1 Introduction

Tax avoidance activity, like tax evasion, is neither unique to any one country nor a purely modern problem. It has been around, in varying degrees, wherever taxes have been levied. Many argue, however, that the scale of tax avoidance activity has grown significantly in more recent decades. They contend that an army of what Tanzi\(^1\) and Braithwaite\(^2\) have respectively called fiscal and moral termites has been eating away at tax revenue bases throughout the world in an unprecedented fashion over the last thirty or so years, and with increasing vigour in the last decade.

In this paper I will explore the argument that some of the major common law jurisdictions face a greater threat than ever before, and that the integrity of the tax bases in those countries is being steadily eroded by sustained avoidance activity. It will be my view – hardly contentious – that there has been a growth in avoidance activity in recent decades.

I will then go on to consider some of the legislative, judicial and administrative responses to such growing threats. I will contend that the combined forces of the legislature, the judiciary and the administration have at their disposal a veritable battery of weapons that is more than capable of dealing with the onslaught of these so-called fiscal and moral termites.

The paper therefore divides neatly into two parts. The first part considers the growth of what has been variously referred to, in Australia, as “aggressive tax planning”\(^3\), in South Africa as “impermissible or abusive tax avoidance”\(^4\) and in New Zealand and the United Kingdom as “unacceptable tax avoidance”.\(^5\) It considers the scope of the problem, the
reasons for the growth in avoidance activity and some of the particular forms that the avoidance activity has taken – the anatomical framework of avoidance.

The second part then identifies the form and nature that the barriers to tax avoidance constructed by governments and the judiciary in some of the common law jurisdictions has taken, and explores the success to date of those measures. In my concluding comments I will draw out the major trends, including convergences and divergences, in this on-going tension between taxpayers and tax authorities.

But first it is both appropriate and necessary to be clear – or as clear as it is possible to be – on some of the terms that I will be using, and particularly to attempt to define and distinguish what is meant by the underpinning concepts of “tax evasion”, “tax avoidance” and “tax planning/tax mitigation”.

As we shall see, the boundary lines between these three concepts are by no means clear. Indeed, some very learned commentators have even cast doubt on the helpfulness of such categorisation. For example, in the McNiven v Westmoreland case\(^6\), Lord Hoffmann has noted that unless the statutory provisions “contain words like ‘avoidance’ or ‘mitigation’, I do not think that it helps to introduce them”.\(^7\) In a somewhat different context, Lord Walker of Gestingthorpe has noted that a “simple tripartite classification [of] tax evasion – illegal and criminal; tax avoidance – legal but unacceptable; tax mitigation – legal and acceptable….is too crude an analysis to promote understanding of what is a fairly complex subject”.\(^8\)

Notwithstanding such distinguished admonitions to caution, we still need to start somewhere, and there is a wealth of literature on what is generally meant by tax evasion, tax avoidance and tax planning/tax mitigation.

Tax evasion is a term that is succinctly defined by the OECD. That body has noted that it involves “illegal arrangements through or by means of which liability to tax is hidden or ignored …[such that]… the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities”.\(^9\) Rather obviously, in an income tax context, it would include the omission of taxable income or the over-statement of tax deductible expenses from reported income or profits. In an indirect tax context, the recent spate of VAT carousel fraud activity in the European Union would be another obvious example of tax evasion. Rather less obviously, tax evasion, as Freedman has pointed out\(^10\) will not always be criminal. Much evasion is dishonest and therefore fraudulent. But some evasion can be innocent, and although that may lead to reassessment for tax purposes, only dishonesty as evidenced by fraudulent behaviour should result in criminal prosecution.

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\(^7\) Ibid at 257.
The distinction between tax evasion and tax avoidance is well recognized. It is the difference between working outside the law and working within the law (though against its spirit). The former Chancellor of the Exchequer in the UK, Denis Healey, was not speaking entirely in jest when he apparently quipped that “the difference between tax avoidance and tax evasion is the thickness of a prison wall”.

But it is not quite as simple to precisely define tax avoidance as it is to define tax evasion. The OECD suggests, “somewhat awkwardly”, that tax avoidance is “an arrangement of a taxpayer’s affairs that is intended to reduce his liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow”.

In Australia the Review of Business Taxation in 1999 offered the view that “tax avoidance [is] a misuse or abuse of the law [that] is often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by Parliament but also includes the manipulation of the law and a focus on form and legal effect rather than substance”. This picks up on a theme that has resonated in Australia since the introduction of its current general anti-avoidance provision – Part IVA of the 1936 Income Tax Assessment Act – which, it was noted, was designed “to strike down blatant, artificial or contrived arrangements”.

One of the clearest definitions of tax avoidance was provided by Lord Templeman in the Challenge Corporation case, where he noted that

“Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had”.

This definition was echoed in Lord Nolan’s judgment in the Willoughby case, which also very succinctly seeks to draw the line between tax avoidance and tax mitigation. Lord Nolan stated:

14 International Tax Terms for the Participants in the OECD Programme of Cooperation with Non-OECD Economies, op cit.
18 CIR v Willoughby [1997] 4 All ER 65 at p.73
The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.

Of course, the line between unacceptable tax avoidance and acceptable tax mitigation or tax planning is by no means as simple to draw as that quotation might suggest. All taxing jurisdictions have significant bodies of legislation, as well as significant bodies of litigation, that can attest to the difficulty of knowing where and how to draw that line. And it is a line, or distinction, that is by no means constant – the boundaries will inevitably change in the light of ever-changing social, legal and economic circumstances.

The well-known and oft-cited dictum from Lord Tomlin in the *Duke of Westminster* case\(^\text{19}\) that “[e]very man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be”\(^\text{20}\) no longer carries the same weight or authority as it did in the 1930s and the decades that followed. Judges may be less likely to be influenced by what has been referred to as the “muffled echoes of old arguments” in one Australian High Court case.\(^\text{21}\)

Not only is the border line between tax avoidance and tax mitigation ever-changing, but so are the participants who contest that border. There is an obvious and on-going tension between the taxpayer and the national revenue authority, and those are ever the principal combatants. But other, broader, forces are also involved. For example, the burgeoning impact of the law of the European Union on member states’ domestic law brings new tensions into play, and cannot be under-estimated or ignored. As O’Shea has noted\(^\text{22}\), “[w]hat is ‘tax avoidance’ from one Member State’s perspective is simply an exercise of the freedoms from another State’s point of view”.

There is insufficient time or space to explore that particular dynamic in this paper, except to note in passing that the outcome of the line of cases from *ICI v Colmer*\(^\text{23}\), through *Marks and Spencer*\(^\text{24}\) to the most recent *Cadbury Schweppes*\(^\text{25}\) decision, all point to a clear distinction that the European Court of Justice (ECJ) makes between tax avoidance and tax mitigation.\(^\text{26}\) But these decisions also suggest that the ECJ, with its focus upon maintaining community freedoms such as freedom of establishment and the free

\(^{19}\) *IRC v Duke of Westminster* [1936] AC 1.
\(^{20}\) Ibid at 19.
\(^{21}\) It is a phrase used by the High Court of Australia in *FCT v Spotless Services Ltd* (1996) 186 CLR at 414.
\(^{23}\) Case C-264/96 *ICI v Colmer* [1998] ECR 1-4695.
\(^{24}\) Case C-446/03 Marks and Spencer [2005] ECR 1-10837.
\(^{25}\) Case C-196/04 Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v CIR, judgment of the ECJ (Grand Chamber) of 12 September 2006.
\(^{26}\) O’Shea, op cit.
movement of capital and services, can also act as a significant block on the attempts of EU member states to counter what they – rather than the EU – perceive as unacceptable tax avoidance.

But, as a broad working definition, it is probably reasonable to conclude, as does a recent South African Revenue Service Discussion Paper on Tax Avoidance, that tax planning or tax mitigation is “concerned with the organisation of a taxpayer’s affairs (or the structuring of transactions) so that they give rise to the minimum tax liability within the law without resort to…impermissible tax avoidance…”.

Armed with these admittedly crude but necessary distinctions between evasion, avoidance and mitigation, we can now begin to identify whether there is a problem of tax avoidance, the possible causes of the growth in avoidance activity in recent years, the scope and nature of the problem and why a growth in avoidance activity can be problematic to national jurisdictions. It is only in the context of that background that we can begin to put into an appropriate perspective the responses of governments to this perceived threat.

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2 Identifying the problem

The growth of tax avoidance activity

Many commentators have explored the phenomenon of tax avoidance and aggressive tax planning over the years. For example, Nigel Tutt’s two books in the 1980s chart the growth of the tax avoidance industry in the UK in the 1970s and early 1980s, particularly focusing upon the role of Ron Plummer’s Rossminster banking group which financed many of the more outrageous tax avoidance schemes devised by Roy Tucker in that era. More recently Doreen McBarnet and Chris Whelan (in 1999) and Judith Freedman (in 2004) have explored the topic in the UK. In the United States respected academics such as Joel Slemrod (in the 1980s) and Joseph Bankman (in the late 1990s) have provided significant analysis of this area, and the same is true in many other countries.

Most recently John Braithwaite has provided a fascinating insight into tax avoidance activity in Australia and the United States. He considers its causes, the different forms that it can take (including schemes that morph through initial endorsement by revenue authorities to boutique to mass marketed schemes – the equivalent of the hotel bell-hop receiving information about the latest hot share market tip), the manner in which regulatory agencies are countering aggressive tax planning, and possible additional means by which the war against this social vice can be waged. The title of his book, Markets in Vice: Markets in Virtue, is not obviously related to the topic of tax avoidance, but reflects the author’s central thesis. He argues that in a globalised, deregulated and competitive marketplace, vices such as paedophilia, pornography, drugs, corruption, problem gambling and tax avoidance are able to flourish. In other words, the market can drive the production of social ‘bads’ just as it drives the production of social ‘goods’. But Braithwaite argues that it is possible to ‘flip’ markets in the vice of ‘bads’ such as tax avoidance to markets in the virtue of tax system integrity. In the book he provides a series of strategies through which he believes ‘bads’ such as tax avoidance can be curtailed. This is a theme that I will return to later in the paper.

The conclusion of Braithwaite, and of all of the other international commentators I mentioned earlier, is that tax avoidance activity has grown significantly in recent decades. Revenue authorities, quite naturally, would readily concur. As noted in the South African Revenue Service Discussion Paper on Tax Avoidance, the growth in tax avoidance

activity is a worldwide concern and “has been a growing problem internationally during the past ten years”. For example, a study by the General Accounting Office in the United States in 2004 revealed that two-thirds of the companies operating in the US paid no federal income taxes on their profits between 1996 and 2000, and that for the year 2000, 94% of all companies paid income tax of less than five per cent of the profits they reported for financial accounting purposes – at a time when the headline or nominal rate applicable to most corporations in the US would have been 35%.35

It may be useful, at this juncture, to illustrate this growth of tax avoidance activity by reference to just one of the common law jurisdictions that are under review this evening – by reference to the experience in Australia.

Australia experienced its first explosion of aggressive tax planning activity in the 1970s. This was characterized by the many ‘bottom of the harbour’ schemes, involving, for example, simple asset strips aided and abetted by crude tactics such as deliberate bankruptcy to ensure tax rightfully due was never collected. Grabosky and Braithwaite36 estimated that some 7,000 companies and over 30,000 taxpayers participated in the Australian tax avoidance schemes of the 1970s. Freiberg37 identified a number of reasons for this explosion of avoidance (and sometimes blatant evasion) activity, including the existence of a staunchly pro-taxpayer High Court, led by Sir Garfield Barwick, a timid revenue authority, the existence of financial inducements (in the form of commissions) paid to the accountants and solicitors of clients induced into the schemes, and an increased willingness of taxpayers to participate in such schemes.

Many of these reasons have also been put forward to explain the re-emergence of aggressive tax planning, particularly in the form of mass marketed tax avoidance schemes, in Australia in the 1990s. The more recent ‘boom’ of tax avoidance activity began as a series of boutique schemes, involving investments in a wide variety of primary production, film, franchise and research and development activities, and developed into a veritable deluge of mass marketed schemes by the middle of the decade. An ATO crackdown in the late 1990s and early 2000s curbed the flood, but only at the cost of tens of thousands of disaffected and often unsophisticated taxpayers who had bought into the schemes under the false premise that their ‘investments’ would provide them with legitimate tax deductions. A Senate Economics References Committee inquiry which reported in 200238 identified that the amount of deductions disallowed by the ATO rose from a mere AUD$54 million in both 1992-93 and 1993-94 to a phenomenal AUD$1.1 billion in 1997-98 and AUD$1.5 billion in 1998-99. By far the largest part of these deductions that were knocked back stemmed from claims arising under mass marketed schemes.

Reasons for the growth in avoidance activity

Many reasons for the growth of avoidance activity have been advanced, and some have already been alluded to. Note in particular Freiberg’s suggestion\(^{39}\) that the courts (in the sense of the staunchly pro-taxpayer High Court in Australia in the period before 1980) and the administration (which proved to be timid in its attempts to counter avoidance activity in Australia until relatively recently) played significant roles in allowing avoidance activity to flourish in Australia in the latter half of the twentieth century. Other common law jurisdictions have experienced similar circumstances, although I would tend to classify the role of the courts and the tax administrations not so much as reasons for the growth of avoidance activity but rather as enabling agents that may have assisted in that growth in some of the common law jurisdictions. Underlying reasons for the growth of avoidance activity are perhaps less immediate and more amorphous.

Professor Braithwaite\(^{40}\) has identified globalisation, increasing deregulation and changes in market forces as principal causes. Indeed, Braithwaite positions his work squarely within a broader market context. He shows how the waves of aggressive tax planning in Australia and elsewhere have initially been supply driven. It is his contention that a relatively small group of promoters, including some acting out of major financial institutions and more latterly the (now) Big Four accounting firms, have been the driving force behind many of the schemes that have been adopted by taxpayers in Australia and elsewhere. Much the same point is made by Richards in a “Legislative comment” relating to the UK’s recently introduced disclosure regime in *British Tax Review* in 2004. He notes there “the conventional wisdom is [that] most of the planning and mass marketing emanates from the accounting firms”.\(^{41}\)

This abundance of supply has, in turn, created a demand for aggressive tax planning opportunities from a much larger group of taxpayers, who feel that they should not miss out on what the ‘big end of town’ is able to enjoy. As Pederick\(^{42}\) noted many years ago: “[c]ynicism grows apace and a race not to be left out of the tax minimisation derby, by hook or by crook, infects the body politic”.

The market approach adopted by Braithwaite permits a broader perspective to be brought to bear on the analysis of aggressive tax planning as a social phenomenon. All too often the literature in this area is dominated by a tight legal commentary that focuses upon technicalities and forgets to place such activities within the social context in which they belong. While there is obviously a place for debate about whether a particular scheme crosses the line that takes it from legitimate tax planning to unacceptable tax avoidance (and, as we have already noted, such debate proliferates within the tax professional

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42 Pederick, W, Fair and Square Taxation for Australia, (*Taxation in Australia*, vol 19, no. 6, 1984, pp. 575-581).
community), we sometimes need reminding that there is a world beyond statute, case law and legal interpretation.

There is also little doubt that the supply of tax avoidance products in the market place has been fuelled by the availability of talented human resources prepared to work in the area and by “rapid advances in computer and telecommunications technology [which have] greatly enhanced the ability of investment banks, accounting firms and other tax advisers to create sophisticated tax and financial models…to market…to multiple taxpayers”.  

While the supply of tax avoidance opportunities has certainly increased for those in the tax paying community, causes that relate to the demand side cannot be ignored. The US Treasury has noted, for example, that changing attitudes may play a large part in the growth in corporate tax shelters in recent decades. It is simply a reflection “of more accepting attitudes of tax advisers and corporate executives toward aggressive tax planning”. And, as noted already, the demand is not merely now restricted to those at the top end of town. Other relatively prosperous sectors of society have shown themselves more than willing to get involved in avoidance activity, as experience with the mass marketing of such products in Australia and elsewhere has shown.

**Why this growth in avoidance activity is a matter of concern**

The question does, of course, need to be asked as to whether all of this growth in avoidance activity needs to be a matter of concern. The answer to this question is relatively straightforward. It may be unpalatable to some to confront the stark sentiment expressed by a South African judge, in the *Ferera* case that “…the avoidance of tax is an evil”, but there is little doubt that tax avoidance activity has harmful consequences in a number of ways.

In the first place, and perhaps most importantly, it impacts negatively on the capacity of national tax jurisdictions to collect the revenue needed for the proper discharge of governmental functions. Revenue collection is the primary function of any tax system, and systematic and widespread avoidance activity will clearly have an adverse impact on that function. There are no reliable estimates on the losses to national treasuries as a result of avoidance activity, but the amounts are likely to be very significant. For example, one estimate has suggested that tax haven activity alone has resulted in annual revenue losses to other countries in excess of US$50 billion. When tax revenues do not flow as anticipated, or when large amounts of expected revenue are diverted by successful avoidance activity, cuts in government expenditure will follow, “with the resulting social and political difficulties that such cuts may bring”.

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43 *Discussion Paper on Tax Avoidance*, op cit, at pp. 7, 8.
45 MacDonald JP in *COT v Ferera* 1976 (2) SA 653, 38 SATC 66 at p. 70.
46 *Discussion Paper on Tax Avoidance*, op cit, at p. 27.
But the harmful effects of tax avoidance activity go well beyond their impact on revenue collections. They also significantly affect the efficiency and equity of tax systems. These impacts are neatly encapsulated by Joseph Bankman where he notes that “[t]ax shelters siphon off resources from more productive ventures, redistribute the tax burden and threaten to undermine compliance”. As the OECD has also noted, any “proliferation of arbitrary and contrived schemes…leads to a perception that the system is unfair [which can] discourage compliance, even by taxpayers that had not previously engaged in…tax avoidance”. It should also not be forgotten that much of the complexity of modern tax systems is a direct result of the introduction of specific integrity measures, involving convoluted anti-avoidance legislation designed to counter real and perceived avoidance abuses.

We can, therefore, safely conclude that the growth in tax avoidance activity is a matter of grave concern, as it can reduce revenue collections, introduce economic inefficiencies by distorting economic behaviour, undermine the integrity of national tax systems and introduce a host of additional and unwanted complexities to those systems.

The nature and form of avoidance activity

Finally, in this part of the paper, I need to say something about the nature and form of tax avoidance activity. What form does contemporary tax avoidance activity take? Is there an anatomy of avoidance activity that can explain its essence? How might the various methods of tax avoidance be classified?

Lord Walker of Gestingthorpe, in an unpublished paper presented shortly after the decision in the Ramsay case was handed down by the House of Lords, attempted just such a taxonomy. He identified “seven types of tax avoidance”, proceeding from the simplest case to the increasingly complex (and to most observers, increasingly objectionable). These were:

1. using a relief;
2. finding a gap;
3. exploiting (or abusing) a relief;
4. anti-avoidance karate (by which he meant the capacity for taxpayers to turn to their own advantage statutory provisions designed to prevent tax avoidance);
5. unnatural assets or transactions;
6. pre-ordained transactions; and
7. dodgy offshore schemes.

Many would argue (as Lord Walker readily concedes) that the first is not tax avoidance at all – that it falls squarely within the realms of tax mitigation. Professor Willoughby, for example, was not engaged in an elaborate or contrived scheme aimed at tax avoidance.

50 Referred to in Ramsay 25 Years On: Some Reflections on Tax Avoidance, op cit, at xxx.
51 WT Ramsay Ltd v Inland Revenue Commissioners [1982] AC 300.
As the judgment in his case clearly shows, he was involved in the utilisation of a tax regime enacted by Parliament which provided tax deferral for bona fide long term retirement saving. But before we readily conclude that “using a relief” should not figure in any taxonomy of avoidance, it might be worth bearing in mind that the more recent House of Lords case of Barclays Mercantile, which did involve an elaborate and contrived scheme, was – at essence – simply about a finance leasing company taking advantage of a relief (in this case, capital allowances) that Parliament had intended to be of benefit to such companies. The fact that the taxpayer in both Willoughby and Barclays Mercantile was successful does not mean that simply “using a relief” can be readily discarded from Lord Walker’s hierarchy of avoidance techniques.

And by the same token (again conceded by Lord Walker) not all offshore schemes are by any stretch of the imagination worthy of the label of “dodgy”.

Notwithstanding these concerns, the hierarchy posited by Lord Walker has stood the test of time and does serve as a useful introduction to an understanding of the nature and form of tax avoidance activity. But more is also required.

Getting to the essence of tax avoidance perhaps requires an understanding of its goals – what tax avoidance sets out to achieve. Clearly the end game is a reduction of tax liability, but that can take a number of forms. It is possible to identify four possible goals that underpin tax avoidance activity: deferral; re-characterisation; elimination; and/or shifting.

Deferral involves the postponement of the payment of a tax liability, and relies on the concept of the time value of money for its effectiveness. As noted already, the Willoughby case might be argued as a case in point where the aim of the exercise was the deferral of the tax liability. In that case, liability was deferred until maturity of the personal portfolio bonds that were the subject of the case, and was not payable as and when income arose from the bonds.

Re-characterisation is simply the conversion of the character of an item or transaction – for example from a taxed or a highly taxed item like revenue to a tax exempt or less heavily taxed item like capital. The 1997 McGuckian case in the UK is a straightforward example of re-characterisation. That case involved a transfer of shares to a non-resident trust, together with the subsequent sale of the rights to dividends from the shares for a lump sum which, it was unsuccessfully contended, was capital in nature.

The third goal – the permanent elimination of a tax liability needs no further explanation.

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52 CIR v Willoughby, op cit.
54 CIR v Willoughby, op cit.
55 Barclays Mercantile Business Finance Ltd v Mawson, op cit.
56 Discussion Paper on Tax Avoidance, op cit, at p. 16.
57 CIR v Willoughby, op cit.
The fourth possible goal – shifting – can relate to income or profit shifting (as in shifting a liability from a highly taxed entity to a less heavily taxed or even exempt entity, as in the Barclays Mercantile case\textsuperscript{59}) as well as value shifting. Value shifting involves the transfer of value between shares or shareholders in order to reduce actual or potential exposure to tax. In the Peabody case\textsuperscript{60}, which was the first case to be heard by the Australian High Court on the application of its re-enacted general anti-avoidance provisions contained in Part IVA of the 1936 Income Tax Assessment Act, value was tax effectively shifted from one class of shares held by a minority shareholder who wished to exit a corporate group to another tax-advantaged entity.

Achievement of any or all of these goals is only possible because of the potential for tax leverage or tax arbitrage that arises as a result of the so-called inconsistencies and discontinuities that exist within national tax jurisdictions and across international tax borders. As the South African Discussion Paper on Tax Avoidance notes\textsuperscript{61}, perhaps a little too optimistically:

“[i]f all forms of income (including gains) and all taxpayers were subject to identical and fully symmetrical tax rules, the opportunities for impermissible tax avoidance would largely vanish. For example, if dividends and interest were subject to the same tax treatment (both in terms of rate and timing), schemes purporting to convert or substitute dividend income for interest income (or vice versa) would not yield any tax benefit. Similarly, if the granting of a deduction by one party were deferred until the amount in question were actually subject to tax in the hands of the counterparty to the transaction, schemes aimed at generating a deferral of tax liability would have little appeal (especially if the same rate applied to all taxpayers).”

Of course the inconsistencies and discontinuities that are evident within and between tax systems are not likely to disappear – they exist for very good reasons. Distinctions between, for example, debt and equity, or capital and revenue, or between the assessability of different sorts of entities and different levels of income are fundamental parts of national tax systems, and they exist for both policy and political reasons. But we have to be aware of the consequences. As Jeff Waincymer points out: “[p]rogressive rates of taxation encourage income-splitting techniques; tax expenditures in favour of activities deemed worthy of encouragement lead to the creation of tax-inspired shelters; …administrative necessities such as limiting the taxing exercise to a particular period encourage manipulations of the timing of deductions and receipts of income streams”.\textsuperscript{62}

Having identified the goals, and appreciating that these goals are achieved through manipulation of the mismatches within and between tax systems, identifying the various

\textsuperscript{59} Barclays Mercantile Business Finance Ltd v Mawson, op cit.
\textsuperscript{60} FC of T v Peabody (1994) 181 CLR 359; 94 ATC 4663.
\textsuperscript{61} Discussion Paper on Tax Avoidance, op cit, at pp.16-17.
contemporary techniques for tax avoidance is not a difficult task – although that is not in any way to under-estimate the ingenuity of their design or the complexity of their construct that is so often a feature of such schemes.

Many techniques share a series of common characteristics, most of which, once again, are very competently summarised in the paper on tax avoidance prepared in late 2005 by the South African Revenue Service.\(^{63}\) In the view of that revenue authority the “badges” or “hall marks” of avoidance typically include any or all of the following features:

- the lack of economic substance (usually resulting from pre-arranged circular or self-cancelling arrangements), with the result that an apparently significant investment proves ultimately to be illusory, and, through various devices, the taxpayer remains insulated from virtually all economic risk, while creating a carefully crafted impression to the contrary;
- the use of tax-indifferent accommodating parties or special purpose entities, often referred to in the jargon as “washing machines”;
- unnecessary steps and complexity, often inserted to prop up a claim of business purpose, or to disguise the true nature of a scheme or “as a device to cloak the tax shelter transaction from detection”\(^{64}\);
- inconsistent treatment for tax and financial accounting purposes;
- high transaction costs;
- fee variation clauses or contingent fee provisions;
- the use of new, complex financial instruments such as derivatives, hybrids and synthetic instruments which have made it possible for promoters to mimic almost perfectly the risks and returns attributable to more traditional financial instruments such as equity shares or “plain vanilla” debt without incurring, at least in theory, the tax consequences typically associated with them; and
- the use of tax havens, particularly in the context of captive insurance companies, captive finance subsidiaries and intangible property holding companies.

Of course this is not to suggest that the existence of these characteristics, either alone or in combination, \textbf{must} necessarily point to the existence of tax avoidance activity. That conclusion can only be drawn after a careful consideration of all of the facts. But it is to suggest that, prima facie, the existence of these features, alone or in combination, \textbf{may} indicate avoidance activity.


\(^{64}\) \textit{The Problem of Corporate Tax Shelters – Discussion, Analysis and Legislative Proposals}, op cit at p. 16.
3 Responding to the problem

Let us now turn away from these matters which relate to the identification of the problems of tax avoidance, and in particular to the difficult problems that arise from attempts to distinguish unacceptable tax avoidance from acceptable tax mitigation, and move on to a consideration of the responses that have been made by governments, and sometimes by international agencies, to battle the threats, real or perceived, of tax avoidance. As I mentioned at the outset, while tax avoidance activity may have grown significantly in recent years, so too has the armoury available to those who would counter such activity. Barriers to tax avoidance have been erected on a number of fronts. For convenience I will explore those barriers under three broad headings – legislative, judicial and administrative – although, as we shall see, the categories are inter-related and have some level of overlap.

In the case of each of the three areas, I will not strive for the elusive goal of a comprehensive analysis of all of the recent developments. Rather, given the constraints of time and space, I will simply provide examples – drawn from the common law jurisdictions with which I am relatively familiar – that serve to illustrate the principles and the conclusions that I wish to draw out.

Legislative barriers to tax avoidance

Common law jurisdictions have not been reluctant to adopt direct legislative responses to the threats posed by avoidance activity, and the pace of the introduction of such measures has quickened in direct response to the perceived growth in the threat. Legislative responses have been on three broad fronts:

- the introduction in all jurisdictions of specific anti-avoidance measures targeted at particular areas where abuse has been identified or where revenue leakage is suspected. The introduction of the direct and indirect value shifting provisions in Australia\textsuperscript{65} in response to the circumstances highlighted by the *Peabody*\textsuperscript{66} case mentioned earlier would be an obvious example of such specific anti-avoidance enactments;
- the continuing refinement and use of general anti-avoidance rules and legal principles in a number of the jurisdictions; and
- the most recent development – the use of product disclosure and promoter penalty rules as a further weapon in the arsenals available to revenue authorities.

I will deal with each of these three broad areas in turn, by reference to some major recent developments in the common law jurisdictions.

Specific legislation targeting tax avoidance

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\textsuperscript{65} Divisions 723, 725 and 727 *Income Tax Assessment Act 1997*, operative from 1 July 2002.

\textsuperscript{66} *FC of T v Peabody*, op cit.
The intellectual dexterity of advisers and the complexity of commercial transactions have, over recent years, caused a mushrooming of schemes and arrangements that have attracted revenue authority attention and later the introduction of specific anti-avoidance rules to control their effectiveness. The use of specific integrity measures – as opposed to the use of general anti-avoidance rules which I will come to shortly – has the advantage of precision. They are – and I am grateful to Professor Andrew Halkyard for this metaphor – the “smart bombs” in contrast to the “carpet bombs” or “weapons of mass destruction”\(^{67}\) that may be represented by general anti-avoidance provisions.

But they also carry the concern, which I have already mentioned, that their aim can be poor or that their impact can be deflected. Sometimes conceived in haste and rushed through national parliaments without due concern for the careful legislative drafting that must accompany any new tax measure, scheme promoters and tax advisers are often able to dodge their impact and even to incorporate them into fresh iterations of avoidance activity – the anti-avoidance karate identified by Lord Walker which I mentioned earlier. The Australian experience with the introduction of specific anti-avoidance measures designed to clamp-down on the alienation of personal services income through the use of interposed entities, introduced to operate with effect from 1 July 2000, is a classic example\(^{68}\). The initial legislation was well-intentioned but poorly conceived, and it is only after a number of refinements and amendments have passed through Parliament over the ensuing years that the measures have begun to operate as intended.

The United Kingdom has been among the more prolific of the common law jurisdictions in introducing new specific anti-avoidance measures in recent years. For example, the 2005 Budget saw the introduction of three new and extensive sets of specific anti-avoidance rules targeting, respectively, arbitrage, double tax relief avoidance and financial avoidance, as well as even more specific provisions to address abusive film schemes.

Two principal factors likely account for the UK’s greater reliance on specific anti-avoidance measures. In the first place, the UK – in contrast to Hong Kong, Australia, New Zealand, Canada and South Africa – does not have a statutory general anti-avoidance provision. While the existence of such a provision will never obviate the need for specific anti-avoidance legislation, and many of those countries who do have such a general rule still manage to generate plenty of specific provisions of their own, those countries with a general anti-avoidance rule do appear to be able to get away with less legislative enactment in this area.

The second reason for the spate of specific anti-avoidance measures in the UK lies in its recent adoption – which I will come to later – of a disclosure regime whereby promoters and users of potentially abusive tax avoidance schemes are required to disclose details of those schemes when they are first available for implementation. This boost to real time

\(^{67}\) This analogy is provided by Andrew Halkyard in “Not a Weapon of Mass Destruction: Can the Ramsay Approach Apply to the Inland Revenue Ordinance in Hong Kong?” (Asia-Pacific Journal of Taxation, Vol 9 No3, Autumn 2005, pp 56-72).

\(^{68}\) The anti-avoidance rules are contained in Pt 2-42 Income Tax Assessment Act 1997.
intelligence has led directly to the introduction of specific legislative measures to counter the identified abuse.

**General anti-avoidance provisions**

The second legislative response to tax avoidance activity is the continuing refinement and use of general anti-avoidance rules in a number of the jurisdictions. The 1998 Consultative Document on the possible introduction of a general anti-avoidance rule for direct taxes in the UK noted then\(^{69}\) that “[t]he United Kingdom is unusual among developed countries in having neither a statute nor an established legal principle to counter tax avoidance in general. Many other countries in the developed world have found such a rule or principle to be a very useful remedy for countering tax avoidance, although not a universal cure”.

General anti-avoidance rules have operated for many years in most other common law jurisdictions, including Hong Kong (sections 61 and 61A of the *Inland Revenue Ordinance*), Canada, (section 245 of the *Canadian Income Tax Act*), New Zealand (sections BG1 and GB1 of the *New Zealand Income Tax Act 1994*), South Africa (section 103 of the *Income Tax Act 1962*) and Australia. Australian governments use a variety of general anti-avoidance rules to combat what are perceived to be abusive avoidance activities. These include Pt IVA of the *Income Tax Assessment Act 1936*, s 67 of the *Fringe Benefits Tax Assessment Act 1986* and Div 165 of the *A New Tax System (Goods and Services Tax) Act 1999*.

General anti-avoidance rules have long histories in some of these jurisdictions – for example such a rule has existed in one form or another right from the commencement of income tax in Australia, and has also existed in New Zealand for over a century. But they have also undergone significant amendment and refinement over the years to adapt to changing circumstances. New Zealand, Canada and South Africa have recently made, or are in the process of making, changes to their rules, while Australia – after undertaking a fundamental shift in approach in 1981 (with the replacement of section 260 by Part IVA), has also announced – though not yet legislated – further strengthening of its provisions to overcome perceived deficiencies.

It is difficult to assess the effectiveness of the general anti-avoidance rules in each of the countries where they have operated. Much, obviously, depends upon the perspective adopted. In South Africa, for example, the South African Revenue Service currently holds grave concerns about the effectiveness of its current provisions.\(^{70}\) Brian Arnold, writing about recent court decisions in Canada\(^{71}\) notes that these decisions “will inexorably render the rule largely ineffective…”, though Revenue Canada has enjoyed some success in the courts subsequently, particularly in the *Mathew* case.\(^{72}\) In New


\(^{70}\) *Discussion Paper on Tax Avoidance*, op cit.


\(^{72}\) *Mathew v The Queen* 2005 SCC 55.
Zealand the general anti-avoidance rules have operated with mixed success. Its own High Court recently held in *Accent Management Ltd*\(^{73}\) that a forestry investment scheme involving a host of the hall marks that have been suggested are likely to constitute tax avoidance was in fact tax avoidance. In contrast, the Privy Council somewhat uncertainly held – in the *Peterson*\(^{74}\) case – that a film scheme which had many of those same hall marks was not avoidance within the terms of the New Zealand general anti-avoidance rule.

The application of the general anti-avoidance provisions has also been anything but certain in Australia. The Commissioner of Taxation has enjoyed considerable success in using the rule to counter aggressive tax planning in the form of mass marketed schemes.\(^{75}\) However, the four cases on Part IVA that have been litigated in Australia’s High Court thus far – *Peabody*, *Spotless*, *Consolidated Press Holdings* and *Hart*\(^{76}\) – have produced mixed results for the Commissioner and have not always provided practitioners with the clear guidance that they often crave as to how the provisions will apply in the particular circumstances in which they are required to advise their clients.

I will say a little more about the jurisprudence relating to some of these cases that have been heard under the various general anti-avoidance rules when I come to consider judicial responses to tax avoidance later.

*The introduction of product disclosure and/or promoter penalty legislation*

The third area where there have been significant recent developments on the legislative front is the enactment, in many of the common law jurisdictions, of product disclosure and promoter penalty legislation. Both are designed to counter, essentially, the mass marketing of what might be loosely called tax exploitation schemes (to borrow the Australian terminology), although both are equally capable of dealing with boutique or one-off avoidance activity. Product disclosure schemes represent a pre-emptive strike, in that they have the capacity to provide revenue authorities with real time intelligence that can allow governments to move rapidly to close down loopholes and block avoidance. Promoter penalty regimes are more reactive and punitive, but can nonetheless act as a significant deterrent to those who might seek to market abusive tax schemes.

I will deal with each of these two approaches – product disclosure and promoter penalty regimes – in turn.

In 2004 the UK followed the lead of the US and Canada by enacting legislation\(^{77}\) designed to provide the tax authority with early information about “tax arrangements”

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\(^{73}\) *Accent Management Ltd & Ors v CIR* (2005) 22 NZTC 19027.

\(^{74}\) *Peterson v CIR* [2005] STC 448.

\(^{75}\) See, for example, *Howland-Rose & Ors v FCT* [2002] FCA 246; 2002 ATC 4200; *Vincent v FCT* 2002 ATC 4742; *Puzey v FCT* 2003 ATC 4782; *FCT v Sleight* [2004] FCAFC 94; 2004 ATC 4477. In contrast, see *FCT v Cooke & Jamieson* [2004] FCAFC 75.


\(^{77}\) Sections 19 and Part 7 (sections 306-319) *Finance Act 2004*. 

and how they work, together with information about who has used them.  

Tax arrangements were carefully defined to include any arrangement (for example, a scheme, transaction or series of transactions) that will, or might be expected to, provide the user with a tax advantage when compared to adopting a different course of action.

When the disclosure regime was introduced in the UK in 2004, disclosure was limited in scope to tax arrangements concerning employment (for example share schemes) or certain financial products. This was significantly widened with effect from 1st August 2006 to the whole of income tax, corporation tax and capital gains tax. There are also disclosure rules relating to Stamp Duty Land Tax, and separate rules for VAT disclosure.

A tax arrangement has to be disclosed where:

- it will, or might be expected to, enable any person to obtain a tax advantage (which is very widely drawn and includes the avoidance or reduction of a charge to tax, a relief from tax, repayment of tax and the deferral of tax or the avoidance of an obligation to deduct tax);
- that tax advantage is, or might be expected to be, the main benefit or one of the main benefits of the arrangement; and
- it is a “hallmarked scheme” by being a tax arrangement that falls within any description (the “hallmarks”) prescribed in the relevant regulations.

Hallmarking is one of the more innovative aspects of the UK’s new disclosure regime. Hallmarks that might suggest a particular arrangement will need to be disclosed can include (depending on whether a promoter or a user is obliged to disclose): the need to keep the arrangements confidential from other promoters or from HMRC; the charging of a premium fee; the involvement of off-market terms, or standardised tax products, or loss schemes or certain leasing arrangements. The existence of just one of these hallmarks can be enough to require disclosure, although the absence of all will still not guarantee absolution! HMRC anticipates that the hallmarks will change over time as what it perceives to be “disclosable” activity itself changes.

In most situations where a disclosure is required it must be made by the scheme “promoter” within 5 days of it being made available. However, where the scheme promoter is based outside the UK, or is a lawyer and legal privilege applies, or there is no promoter, the user has to make the disclosure. In addition a person who designs and implements their own hallmarked scheme must disclose it within 30 days of it being implemented. Penalties for non-disclosure can be significant: £5,000 for each failure as an initial penalty, plus an additional daily penalty of £600 where the failure to disclose continues after the imposition of the initial penalty.

The introduction of these disclosure requirements in the UK has caused widespread concern within the tax profession, as well as providing HMRC with unparalleled access

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79 Section 318 Finance Act 2004.
to real-time intelligence that has enabled it to move swiftly to legislate against avoidance activity deemed to be a threat to the revenue base.

By way of contrast, Australia (and likewise Hong Kong, New Zealand and South Africa) has not yet implemented a disclosure regime of this nature, though it is a matter of some speculation as to whether it is merely a question of time before the revenue authorities in those countries manage to persuade their political masters of the absolute necessity for such wide-reaching provisions. But, to date and in Australia at least, the recent emphasis has been upon the enactment of legislation designed to impose penalties upon the promoters of what have been labeled “tax exploitation schemes”.

In late 2003, the Australian Government announced its intention to introduce measures, including a new civil penalty regime, to deter the promotion of tax avoidance and tax evasion schemes. Exposure draft legislation to give effect to this announcement was introduced in August 2005. The explanatory material noted that there were (at that time) no administrative penalties that could be imposed on the promoters of tax exploitation schemes. By way of contrast, taxpayers found to have participated in tax exploitation schemes might be subject to scheme penalties. The amendments, therefore, sought to address this inequity, and to create a deterrent to the promotion of tax exploitation schemes.

Legislation designed to deter the promotion of tax exploitation schemes in Australia received the Royal Assent in early 2006. The legislative provisions seek to deter

- the promotion of tax avoidance and evasion schemes (collectively referred to in the legislation as tax exploitation schemes); and
- the implementation of schemes that have been promoted on the basis of conformity with a product ruling, in a way that is materially different to that described in the product ruling.

In summary the provisions enable the Commissioner to:

- request the Federal Court of Australia to impose a civil penalty on a scheme promoter or implementer. The maximum penalty the Federal Court can impose is the greater of 5,000 penalty units (currently equal to AUD$550,000) for an individual or 25,000 penalty units (currently equal to AUD$2.75 million) for a body corporate and twice the consideration received or receivable, directly or indirectly, by the entity or its associates in respect of the scheme;
- seek an injunction to stop the promotion of a scheme or implementation of a scheme not in conformity to its product ruling; and
- enter into voluntary undertakings with promoters or implementers about the way in which schemes are being promoted or implemented.

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80 Assistant Treasurer’s press release C117/03 (Treasury, Canberra, December 2003).
81 Division 290 of Tax Administration Act 1953.
82 Chapter 3 Explanatory Memorandum to Tax Laws Amendment (2006 Measures No. 1) Act 2006.
In deciding what penalty is appropriate, the Federal Court can have regard to all matters it considers relevant, including the amount of loss or damage incurred by scheme participants and the honesty and deliberateness of the promoter's conduct.

The Explanatory Memorandum notes\(^8^3\) that the civil penalty regime is not intended to inhibit the provision of independent and objective tax advice, including advice regarding tax planning. Some commentators have, however, expressed serious reservations about the potential impact on tax advisers providing tax planning advice, as well as expressing concerns about many other aspects of the promoter penalty provisions.\(^8^4\)

**Judicial barriers to tax avoidance**

If the legislatures of the various common law jurisdictions have been active in recent years in seeking to counter tax avoidance activity, their productivity has been more than matched by the judiciaries in those regimes. Cases relating to tax avoidance and tax planning have typically constituted one of the major areas of tax litigation in many of these regimes.

This is not in any way to suggest, as the use of the term “judicial barriers” might, that the respective judiciaries have necessarily been pro-revenue in their deliberations. Indeed, many of the major cases that have recently been heard have provided disappointing outcomes to revenue authorities. Nor is it to suggest that the deliberations of the courts have necessarily provided any greater clarity on the dividing line between what might be regarded as acceptable tax mitigation or unacceptable tax avoidance. The line remains as unclear as ever.

But an examination of recent cases, particularly those heard in the superior courts in common law jurisdictions, does reveal some significant developments in the jurisprudence in this area, and in particular shows that there is now a greater certainty in the approaches that those courts are likely to take in the interpretation of the statutory provisions that exist in their respective jurisdictions. Such an examination also leads to the tentative conclusion that there is some level of convergence in the interpretative approaches in many of the common law jurisdictions, although by no means a consensus in how such cases should be approached. Moreover, that degree of convergence that has occurred has come about from very different starting positions and through very different routes.

I propose to consider some of the cases heard in recent years in the superior courts of the UK, Australia, Canada, New Zealand and Hong Kong to illustrate these points. I will start by considering some recent House of Lords decisions in the UK.

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\(^8^3\) Paragraph 3.50 Explanatory Memorandum to *Tax Laws Amendment (2006 Measures No. 1) Act 2006*.

\(^8^4\) For example, King, J, “New Measures Deterring the Promotion of Tax Exploitation Schemes”, *Australian Tax Review* (2006) 35 (3)).
The cases of *Barclays Mercantile*⁸⁵ and *Scottish Provident*⁸⁶ were decided together by the House of Lords in a unanimous decision to which each of the five Lords (Nicholls, Steyn, Hoffmann, Hope and Walker) contributed. The former was decided in favour of the taxpayer, thereby upholding the decision of the Court of Appeal and rejecting the outcomes of the High Court and Special Commissioners. *Scottish Provident*, in contrast, was decided in favour of the UK revenue authority, reversing the two lower court decisions. It is the former case that is of greater interest for the points I wish to make.

The facts in the *Barclays Mercantile* case are relatively simple and are worth recounting, as they are quite similar to another Canadian case that I will shortly discuss. John Tiley, in a case note in *British Tax Review*⁸⁷ summarised the facts in *Barclays Mercantile* thus:

“…[A]n Irish company, (BGE), had built a pipeline. They sold the pipeline to the taxpayers (BMBF) for £91.3m. BMBF leased the assets back to BGE which granted a sub-lease onwards to its UK subsidiary. The question was whether BMBF was entitled to a capital allowance in respect of the £91.3m spent, as BMBF argued, to acquire an asset used in its business of finance leasing. The simple finance deal was then hedged around with many complex money flows; BMBF argued that the purpose of these arrangements was to ensure that the sums due from BGE under the lease arrangements would actually come through.”

It was the contention of the UK Inland Revenue (as it then was) that if the scheme were looked at as a whole, then it became clear that – as a result of the circular flow of funds involved – BMBF had not incurred expenditure on the provision of plant and machinery for the purposes of its trade of finance leasing. Indeed, to adopt Lord Templeman’s analysis in the *Challenge Corporation* case⁸⁸, BMBF had not suffered or incurred the economic loss which Parliament intended before it was entitled to the capital allowances.

The House of Lords rejected this line of argument, and determined that the focus of its enquiry should only be upon the acts and purposes of the finance lessor (BMBF) in relation to its entitlement to the capital allowances. It should not consider the acts and purposes of the finance lessee (BGE). “The statutory test was based on the purpose of the lessor’s expenditure, not the benefit of the finance to the lessee”.⁸⁹

The whole emphasis in the *Barclay Mercantile* judgment, which was also evident in *Scottish Provident*, was that the role of the judges was to interpret the words of the statute, and to do so in a purposive fashion. As John Tiley notes, as a result of these cases “we

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⁸⁵ *Barclays Mercantile Business Finance Ltd v Mawson*, op cit.
⁸⁶ *Scottish Provident Institution v Inland Revenue Commissioners* [2004] UKHL 52; [2004] 1 WLR 3172(HL).
⁸⁸ *CIR (NZ) v Challenge Corporation Ltd*, op cit.
⁸⁹ *Barclays Mercantile Business Finance Ltd v Mawson*, op cit at para 42.
are left with the simple fact that tax law is about interpreting statutes and that statutes should be interpreted purposively…and in their context”.  

This represents a clear departure from the view that had developed in the UK and elsewhere in the line of cases starting with Ramsay and developing through Furniss v Dawson. Those cases had suggested that there was an extra-statutory anti-avoidance rule of law, or doctrine – the so-called “Ramsay doctrine” – which was to be applied by the courts when considering avoidance issues. Effectively that doctrine asserted that where there was a preordained transaction or series of transactions which had steps inserted for no commercial purpose, those steps could be ignored and the relevant statutory provisions could be applied to the end result. Andrew Halkyard reminds us of some of the epithets applied to the Ramsay doctrine: “the doctrine of disregard”; the principle of fiscal nullity”; “a judge-made anti-avoidance weapon” “a weapon of mass destruction” and “a broad spectrum antibiotic which kills off all anti-avoidance schemes”.

The McGuckian and MacNiven cases in the UK had already begun to demolish the notion that a separate judicial anti-avoidance doctrine did exist, and suggested a return to the primacy of the statutory language. Barclays Mercantile has completed the process. Lord Hoffmann, writing on tax avoidance after being involved in the case, states:

“The primacy of the construction of the particular taxing provision and the illegitimacy of rules of general application has been reaffirmed by…[Barclays Mercantile]. Indeed, it may be said that this case has killed off the Ramsay doctrine as a special theory of revenue law and subsumed it within the general theory of the interpretation of statutes…”

The Scottish Provident case, and to a lesser extent the more recent House of Lords decision in favour of the revenue in West v Trennery, have indicated that the judiciary has not opened the floodgates to the aggressive tax planners. There is no reversion to a literal approach to statutory interpretation, which was part of the rationale for the emergence of the Ramsay doctrine in the first place. Instead a textual, contextual and purposive approach is likely to underpin judicial reasoning in the UK’s consideration of avoidance cases in the future. As Judith Freedman notes: “The House of Lords has now confirmed that the essence of the “new approach” to tax avoidance in the United Kingdom is that the court gives tax provisions a purposive construction in order to

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91 WT Ramsay Ltd v Inland Revenue Commissioners, op cit.
94 IRC v McGuckian, op cit.
95 MacNiven v Westmoreland Investments [2001] STC 237 (HL).
98 Scottish Provident Institution v Inland Revenue Commissioners, op cit.
determine the nature of the transaction to which it is intended to apply, before going on to
decide whether the actual transaction (which might involve considering the overall effect
of a number of elements intended to operate together) answers that statutory
description".100

This is not to suggest that the current UK position is stable, or that it provides the
certainty of outcome that advisers crave. But, it has removed some of the old chaos101
and at least suggests that it is able to provide certainty of approach, if not of outcome.

The Ramsay doctrine held particular sway in the UK in part because the UK does not
have the “provision of last resort” that is represented by a statutory general anti-
avoidance rule. In that respect it is not dissimilar to the US where a host of judicial
doctrines, including the business purpose test, the step transaction doctrine, the sham
document and the economic substance doctrine, have prevailed in cases relating to tax
avoidance. But although the UK shares with the US the lack of a general anti-avoidance
rule, it does not share – as Barclay Mercantile has made absolutely clear – any tradition
in which judicial anti-avoidance doctrines make good statutory deficiencies.

There is, however, also evidence of a greater consistency in the interpretative approach to
tax avoidance cases taken by the superior courts in countries which do have statutory
general anti-avoidance rules. In comparing the outcomes of the two recent anti-
avoidance cases to have been heard by the Canadian Supreme Court (Canada Trustco102
and Mathew103) with the UK outcomes in Barclays Mercantile and Scottish Provident,
Judith Freedman notes the “similarities between the positions reached in the two
countries via different routes. In each country the intention of the particular statute
concerned, as revealed by its wording construed in context, is paramount; in each
jurisdiction the fact that a transaction is motivated by tax saving is not, on its own, fatal
to its effectiveness for tax minimization purposes”.104

In cases such as these, both Canada and the UK have also affirmed that there is no place
for a business purpose test – along the lines of the doctrine that has prevailed in the US
since its seminal case of Helvering v Gregory105 in the 1930s.

The emerging jurisprudence on Australia’s general anti-avoidance rule suggests that the
courts, in Australia as well as the UK and Canada, must consider the words of the statute
interpreted in a purposive fashion, as required by the provisions of the Acts Interpretation
Act – provisions that are not dissimilar in impact to section 19 of Hong Kong’s
Interpretation and General Clauses Ordinance. The provisions of Part IVA are quite

100 Freedman, J, “Converging Tracks? Recent Developments in Canadian and UK Approaches to Tax
Avoidance”, op cit.
Uncertainty”, op cit.
102 The Queen v Canada Trustco Mortgage Co 2005 SCC 54.
103 Mathew v The Queen 2005 SCC 55.
104 Freedman, J, “Converging Tracks? Recent Developments in Canadian and UK Approaches to Tax
Avoidance”, op cit at 1039.
105 69 F 2nd 809 (1934).
prescriptive, and if interpreted literally could annihilate virtually all tax planning transactions. Part IVA involves a consideration of three basic requirements. Firstly, there must be a “scheme”. This is so broadly defined as to encompass virtually any act or transaction. The second is that there must be a “tax benefit”, again broadly defined. The final element, which is the area of greatest contention, is that the scheme must have been entered into for the sole or dominant purpose of obtaining a tax benefit. This requires an objective assessment, based upon analysis of eight factors, including the manner in which the scheme was implemented, its form and substance, and its effect.

There is some evidence of a tension between the lower and higher courts in Australia over the interpretation of Part IVA. The Federal and Full Federal Courts have shown themselves willing to adopt a more commercial approach to the interpretation of the provisions. This is not to suggest that a “business purpose” test has emerged in those courts, but they are certainly more likely to find in favour of the taxpayer where – on an objective examination of the circumstances surrounding the transaction – they are able to establish a commercial motive for the transaction. In its deliberations, in contrast, the High Court has repeatedly insisted that this is not the appropriate approach, and that the legislation must be construed purposively with a view to establishing the appropriate outcome. Upon occasions this approach has favoured the revenue (Spotless, Hart) and upon others the taxpayers have succeeded (Peabody).

Recent judicial decisions in Hong Kong and New Zealand also confirm the purposive approach to the interpretation of taxation statute in common law jurisdictions. For example, the Arrowtown 106 case in Hong Kong reasserted “the need to apply orthodox methods of purposive interpretation to the facts viewed realistically”. 107

The facts in the Peterson 108 case in New Zealand, heard by the Privy Council in 2005, bear some resemblance to those in Barclay Mercantile and Canada Trustco, save that the object of investment was films 109 rather than pipelines or trailers. The outcome was also similar, in that the taxpayer was successful in claiming depreciation allowances (the claim was for capital allowances in Barclays Mercantile and capital cost allowance deductions in Canada Trustco). This tends to confirm the view that there is some degree of convergence in the jurisprudence in some of the common law jurisdictions in the approach taken by the courts to avoidance type cases, albeit through the interpretation of very different legislation. The Canadian and New Zealand general anti-avoidance rules have some similarities, but are – in substance – quite different from each other. And both are very different from the specific legislative provisions that were in play in Barclays Mercantile.

The Peterson case also illustrates very clearly the absolute difficulty of determining, with any degree of certainty, where the borderline lies between what Lord Millett (who

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106 Collector of Stamp Revenue v Arrowtown Assets Ltd [2004] 1 HKLRD 77.
108 Peterson v CIR, op cit.
109 “Utu”, which was commercially successful, and “The Lie of the Land”, which was not.
delivered the majority decision in favour of the taxpayer) deemed an “acceptable tax advantage” (for which read tax mitigation) as opposed to an “unacceptable tax advantage” (for which read tax avoidance). The Privy Council split three to two in favour of the taxpayer, and it is interesting to note that both the majority judgment (Lord Millett, Baroness Hale and Lord Brown) and the minority judgment (Lord Bingham and Lord Scott) made reference to the fact that this was not a borderline case. The majority regarded it as clear that the general anti-avoidance rule was not applicable; by the same token the minority noted, in their judgment, that “a clearer case [for the application of the New Zealand general anti-avoidance rule] can hardly be imagined”.

**Administrative barriers to tax avoidance**

*National initiatives*

In addition to these legislative and judicial responses to the growth in avoidance activity that have taken place in recent years, revenue authorities in all common law jurisdictions have also been very active in ensuring that their administrative machinery is as well-positioned as it possibly can be to identify and counter what they regard as unacceptable tax avoidance activity. Even the most cursory of trawls through tax office websites around the world brings up a host of national initiatives.

Simply for the purposes of illustration I will now say a little bit about the approach to ensuring tax compliance that is currently adopted by the taxation office in Australia. The ATO prides itself, often but not always justifiably, at being at the forefront of world’s best practice in terms of tax administration. Much of its activity is replicated in the other common law jurisdictions.

The ATO publishes a comprehensive annual compliance program which describes the tax compliance risks it is most concerned about and what it is doing to address them. “Aggressive tax planning”, which the ATO defines as “the use of transactions or arrangements that have little or no economic substance and are created predominantly to obtain a tax benefit that is not intended by the law,” features as a prominent part of that annual program. The program identifies the ATO’s general approach to aggressive tax planning, certain headline issues, and its current focus and priorities, as well as actions taken and successes achieved in the preceding year.

As Braithwaite has noted, the ATO’s response to aggressive tax planning has moved beyond the “command and control” framework that typified the 1970s and 1980s to one of “responsive regulation” and “meta risk management” from the 1990s onwards. Braithwaite explains that under the command and control approach “[t]axpayers lodged their returns, the ATO assessed them and decided how much tax was due. Audits were

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10 Peterson v CIR, op cit, at paras 35-37.
11 Peterson v CIR, op cit, at para 96.
13 Ibid.
conducted to detect the provision of false information on returns, which, when detected, typically resulted in the imposition of modest penalties." That command and control mentality involved the seesaw of ‘carrot and stick’ approaches, oscillating between a customer service focus and one which relied on punitive legal action, depending on whichever particular philosophy happened to be in the ascendat at a particular time within the organisation.

Responsive regulation involves an enforcement pyramid (now encapsulated in the ATO’s Compliance Model) in which the bulk of taxpayers engaged in cooperative compliance are situated at the base of the pyramid, while a small hard-core of recalcitrant offenders are at the apex. Little enforcement activity is required for those at the base of the pyramid; essentially they require only the positive encouragement to comply. On the other hand the revenue authority possesses a credible capacity to escalate up the pyramid to progressively more severe sanctions in the face of persistently aggressive non-compliance. In Braithwaite’s terms, responsive regulation involves “sending clear signals through concrete enforcement actions that the agency is willing to escalate in order to create a culture where systemic preventive solutions and good relationships with taxpayers will do most of the compliance work”.

As part of this responsive regulation, meta risk management simply refers to the “risk management of risk management”. It entails the ATO monitoring of the tax community’s self monitoring and self regulation.

It is within the context of this responsive regulatory framework that the Commissioner of Taxation has released – in December 2005 – a series of publications designed to outline the ATO approach to the application of the general anti-avoidance rules, with a particular focus on the application of Pt IVA. The package includes a two-page statement outlining how the ATO will refocus its test case program on the application of Pt IVA to income splitting arrangements; an eight page practical guide outlining the basic principles of how and when Pt IVA applies to tax schemes; and an ATO Practice Statement Law Administration (PS LA 2005/24) comprising nearly 100 pages which updates advice to ATO staff on the application of Pt IVA and other broadly equivalent general anti-avoidance rules of other tax laws. The practice statement provides extensive detail on the operation of these provisions and the processes leading to a decision on their application.

The ATO, like all revenue authorities, is between a rock and a hard place when it comes to the publication of such information. On the one hand the tax advising profession welcomes any light that can be thrown on how these general anti-avoidance rules apply in practice. For example, the statement outlining how the ATO will refocus its test case program on the application of Pt IVA to income splitting arrangements makes it very clear that “genuine” husband and wife partnerships that derive personal services income and share equally in profits and losses (notwithstanding that only one spouse performs the bulk of the work), will not be subjected to challenge under Pt IVA (absent unusual

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115 Ibid, p.68.
features). A cynic might suggest that this decision owes more to a pragmatic acceptance that there are simply too many such partnerships to challenge rather than the application of a principled approach to the issue, but there can be no doubt that the approach provides practitioners with the certainty of outcome they crave in that particular instance.

But on the other hand, practitioners will still need to be conscious that these publications merely express the Commissioner’s view on the potential application of Pt IVA or one of the other general anti-avoidance rules – they are not a substitute for the law itself, nor do their arguments and discussions necessarily hold any particular sway with the judges who must ultimately arbitrate in the cases that come before the courts. The assiduous practitioner or commentator will be able to pick any number of holes in the ATO guidelines, and the need for a careful review of the potential application of the general anti-avoidance rules will not go away as a result of this latest information.

Cross jurisdictional initiatives

Initiatives undertaken by national revenue authorities such as those I have just outlined from the Australian Tax Office have been supplemented by many international activities involving cooperation between tax authorities and work by multinational organisations. Work done on the elimination of tax havens and harmful tax competition by the OECD120 would be just one example of the sorts of initiatives that have been taken in this area. Another example, which I will dwell on in slightly more detail because it is less widely known, is the work of the Joint International Tax Shelter Information Centre (“JITSIC”) in countering international cross-border tax arbitrage activities on a real time basis.

JITSIC was established in May 2004 between the tax authorities of Australia, Canada, the UK and the US, with the objective of supplementing “the ongoing work of tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements, and schemes.”121 An early Press Release noted that an initial focus would include “the ways in which financial products are used in abusive tax transactions by corporations and individuals to reduce their tax liabilities, and the identifications of promoters developing and marketing those products and arrangements”.122

The purpose of this international task force is to:

- provide support to the parties through the identification and understanding of abusive tax schemes and those who promote them;
- share expertise, best practice and experience in tax administration to combat abusive tax schemes;

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- exchange information on abusive tax schemes, in general, and on specific schemes, their promoters and investors, consistent with the provisions of bilateral tax conventions; and
- enable the parties to address better the abusive tax schemes promoted by firms and individuals who operate without regard to national borders.\footnote{Joint International Tax Shelter Information Centre Memorandum of Understanding, op cit.}

Mark Boyle, in an article last year in the British Tax Review\footnote{Boyle, M, “Cross-Border Tax Arbitrage – Policy Choices and Political Motivations”, op cit at 533-534.}, has suggested that there are initial indications that JITSIC's efforts are working and cites Mark Everson, the head of the IRS, as saying: “We have seen things we either would never have picked up or would have picked up years down the road .... We have seen a series of kinds of transactions, or in some cases particular transactions, that merit follow-up by the individual taxing authorities.”

Boyle also notes, however, that the actual output and practical impact of the organisation is difficult to ascertain. He states:

“This is in part due, no doubt, to the nature of the taskforce. While its membership and mission are public knowledge, the rest of JITSIC’s operations seem shrouded in secrecy. The dates of its meetings, for instance, are not announced ahead of time – rather, we are told that the JITSIC members will meet ‘periodically’. More importantly, no formal reports of the meetings appear to have been published yet. Even in the US, where the rights of freedom of information are far stronger than in the UK, intelligence as to what JITSIC has been talking about and where we can expect its steely gaze to turn next is scarce. Despite the lack of official pronouncements, it is widely believed that the hand of JITSIC is to be discerned at the heart of the new UK anti-arbitrage rules. Ernst & Young suggest in their 2005 Budget report that: ‘this legislation could be a direct result of the collaboration between the Revenue and the US, Canadian and Australian tax authorities on cross-border avoidance transactions.’ Deloitte take an even stronger line, stating: ‘This proposal appears to be the first result of the Multinational Task Force, established at the time of Budget 2004, between representatives of the US, Australia, Canada and the UK.’\footnote{Boyle, M, “Cross-Border Tax Arbitrage – Policy Choices and Political Motivations”, ibid.}

We can see from this specific example of international collaboration between some of the revenue authorities – and there are plenty of other examples of both broader and narrower cooperation\footnote{For example, there is the Forum on Tax Administration, established by the OECD in 2002 and comprising senior tax administrators from the 30 OECD countries. The current chair is Mark Iverson, the current IRS Commissioner.} – that governmental responses to tax avoidance activity go well beyond legislative and judicial initiatives. Revenue authorities have shown themselves to be more than willing to adopt a proactive and cooperative administrative stance to complement activity in the legislative and judicial spheres.
4 Conclusions

So what conclusions can be drawn from this exploration of recent legislative, judicial and administrative developments in and between some of the common law jurisdictions?

Two are obvious and have already been canvassed. In the first place, tax avoidance activity has grown – and has grown significantly – in recent years in all countries. And secondly, that growth has been matched – again in all jurisdictions – by a broadly commensurate and increasingly well-targeted growth in legislative, judicial and administrative barriers or responses to avoidance activity. Increasingly there is some degree of convergence in the responses of national jurisdictions, and increasingly the opportunities for a coordinated response are being taken by governments and their revenue authorities.

But there are also other clear-cut conclusions that can be drawn from this exploration. It has been argued, for example, that the courts – and particularly the superior courts – in all of the common law jurisdictions have reached the position of accepting that taxing statutes, just like other law, are to be consistently interpreted in a purposive fashion, having regard not only to the words of the legislation but also to the intended legislative effect. This convergence exists notwithstanding different starting points and different routes.

Inevitably, some of the conclusions that have to be reached are not as clear cut. There is, for example, no obvious conclusion as to whether the arsenal of anti-avoidance weaponry is better served with or without a general anti-avoidance measure. The US – where judges have applied a robust, practical and commercial approach to tax avoidance cases – appears not to need such a rule. In the UK the jury is out. In most of those countries that do have a general anti-avoidance rule the provisions usually appear to operate successfully, but only – as in all provisions of last resort – where they are used sparingly. Over-use by revenue authorities is an abuse and can only serve to depreciate the value of the provision.

Above all else, we have to reach the inevitable conclusion that despite the large number of cases that have been heard in recent years and despite a greater certainty of interpretive approach by the courts, there is still no certainty of outcome. The dividing line between acceptable tax mitigation and unacceptable tax avoidance remains as indistinct as ever. As has been noted by Michael Littlewood in writing about decisions of the Privy Council in this area, the line is one of the most difficult in the whole of the law. “All in all, to describe the distinction between avoidance and mitigation as “vague” is to understate the problem, for it suggests that there is general agreement as to roughly where the line lies and that the disagreement is only as to marginal cases. But none of their Lordships appear to have regarded any of the cases as marginal. It is difficult, therefore, to extract from them any guidance as to where the line lies”.

Perhaps we have to conclude that the courts will never be in a position to provide certainty of outcome, but that consistency of approach is at least a step in the right direction. Ultimately issues that relate to how aggressive a stance should be taken so far as tax planning is concerned must remain a matter for determination – on a self-policing basis – for corporate and personal taxpayers themselves. The judiciary can play a role in the process, but such issues belong, in the final analysis, in the realms of moral and ethical behaviour. Corporate and personal social responsibility – and the reputational damage that excessive and egregious avoidance activity can attract – remains the ultimate deterrent, notwithstanding the impressive arsenal that can be available to those who seek to counter avoidance. Indeed, as Lord Greene succinctly put it more than half a century ago: “It scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers”.  

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128 Lord Howard de Walden v IRC [1942] 1 All ER 287.