down, and the Devil turned round on you – where would you hide, Roper, the laws all being flat? (*Leaves him*). This country's planted thick with laws from coast to coast – Man's laws, not God's – and if you cut them down – and you're just the man to do it – d'you really think you could stand upright in the winds that would blow then? (*Quietly*). Yes, I'd give the Devil benefit of law, for my own safety's sake."

We need to be able to stand up when the winds blow. It is never too early to make sure that the forest is in good order; and even the least part of the forest needs tending to keep the trees healthy. There is a job for tax lawyers to do: it is the job of keeping their part of the thicket of the law in sound order, safe from a too pervasive role for purposive construction. It's an important job and it begins with supposed doctrines about tax avoidance, which is why I said at the beginning of this talk that that may yet be a field of dreams for the aspirational lawyer. "The worst possible disorder that can fall upon a country is when subjects are deprived of the sanction of clear and positive laws", said Erskine; and perhaps I might adapt the Psalmist and say, "Unless the tax lawyer watches over the house, they labour in vain who build it".

¹ From a lecture given in Oxford on 5 March 2008 and subtitled "An uninspiring title for a talk intended to be inspiring".

² [1982] AC 300.

³ [1984] AC 474.

⁴ [1989] AC 398.

⁵ [2003] 1 AC 311.

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- ⁶ [2003] HKRCA 46
⁷ [2004] UKHL 51
⁸ [2004] UKHL 52
⁹ [1936] AC 1
¹⁰ [2008] STC 2008
¹¹ [2008] STC 1965
¹² [2008] EWHC 19 (Ch)
¹³ [2004] UKPC 16