THE CURRENT FOCUS ON TAX AVOIDANCE

David Goldberg

Let me ask you to picture the scene.

It is sometime in February of this year. I am in a restaurant in Hong Kong, having dinner with a friend of mine who works for the local revenue. A great truth is about to be revealed.

I have just remarked that it is rather nice to get away from the general doom and gloom of the United Kingdom to the vibrant Far East where, at any rate to the visitor, it seems that the focus is on the reality of life, the fact that life is actually quite hard, that there is a need to get, to provide the means of survival and a desire to spend.

In the West, on the other hand, the pathetic but constant cry is that everything must be fair.

I have never found the demand for fairness particularly compelling: some 40 or so years ago, another friend of mine complained that he did not have the good looks of Robert Redford and he found that very unfair, but he noted that that particular unfairness was – short of surgery which could very well make things worse – irremediable.

The Paralympics have just given us another example of how much of life produces irremediable unfairness and of how little good is achieved by crying that it is unfair: at any rate, the lives of the athletes would have been poorer if, instead of seeking to do something with their lives, something inspiring and uplifting, they had sat down and wept at the unfairness of losing a limb, of being mentally challenged or of being only partially sensed.

Life is more satisfying than it otherwise would be if we recognise that it is, inherently, unfair, and that attempts to make it fair will, inevitably, fail: all that they will do, if anything, is illogically change where the unfairness falls.

And so, in the picture, I am complaining to my friend about how stupid, how lacking in context, how meaningless the cry for fairness is.

My Hong Kong friend, to my surprise, said that it was the same in Hong Kong: the cry everywhere there, just as in the West, was that things had to be fair.

But, she added, I was wrong when I said that the concept of fairness was meaningless.

"Fair" she said "means what is in my interest".

That is the great truth which was revealed.

I am used to the idea that how a thing looks depends on where we are looking at it from: so far as physical things are concerned, the frame of reference is everything.

But the idea that the frame of reference is relevant to an idea or to a concept was new to me, and so I started to think about the frame of reference in relation to abstract concepts, like fairness.

It seems to me that the frame of reference – my position as I think about an idea – is relevant to the determination of what is tax avoidance.

One person's sensible tax planning is, viewed from another place or time, outrageous tax avoidance.

On occasion, I act for the Revenue and, when I do, I get very angry on behalf of the Revenue about some things which give me an uncomfortable feeling.

The uncomfortable feeling comes from my suspicion that, if a taxpayer had come to me proposing the thing which has angered me on behalf of the Revenue, I would have blessed it and even found it rather amusing.

Because the frame of reference affects everything, there is a huge difficulty in defining tax avoidance.

The newspapers refer to specific reliefs – for example those given to pension contributions – as loopholes.

Quite how it is possible to define a specific legislative relief as a loophole, I do not understand: the thinking seems to be

based on an assumption, which is quite contrary to the truth, that everything and everybody is automatically subject to tax unless there is some specific exemption – which can then be called a loophole.

The idea that that is the position is ludicrous to anybody with any knowledge of the matter.

How much tax is automatically payable? On what is it payable?

It is impossible to have anything like informed or sensible debate, when it is not understood by all parties to the debate that tax is an artificial construct with arbitrary boundaries.

The problem has been compounded by the attitude of our politicians.

Earlier this year the Chancellor – the Chancellor himself, who really really ought to know better – said that it was tax avoidance to give your money to charity and then to claim the relief from tax specifically given for such gifts.

I doubt if anybody with any commonsense would really call an out and out gift to charity tax avoidance, but we had our Chancellor actually saying it was.

Another point here is that, for a tax system to be fair – assuming that word to have any meaning – it must be fair in all ways: it must be fair as between taxpayers themselves, as between taxpayers and HMRC and as between HMRC and taxpayers.

I doubt if our tax system satisfies the last of those requirements.

To take one example, can anyone really justify the effectively retrospective application of the pre-owned assets tax, or the even more openly retrospective legislation that we have seen recently?

In any event, what is really important in a tax system is that it should be "right": it must at least produce a reasonably predictable and sensible answer.

However, the atmosphere has become febrile.

It is in this convulsive situation that cases come to Court, and it is proposed that we have a new provision to be known by the acronym of the GAAR.

I am concerned that rational debate is impossible in the current atmosphere, and that we are sleep-walking into a dangerous situation: is this a situation in which the tax system can be described as right?

Let me try and be a bit more particular about my concerns, by dealing first with what happens when a case, which has been stigmatised as being about tax avoidance, goes to Court, and then by considering some aspects of the proposed GAAR, which is the kind of provision which only small economies which do not think all that well of themselves have so far implemented.

One of the reasons for the GAAR is said to be the decision in *Mayes*[1].

As I am sure everybody here will know, Mr Mayes bought a second-hand life assurance policy which he surrendered; and he then claimed that he had made a form of loss for tax purposes.

The loss arose under the specific provisions of the legislation dealing with life policies, and it arose because, at various points in the existence of the policies, large premiums were paid up on the bonds and then withdrawn.

The argument for the Revenue was that, since the payment of the premium and its withdrawal were all part of a pre-conceived plan, they were, on a purposive construction of the legislation, to be disregarded for tax purposes.

Of course, if they were disregarded, the loss which Mr Mayes was claiming would not exist.

We all know that in a case like this the law is easy: all that is necessary is to apply the statute, construed purposively, to what happened, adopting a realistic view of the facts.

However, in the *Mayes* case, the legislation is very prescriptive: if, on a realistic view of the facts, a premium was paid and then withdrawn, the legislation provided for the loss which Mr Mayes was claiming; that is what the legislation said, and there is little room here for reading things into the statutory language or giving it a meaning which it does not naturally bear.

That is largely because the loss here is not some sort of a commercial loss: it is an entirely artificial construct of the legislation, so this is not the sort of case in which it is possible to have some kind of instinctive feeling as to whether there should be a loss or not.

Nonetheless, a factual issue still arises: on a realistic view of the facts, was the premium really paid and withdrawn, or was it, really, never paid at all?

The difficulty for the Revenue in saying that it was never paid was that they had agreed that, as a matter of fact, the premium had been paid.

They were arguing that, as a matter of law, the premium should be regarded as not being paid, but this was a bit inconsistent with their concession that, as a matter of fact, a premium had been paid.

It is important here that what was agreed was that a premium was paid: the Revenue did not merely accept that a sum of money which looked like a premium had been paid; they actually accepted that a premium had been paid.

It was this acceptance which made it difficult for a Court – a Court composed of judges who might not be expected to be sympathetic to tax avoidance – to say that a premium had not been paid.

Although most tax avoidance cases are said to be about what the statute means, they are very often really about what the facts are, and nearly every *Ramsay*[2] type case – I shall not go so far as to say all *Ramsay* type cases, but nearly all of them – can be explained as decisions on the facts.

Mayes is a relatively unusual case in that it involves provisions that do not relate to anything which might be called a commonsense situation: it is about what is plainly an entirely artificial construct of the legislation, and it is in that context that the factual concessions made by the Revenue made it difficult for the Revenue to win.

In a sense, *Mayes* became difficult for the Revenue because they had accepted that the facts were such that, on any natural reading of the legislation, Mr Mayes got his loss.

Nonetheless, they wanted to argue – and did argue – that, although the facts supported Mr Mayes' argument, the meaning of the legislation did not.

In *Mayes*, then, HMRC were arguing for a meaning of the legislation which diverged radically from their view of the facts.

In most cases of this sort, this dichotomy is absent: HMRC usually argue for a view of the facts which supports its interpretation of the legislation; in not doing that in this case they might have been over-cautious, insufficiently bold.

Because of the dichotomy present in *Mayes*, it cannot be regarded in any way as a representative case.

Moreover, the intensely specific nature of the statutory provisions engaged, and the inherently unnatural situation with which it deals make it unrepresentative.

Nonetheless, the case has been held up as a reason why we should have a GAAR, and it is perhaps worth pointing out – because this is relevant to some of the issues raised by the GAAR – that it might also be an example of a case in which it can be said that there are shortcomings in the legislation.

The taxpayer in *Schofield*[3] was not so fortunate as Mr Mayes: he lost his case that he had made a loss, perhaps – in part – because the facts at least raised the question of whether he had indeed made a loss.

The arrangements in *Schofield* involved options, and there is a lot of mumbo jumbo jargon involved in options which tends to confuse the position.

However, stripped of the jargon, Mr Schofield bought two assets, each of which was capable of going up or down in value, but on at least one of which it was more or less inevitable that he would make a loss.

This is a bit like betting on two horses to win in the same

race: it is something that you might do, but not something you are likely to do in a wholly commercial situation.

In order to raise the money to buy these assets and to balance the loss that was expected to arise on one of them, Mr Schofield sold, to the person from whom he bought the assets, two more options.

These sales were made in a way which did not attract any liability to tax, and, save to note that the sales took place, and that the assets sold balanced, in value terms, the assets purchased, we can put the details of the sales to one side.

As expected, one of the assets which Mr Schofield had bought went down in value, and he disposed of it for less than he paid for it.

He then emigrated, and, after he had become non-resident, he disposed of the other asset he had acquired, at a substantial gain, which was not taxable – only because he was non-resident and remained non-resident: the gain did not reflect the loss on the first asset and was, indeed, independent of it.

I think everybody knows that, if Mr Schofield had not successfully become non-resident, he would have been charged to capital gains tax on the gain made on the disposal of the second asset and would have had no defence to the charge.

However, it being convenient to them, the Revenue denied the existence of a gain on the second asset.

That was, of course, necessary to give their argument consistency, because, if there were a gain on the second asset, it is inevitable that there must have been a loss on the first asset.

Nonetheless, the Court, astonishingly – and I do mean astonishingly – has said that, on these facts, each and every one of the following is true: Mr Schofield never acquired an asset, never made a disposal and never made a loss.

Although the Court has said that each of these three things are true, it is quite apparent that the basis of the decision is that Mr Schofield did not acquire an asset.

That must be the case, because, if he did acquire an asset, then, since he no longer has it, he must have disposed of it, and, in that case, there must on the facts have been a loss on the first asset and a gain on the second asset.

In reaching this conclusion, the Court relied exclusively on *Ramsay,* taking the view that nothing since *Ramsay* was relevant: *Ramsay* allowed you to ignore things and the Court ignored them.

Most of us thought that the recent cases had made clear that *Ramsay* was not about ignoring things: indeed, that is exactly what *Mayes* says.

Mayes also says that it is not sensible to look to cases before *Barclays Mercantile*[4] to find out what the law is.

And yet, here in *Schofield*, we have a Court saying that you have to go back to *Ramsay*, a case which, factually, is not remotely like *Schofield*.

However one likes to look at it, *Mayes* and *Schofield* seem to adopt conflicting approaches.

An application for permission to appeal to the Supreme Court has been made in *Schofield* and we shall have to wait to see what happens to it.

But the contrast between *Mayes* and *Schofield* leaves the law in a mess.

Different judges were involved in each case but that, on its own, does not explain the different outcome in the two cases: that is explained partly by the concessions made in *Mayes* and not made in *Schofield*, and partly by the instinctive feeling that some people might have on the facts of *Schofield*, that Mr Schofield did not actually suffer a loss – a feeling that does not arise in *Mayes* in the same way, because the underlying question is so much more artificial – so much more obviously a question of what the statute provides than of what the commercial situation is.

I should say that, having thought about it all rather a lot,

I do think that Mr Schofield suffered a loss, just as I suffer a loss on a bet if I bet on two horses to win in a race, and one of them wins and the other loses: even though, overall, I might make a gain, I still have a loss on the losing bet.

The question which then arises is why what happened in *Schofield* creates so much distaste in the judiciary that it has – so far – been decided against the taxpayer, while what happened in *Mayes* – a case which could, as it seems to me, have been decided against the taxpayer on exactly the same basis as *Schofield* was decided against the taxpayer – does not seem to have aroused the same degree of distaste.

The question is relevant because the law is unclear, and, even without the GAAR, any tax adviser proposing a course of action needs to ask how a Court or Tribunal will react to it if it has to rule on it.

There can be no doubt that the identity of the judge is a large factor in determining how a case will be regarded and, indeed, decided, but it is clearly not the only determinant: I doubt if the difference between the judges in *Mayes* and in *Schofield* explains the different outcomes.

Before *MacNiven*[5], Lord Templeman was the leader of the judicial anti avoidance movement, and he made a distinction between transactions which had real economic consequences and those which did not.

It is tempting to think that this kind of formulation could provide a sound basis for determining what will work and what won't; and it is worth noting that a reference to economics appears in the current draft of the GAAR.

However, more thought shows that the distinctions between real and unreal consequences and between economic and non-economic consequences are illusory: like fairness, it is all a matter of opinion.

What Mr Schofield did, had – from my point of view – real economic consequences, consequences no less real than what

Mr Mayes did and, indeed, in some ways more real: it was just like bed and breakfasting which Lord Templeman said was acceptable and worked – see *Ensign*[6].

And it has to be said that there is no reference to economics in the judgments in *Mayes* or in *Schofield*.

So I doubt if references to reality or to economics are going to help provide any clarity here, any more than appeals to the supposed purpose of the legislation will do that.

Another point is that *Mayes* and *Schofield* were decided at different times and in different emotional climates.

When *Mayes* was decided, there was no general criticism of tax avoidance.

Schofield was argued when it was public knowledge that comedians had been taking the advice of accountants and the general clamour was for tax to be payable by everyone and on everything.

Ill-informed press reports should not affect judges but, like you and me, judges are human, and they are affected.

The law is without shape: it is a mess; and, on top of this blancmange, we are now, apparently unstoppably, to have a GAAR.

I have grave concerns about the form of GAAR which is presently before us: to my mind, it is an affront to the rule of law, a provision which, in its current form, no civilised state should be prepared to accept.

Strong words indeed. Can they be justified?

The full title of the GAAR is the General Anti-Abuse Rule, and the use of the word "abuse" rather than "avoidance" is meant to provide some reassurance that the rule will have a somewhat limited scope.

However, I doubt if that will turn out to be the case.

Moreover, the current draft of the GAAR is the wrong solution to a so-called problem which should not exist: it treats the wrong problem.

Our tax code contains something over 13,000 pages of primary and secondary legislation.

The purpose of a code that long is to set out detailed rules for every situation of which the draftsman could think: if the purpose is not to deal in detail with what might happen there is no need for such length.

Taxpayers then go through the rules and find things to do for which a certain outcome, favourable to the taxpayer, is prescribed by the details: that is what rules are for; there is no point in having rules unless they are to operate as rules.

On seeing what has happened, some observers claim that the outcome is unintended and offends some alleged spirit of the law – which is a fancy phrase, meaning no more than that the observer, for no very well-defined reason, does not like what the taxpayer has done.

That is the so-called problem: some observers do not like what the detailed rules allow you to do.

To the observer who says "I do not like what the taxpayer has done", the problem seems to be one of taxpayer behaviour which needs to be swatted like an irritating fly.

But what if the problem is caused by the tax code itself, has arisen because nobody has given any thought to what we want a tax code to do, has arisen because the tax code is doing the wrong things?

In other words, it is at least plausible that the problem is not taxpayer behaviour, but the tax legislator's behaviour.

In this country, we do not seem to have thought about what we want our tax system to do: we have just gone on happily adding to an overbearing tax code, until it is near the point of collapsing under its own weight; this year's Finance Act, filled with miserable and unprincipled tinkering, is a paradigm of what is wrong.

I have no fundamental objection to a GAAR, so long as its terms comply with the requirements of the rule of law, and it is adequately linked to a rational system of taxation.

The chief requirement of the rule of law is that law should be relatively certain: absolute certainty is unachievable, but clarity and a high degree of certainty are not.

A rational tax system is one which responds adequately to the concerns of those subject to it, while satisfying the needs of the State imposing it.

In order to see whether a tax system satisfies that requirement, we might ask a very large question. How would we design a tax system if we were starting today with a blank sheet of paper and no idea at all of the existing system?

I think we should want three things of the system.

First, it should be as nearly neutral in effect as it can possibly be, so that it does not require a decision, which ought to be taken on economic grounds alone, to be taken for tax reasons: for example, I should not have, or even wish, to acquire, to retain or to dispose of a particular asset because the tax system encourages me to do that.

Secondly, we should not ask the tax system to perform a social engineering function: tax systems quite often do that, but there are more honest ways of achieving government policy, and I think it would be better to use those methods (whatever impact that might have on national accounts) rather than to use tax to distort life.

Thirdly, we should endeavour to ensure that those subject to it find the tax system to be acceptable.

The acceptability, to those subject to it, of a tax is a function partly of its intelligibility, partly of the administrative burden which it imposes and partly of its rate.

Intelligibility of a tax is a function of simplicity: the simpler a tax system is, the more intelligible and, for that matter, the less administratively burdensome it will be.

Rate is a function of the amount of money which the system needs to collect and of the tax base, so the broader the base, the lower the rate can be.

The breadth of the base is a function of the basic charging provisions and of the reliefs given, so that the fewer reliefs, the broader the base.

Simplicity is a function of the breadth of the base, so that the broader the base, the simpler the tax.

The need for reliefs is a function of the tax rate, so the broader the base and the lower the tax rate, the fewer the necessary reliefs.

It follows that the fewer the reliefs, the greater the acceptability of the tax system.

That is because, if there are fewer reliefs, the base is broader, the tax is simpler and the rate lower than it would be with a greater number of reliefs.

Thus the removal of reliefs and the concomitant reduction in rate produces the three fundamental requirements for an acceptable tax system: intelligibility, ease of administration and a rate which people are willing to pay.

Acceptability, then, is achieved by simplicity: in order to achieve the third of the criteria which I set out for a good tax system, we need a simple system with a low rate and few reliefs.

Happily, a system in that form will also achieve the first two of my criteria: a low rate system will not force any particular economic decision and a system which has few reliefs will not be trying to affect behaviour.

Moreover, simple tax systems with their broad base and few reliefs make avoidance very hard: it is, after all, usually the manipulation of reliefs which is the tax avoider's weapon of choice.

A bad tax system creates the so-called problem of tax avoidance: a good tax system prevents it or, at any rate, by its fundamental design, limits the opportunities for avoidance.

Thus tax avoidance is not a problem of taxpayer behaviour, but a function of bad or, at any rate, inadequately thought-through legislation: just as bad money drives out good, bad law drives out good.

It seems to me, therefore, that the case for a simple low rate system is unanswerable.

Systems like that are quite often called *flat tax* systems, but that title mis-describes them. The important thing about a tax system is not that it is at a flat rate but that it is simple, so I think they would be better called *good taxes*.

A simple tax system can easily accommodate two rates of tax, one for those earning up to a certain level and another for those earning at a higher level, if that is thought to be a social or political necessity; and the broadening of the base would allow low earners to be taken out of the charge to tax, because it automatically collects in more revenue than a narrow base.

I might add that, if fairness is regarded as an essential element, and if fairness is taken to mean that "the rich must pay more" – the fiscal slogan which is the equivalent of the supermarket "Now costs less", a two rate tax system with limited reliefs achieves that.

I do not quite understand why the public and many of our politicians seem to believe – or are encouraged by some to believe – that our existing system does not provide for the rich to pay more, though I note that there are very few people who consider themselves to be rich, that being another comparative term.

However, no matter how the concept of being rich is defined, our tax system provides rather well – perhaps too well – for the rich to pay more, but it does not measure up to the criteria for a desirable tax system: it does not meet any of those criteria; it is verbose, parts of it are unintelligible to the point at which its complexity can literally make me weep, and most of it seems to me to be unnecessary.

It is so complicated that HMRC are not able adequately to police it, and the response has been to put an increasing burden on taxpayers to police themselves – which, of itself, makes the tax system less acceptable to those subject to it.

On top of that, it is full of reliefs which are an attempt to distort human behaviour (how many of us regret that, in one

way or another, we were effectively compelled to do something because of the fiscal incentives attached to it rather than because of its innate good sense) and which narrow the base, something made necessary because the tax is charged at relatively high rates.

Indeed, it is the reliefs which usually lead to the sort of tax avoidance schemes to which so many now object on the basis that this infringes some spirit of the law.

The question is whether the GAAR is an adult response to the situation.

The GAAR is going to be added to everything that we already have; and, by recommending or supporting the addition of a GAAR, those suggesting it somehow seem to accept that we have a wonderful tax system which needs to be protected by the fence of the GAAR.

So let me ask whether the addition of a GAAR is going to make our tax system more acceptable? Is it really going to stop riots in the streets as its author and chief proponent has claimed? Is it going to make our system work better?

There is a Japanese epigram:

"The sign on the fence says
Do not pluck these blooms,
But it is useless against the wind
Which cannot read"

The spirit of the law is like the wind: it cannot read and it cannot be read; and the addition of a GAAR to our over-complicated code is more likely to increase fraud than it is likely to improve tax collection.

On top of that, the current draft of the GAAR seems to me to be open to some fundamental objections.

It is, however, commendably short, and there is something to be said for brevity: indeed, those of us who have done any work with the Australian GAAR in Part IVA of their legislation will be grateful for the fact that this legislation, albeit still missing some parts, is only three pages long.

Nonetheless, brevity may bring with it an undesirable lack of clarity.

In order to fall within this provision, there must be, first, "tax arrangements" which are, secondly, "abusive".

The requirement that the tax arrangements be "abusive" is advertised as a limitation on the operation of the provision: the taxpayer is not caught just because he does something mainly to obtain a tax advantage.

In this respect, the draft resembles the sort of GAAR which can be found in some Commonwealth jurisdictions, which include what is called a "safe harbour".

But there are differences between that type of model and what we have here.

The chief difference is that most GAARs provide that whether an arrangement is done mainly for tax purposes is to be determined by reference to a list of factors.

Most GAARs apply if, by reference to the listed factors, it would be objectively concluded that tax avoidance was a main purpose of what was done.

In determining whether that sort of GAAR is to apply or not, the strain is taken by the main purpose test.

In this case, however, the determination that something has been done to obtain a tax advantage is to be made by reference to only one test: is it reasonable, in all the circumstances, to conclude that obtaining a tax advantage was a main purpose of the arrangement?

This requirement of reasonableness is, of course, meant to be a safeguard.

But I find the test rather elusive: reasonable to whom and by what standard? Not, I rather think, to the man on the bus or by his standard.

The draft GAAR contains no way of measuring what is reasonable and what not reasonable: it may be doubted if the word "reasonable" adds clarity to the test; it may obscure.

Because that is so, the question of whether a course of action is abusive or not is likely to play a large measure in the determination of whether something has been done for a tax avoidance purpose: if what has been done is found to be an abuse of the tax system, it is likely to be reasonable to conclude that it was done mainly to obtain a tax advantage.

At any rate, psychology plays a large part in law, and, psychologically, if something bears the hallmark of being an abuse, it is unlikely to be thought reasonable to do it.

The problem of reasonableness arises again in what has become known as the double reasonableness test in the determination of whether something is abusive or not: arrangements are abusive if they cannot reasonably be regarded as a reasonable course of action in all the circumstances.

Again, the question of 'reasonable to whom' arises. What is reasonable to a businessman may well not be reasonable to a Revenue official.

A judge is, no doubt, expected to sit neutral between the two sides, but how does he determine what is reasonable and what not?

That the burden of establishing that the GAAR applies is on HMRC ought, in theory, to help the taxpayer here, but experience suggests that, in practice, where the burden lies may not matter very much.

In determining whether there is an abuse, the indications in the draft section 2(4) are to be taken into account.

One of these indications is that the arrangements result in an amount of income for tax purposes that is significantly less than the amount for economic purposes.

There is no definition of economic purposes, and there is no provision anywhere in our tax code that taxes by reference to an economic outcome.

It follows that anything that is done which, when the detailed rules and the legislation are applied to it, produces a profit

less than the economic profit, will bear the hallmark of being abusive; and, assuming there to have been a tax advantage, the apparently unlimited power of counteracting tax advantages contained in the draft section 4 will then arise.

That power, as presently drafted, seems to me so wide that tax can then be imposed on an economic profit contrary to the whole tenor of the Yellow Book or the Red Book or whichever colour book you happen to use.

The point that that is the case is reinforced by the requirement, in the draft s.2(3), to take account, in determining whether arrangements are abusive, of any intention to exploit shortcomings in the legislation.

That seems to me to be a further indication that the power to counteract tax advantages is to be exercisable so as to enable the correction of shortcomings in the legislation.

Indeed, if the intention is that the power to counteract tax advantages is to be limited, so that it only allows tax to be imposed according to the detailed rules in the Yellow Book, it has to be asked why taking advantage of a legislative shortcoming, or the taxation of a profit less than the economic profit, are hallmarks of abuse.

If the only counteracting power is to tax in accordance with the rules, it cannot sensibly be said to be abusive to produce a profit which, although less than the economic profit, accords with the rules of computation, even if it takes advantage of a legislative shortcoming.

It might be argued that the requirement to have regard, in determining whether something is abusive or not, to <u>all</u> the circumstances including the relevant tax provisions, should limit concerns about the width of the indications of abuse.

However, the scope for elasticity in determining whether there are any "shortcomings" in the relevant tax provisions increases, rather than reduces, any concern that this GAAR floats like a butterfly above the wording of the legislation and,

in a very large way, gives a discretion as to what tax is to be paid, so that it might well sting like a bee.

Indeed, since the GAAR applies to IHT and one of the indications of abuse is that a transaction is carried out at other than market value, the case of a gift made for ordinary estate planning purposes needs to be considered.

I should hope that a gift by a parent to a teenage child (made outright rather than to a trust) would not be attackable under the GAAR.

However, the form of the gift suggests that it was made to avoid both an immediate and a later charge to IHT and, being a transaction at less than market value, it bears one of the hallmarks of abuse.

Thus the only reason why a gift like that is not caught by the GAAR is that it is a reasonable thing to do.

But why is it reasonable?

If it can be, as it was suggested a few months ago that it was, that to make gifts to charity – genuine gifts to genuine charities – was unacceptable avoidance, there can be no absolute reason why a straightforward gift to a child should not be caught by this rule.

But if there is no absolute rule, what is it that makes a gift to a child a reasonable thing to do?

I should be grateful if someone could explain that to me by reference to objective criteria and without reference to subjective likes and dislikes.

If the answer is that the legislation implicitly invites the making of gifts, the question which arises is why the Dawson family were not accepting a statutory invitation in *Furniss v Dawson*[7]? It turned out that they had gone to the wrong party, no doubt misreading the invitation and the reality is that, as the fuss over charitable donations shows, views of what a statute is inviting you to do can differ.

I doubt if there really is a rational distinction between the

apparent invitations in the IHT code and the then form of CGT code.

Does everything, then, depend on how many people like a particular course of action? Is something reasonable and non-abusive just because everybody does it?

This provision differs in its operation from the way GAARs in other countries work: most GAARs operate by reference to the determination, in accordance with a list of specified indicators, of whether something was done mainly for a tax avoidance purpose.

If it is objectively determined that it was, the power of counteraction then arises.

That power is to treat the taxpayer either as if he had not undertaken the offensive transaction, or in such other way as is just and reasonable.

That sort of power allows the taxing authority to tax the subject on the basis of a set of assumed facts, but the authority must then tax in accordance with the detailed rules set out in the relevant tax code, applying those rules to the assumed facts.

Conversely, this GAAR is lacking the list of specified indicators and is intended to operate chiefly by reference to whether what is done is an abuse.

That has been advertised as a narrowing of the scope of the GAAR: it is what is said to make the GAAR acceptable.

However, the definitions used in relation to the concept of abuse are so broad and so ill-connected to our existing code that it will, or is at least likely to, broaden rather than to limit the scope of the GAAR – and that is especially so, given that HMRC guidance is to be taken into account in determining what is an abuse.

Moreover, it seems to me that this GAAR does not just allow HMRC to tax in accordance with existing rules on the basis of assumed facts: it seems to me to allow the tax authority to make up the law; at any rate I think that the draftsman has not thought through what constraints on counteraction there should be.

It is my experience of dealing with GAARs in other countries that, no matter how dressed up they are, they always give a degree of discretion to the person charged with deciding whether the GAAR is to apply or not.

In the end, where there is a GAAR, an arrangement, which may be regarded as mitigating tax, works if the person deciding the matter finds it, by reference to unstated criteria outside the wording of the legislation, acceptable and does not work if he or she finds it unacceptable.

Where you have a system which is based on clear principles, the giving of a discretion in that form may – just may – be acceptable, because whether something accords with what the draftsman intended or not is fairly easy to see.

At any rate, where there are clear principles, it is fairly easy to tell whether an arrangement contradicts what was intended: for example, in a system which just taxes profits, there are only two ways of trying to reduce your tax bill: you can reduce receipts or increase expenses to un-commercial levels.

Both methods of "avoidance" are relatively easy to detect, and neither works or should work.

But with our system, there is no clear principle.

The thinking behind this GAAR is that there is a principle underlying our tax code; but the principles implied by the indications of abuse are far from anything that I can recognise as being enshrined in our legislation.

We should not and would not find this tax code acceptable:

> "(1) Everybody shall pay as much tax as the Revenue consider he, she or it should pay;
>
> (2) A person who does not agree with the Revenue's assessment may appeal to a judge who shall uphold the Revenue's assessment if he considers it to be reasonable or shall otherwise assess such figure as he considers right."

This GAAR, with its broad and undefined conceptions, comes dangerously close to reducing our 13,000 pages of

legislation to those two sections: in my view, in its current form it comes more than dangerously close to doing that; where it applies, it does it.

The only justification for 13,000 pages of legislation is that they contain rules which people can follow to determine what their tax liability is.

Our code does not do that job very well, but that does not justify a rule which requires us to self-assess ourselves (with penalties for failure to do so), on the basis that it applies if we think we have acted in an abusive way, and which takes precedence over the other rules *and* provides that tax can be charged by reference to some test of economic equivalence.

When the mob howls, the rule of law – not the spirit of the law, but the rule of law in all its majesty and strength – must speak. It does not like provisions which are as wide and uncertain as this.

It is time to re-think our tax system, not patch and mend it. It is broken, it needs wholesale reform, not a GAAR. The problem has been misdiagnosed and the GAAR is not a cure for it: it will make the real problem – the slovenly behaviour of the legislature – worse because it will encourage just that sort of thing.

Endnotes

1 *Mayes v HMRC* (2011) STC 1269

2 *Ramsay (WT) Ltd v IRC* [1982] AC 300

3 *Schofield v HMRC* [2011] UKFTT 199 (TC)

4 *Barclays Mercantile Business Finance Ltd v Mawsom* [2005] 1 AC 684

5 *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311

6 *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655

7 *Furniss (Inspector of Taxes) v Dawson* [1984] AC 474