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The Political Economy of Tax Avoidance

A. A. SHENFIELD

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The Political Economy of Tax Avoidance

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A. A. SHENFIELD

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Occasional Paper 24 is an amplified version of an address delivered by Mr A. A. Shenfield to the British branch of the International Fiscal Association on 16 October, 1968. The text was originally designed for an audience of accountants and lawyers primarily concerned with tax matters. Mr Shenfield is an economist as well as a lawyer, and he was asked to amplify and explain terms and propositions of interest to teachers and students and others concerned with the economic implications of his address.

The result is a closely reasoned analysis of the meaning of tax avoidance, the relationship between tax avoidance and tax evasion, governmental efforts to control tax avoidance, and of the legal, economic, and moral implications for society.

The Institute wishes to thank Professor A. R. Prest and Mr Graham Hutton for commenting on the text. It does not necessarily endorse the analysis or conclusions of its authors. It offers Mr Shenfield's Paper as an incisive examination of practices that should be studied not only for their technical and moral aspects, but also for their economic significance as a symptom of taxation that has passed beyond the stage at which it is generally accepted by the populace.

November 1968 EDITOR

THE AUTHOR

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The views expressed in this Paper are entirely the author's and are in no way to be attributed to the Industrial Policy Group or to any member of it.

The Political Economy of Tax Avoidance

A. A. SHENFIELD

I

Tax Avoidance and the Courts

Every student of problems of taxation is aware of the peculiar half-world inhabited by tax avoidance. To the man-in-the-street, indeed, it dwells in no half-world because he sees no distinction between tax avoidance and tax evasion, and even if he did grasp the legal distinction between the two,[1] he would still consign avoidance to a place in the underworld side by side with evasion. For the man-in-the-street likes to display himself as a bluff sceptic of legal distinctions between practices which appear to be morally similar, especially if those whom he envies engage in the lawful practice, in this case avoidance, while he himself is more likely to be tempted by the unlawful one, in this case evasion.

In better-instructed circles the legal distinction between avoidance and evasion is not only grasped; it is also respected. Yet even in such circles avoidance is commonly regarded with some distaste, suspicion, or unease. Indeed, it is probable that the majority of those who consciously practise avoidance, or advise others how to do so, do not care to let their minds dwell on its morality or its consistency with the requirements of good citizenship. They are content that it is lawful. This ambivalence, however, leaves it in a precarious half-world in which its lawfulness is always at risk. For practices which are widely regarded with moral repugnance, even if the repugnance may arise from ignorance, envy, or the application of double standards, are always in danger of loss of legality.

Strangely enough, although courts of law have made many pronouncements on avoidance and authors of works on taxation have often lingered to examine their judgements, and although avoidance

[1] The reader will no doubt know that evasion is the criminal breach of the tax laws, while avoidance is the lawful disposition of one's resources in such a manner as to reduce the tax burden falling upon them.

is clearly regarded as a fiscal matter of no small importance, no serious study has as far as I know been made of it from the standpoint of the political economist.[1] I use that old-fashioned term because fiscal problems stand more certainly than almost all others across the borderland between economics and politics. Is avoidance in the public interest or contrary to it? To answer this question one must of course consider its morality. But one must also consider its economic effects, its bearing upon the obligations of the citizen to the state and of the state to its citizens, and its relevance to the principles upon which the canons of taxation ought to rest. Without the consideration of such matters, the assessment of avoidance is likely to be confused and erratic.

A confusion of judgements

Judicial praise . . .

The confusion is amply displayed in the judgements of our courts. Consider some of the cases which are usually cited as the leading authorities in the taxation textbooks. First, the famous passage in Lord Clyde's judgement in Ayrshire Pullman Motor Services and Ritchie v. the Inland Revenue Commissioners.[2]

> 'No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow – and quite rightly – to take every advantage which is open to it under the taxing statutes for the purpose of depleting the tax payer's pocket. And the tax payer is in like manner entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.'

These are, in my view, admirable sentiments. Furthermore, they

[1] There are some very illuminating passages in the *Final Report of the Royal Commission on the Taxation of Profits and Income* (Cmd. 9474, HMSO, 1955), and in the Report of the Canadian Royal Commission on Taxation, 1966 (the 'Carter Commission'), but they are necessarily only a partial treatment of the matters which interest the political economist. Also Professor R. M. Titmuss, in his *Income Distribution and Social Change* (Allen and Unwin, 1962) has attempted to show how avoidance has defeated attempts to produce a 'fairer' (i.e. a more egalitarian) income and capital distribution and to indicate the extent of its effects. However, this book is so suffused with its author's well-known enmity for tax avoidance that if it has value, it is mainly because it enables the student to see an example of the pathology of egalitarianism. As Professor A. R. Prest has said, it suffers from 'lack of precision, errors, crucial omissions, irrelevance and tendentious assertions' (*British Tax Review*, March-April 1963).

[2] 1929 14 T.C. 754.

correctly state the law not only as it was in 1929 but also as it is now, notwithstanding some judicial statements apparently to the contrary. Yet there is something wrong with the statement. Why did Lord Clyde think it necessary to interpolate the words 'moral or other'? What business was it of his to refer to the morality of avoidance? He knew very well that, in lawyers' language, there is no equity[1] in the construction of taxing statutes. When a court is concerned with taxation, a litigant does not have to appear with 'clean hands', as he does when seeking relief from a court of equity. Nor is the court concerned with the merits of the parties, other than those which arise from the strict construction of the relevant taxing statutes. That great judge, Lord Atkin, put the matter with complete clarity and precision in the following passage from his judgement in Inland Revenue Commissioners v. Duke of Westminster.[2] After referring to devices for avoidance, he said:

> 'I do not use the word device in any sinister sense; for it has to be recognised that the subject, whether poor and humble or wealthy and noble, has the legal right so to dispose of his capital and income as to attract upon himself the least amount of tax. *The only function of a court of law is to determine the legal result of his dispositions so far as they affect tax.*' (My italics.)

Though Lord Clyde's view of the morality of avoidance was in my opinion entirely correct, his reference to it was unfortunate. What authority did he have to make such a statement? What relevance did it have to the case before him? What evidence was there before him on which to rest such an assertion? What bearing did it have on his decision between the parties? The answer to each of these questions is, none. Why then should anyone be impressed by the assertion? It is a reasonable conclusion that the case for the morality of avoidance was weakened, not strengthened,

[1] The strict requirements of the law have for centuries been made more consonant with natural justice by the parallel development of a system of equity. This has no place in taxation law. As Lord Cairns said in Partington v. Attorney General, 1869 LR 4, HL 100: 'If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any statute, what is called an equitable construction, such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.'

[2] 1936 A.C. 1.

by it. For those who have a feeling of distaste or unease about avoidance are unlikely to be convinced by a simple assertion of this kind, unsupported by argument or analysis. And in so far as respect for the views of a learned judge may influence opinion, the influence is more likely to be negative than positive when he appears to believe that a subject of some possible complexity can be dealt with in such a fashion. It would have been better for Lord Clyde to keep strictly to the matter in hand, as did Lord Atkin.

Notice, incidentally, that Lord Atkin was the one judge in the House of Lords who found against the scheme of avoidance before him. His brother judges all found in favour of it. This does not mean that Lord Atkin betrayed the principle in the quotation from his judgement set out above. On the contrary, he hewed closely to it. He did not look behind the covenants offered by the Duke of Westminster to his workers in order to find the 'true substance'[1] of the transactions, as a judge who misunderstood the rights of a tax avoider might have done. He looked at the true *legal* substance, that is the legal character or effect of the Duke's covenants, and found that, as it appeared to him, the Duke was not in a position to claim relief of tax. His brother judges equally rightly sought to find the true legal character or effect of the Duke's covenants, and reached a different conclusion. All the judges at this final hearing of the case, Lord Atkin included, clearly upheld the principle that 'the subject . . . has the legal right so to dispose of his capital and income as to attract upon himself the least amount of tax'.

. . . and condemnation

In another famous case, Latilla v. Inland Revenue Commissioners,[2] Lord Simon, then Lord Chancellor, made a statement which has become a favourite quotation in the textbooks. Referring to tax avoiders, he said:

> 'There is no doubt that they are within their legal rights, but that is no reason why their efforts or those of their professional advisers should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship. On the contrary one

[1] I.e., the financial, business or economic effect. Cf. Lord Tomlin in the same case: 'This so-called doctrine of "the substance" seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.'

[2] 1943 A.C. 377.

result of such methods, if they succeed, is of course to increase *pro tanto* the load of tax on the shoulders of the great body of good citizens who do not desire, or do not know how, to adopt these manoeuvres.'

Certain features of this statement are extremely odd. First, what was the purpose of Lord Simon's observation on the character of the efforts of tax avoiders and their professional advisers? Had Mr Latilla asked for the blessing of the Court upon the transactions in issue on the ground that they were 'a commendable exercise of ingenuity' or the 'discharge of the duties of good citizenship'? Had the morality of tax avoidance come into issue at all in the course of counsels' arguments on either side? Did the Court's unanimously unfavourable judgement upon Mr Latilla's (or, to be more accurate, Mrs Latilla's) transactions depend in the slightest degree upon Lord Simon's observations on the character of tax avoidance? To all these questions the answer is, of course not. The questions before the Court were (a) did the transactions concerned fall within the ambit of Section 18 of the Finance Act, 1936, and (b) was the avoidance of tax a main purpose of the transactions, as required by Section 18 if a tax liability were to arise? On the facts before it the Court could not have reached any other verdict than it did. The transactions concerned clearly fell within the requirements for taxability laid down by Section 18, and the Court was entirely right to give judgement against Mr Latilla. Lord Simon's interpolation on the merits of avoiders clearly had nothing to do with it. Indeed he himself said 'There is no doubt that they [i.e. tax avoiders] are within their legal rights', and he would of course have given judgement for Mr Latilla, whatever he thought of the morality of his transactions, if their legal character had been such as to enable them to escape liability to tax. No doubt in giving judgement for Mr Latilla in these circumstances, he would have permitted himself the expression of some disdain.

Secondly, this passage from Lord Simon's judgement is cited again and again in the textbooks to show that by 1943 the attitude of the courts to avoidance had changed since the Ayrshire Pullman and Duke of Westminster cases (the change being sometimes attributed to the atmosphere of war). But there is nothing in Latilla v. the IRC to show that the attitude of the courts to the legal character of avoidance had changed. Lord Simon's view in

1943 of the morality of avoidance was no doubt at the opposite pole to Lord Clyde's in 1929, but this did not affect the judgement of the House of Lords in the case before it nor did it change the law. His observations on ingenuity and the duties of good citizenship would have been a judicial red herring if they had influenced the judgement; and they have indeed been a judicial red herring in so far as they have led students of taxation to believe that they indicated a change in the attitude of the courts to the legal rights of tax avoiders. The true importance of these observations of Lord Simon's lies in the encouragement they have given to popular hostility to tax avoidance, which in turn has given a stimulus to Chancellors of the Exchequer to adopt harsh and, in a sense, lawless[1] methods of preventing or countering avoidance.

Thirdly, on what evidence did Lord Simon find that a result of tax avoidance was 'of course to increase *pro tanto* the load of tax on the shoulders of the great body of good citizens'? Notice the 'of course', the '*pro tanto*', and the 'good citizens'. I shall attempt to show later[2] not merely that this statement is not 'of course' true, but also that as it stands it is hardly true at all. I shall also attempt to show that if burdens are at all shifted to other taxpayers by tax avoiders, the shift is not '*pro tanto*'. As for the 'good citizens', this was simply an attempt to denigrate the tax avoider by contrasting his behaviour with the goodness of non-avoiders. The regrettable truth is that Lord Simon made this statement *sans* evidence, *sans* analysis, and indeed *sans* thought. Without really applying his mind to the matter, he gave vent from the eminence of the Woolsack to an observation suited in its lack of knowledge and reasoning to utterance by a simple man-in-the-street.[3]

[1] Below, pp. 28-33.

[2] Below, pp. 22-24.

[3] In the course of his career Lord Simon left the Bar twice in order to take up public appointments (Home Secretary in 1915 and Foreign Secretary in 1931: he later became Home Secretary again, Chancellor of the Exchequer and Lord Chancellor but these appointments came after he had left the Bar to become Foreign Secretary). Each time large post-cessation receipts of fees accrued to him free of tax (a benefit of which the Bar has now been largely deprived by the Finance Act, 1968). No doubt the prospective accrual of tax-free post-cessation receipts played no part at all in Lord Simon's decisions to take these appointments, and therefore he was not a tax avoider, merely enjoying passively the gentle rain which fell upon him without his seeking it. But it is perhaps permissible to wonder whether he asked himself if his freedom from tax shifted the load of tax *pro tanto* onto the shoulders of his fellow citizens. It is perhaps also permissible to ask whether, since his political career obviously made offers of appointments likely, he warned his clerk never to let solicitors think that delay in the settlement of his fees would be welcome.

A later case is sometimes cited to show that after the war the attitude of the courts to tax avoidance moved back to something like the pre-war position. In Vestey's Executors v. the Inland Revenue Commissioners[1] Lord Normand said:

> 'The court will not stretch the terms of taxing acts in order to improve on the efforts of parliament and to stop gaps which are left open by the statute. Tax avoidance is an evil, but it would be the beginning of much greater evils if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved.'

This is a magisterial statement, expressed with high authority. It warns us against evils which the unpopularity of avoidance, intensified by statements such as Lord Simon's in the Latilla case, might propel us into. But why did Lord Normand say 'tax avoidance is an evil'? What evidence was there before him on this question? What relevance did this assertion have to the case before him? Was he not giving vent to thoughtless prejudice against avoidance even in the moment of warning against the evils of allowing the prejudice to influence a court's judgement? What he should have said, I submit, is something like the following:

> 'The Court will not stretch the terms of taxing acts in order to improve on the efforts of parliament and to stop gaps which are left open by the statute. Tax avoidance may be said to be an evil. This is not a question which is before the Court for decision, nor indeed is it a question apt for decision by a Court of law. But it would be an evil, and a great one, if, in order to counter the alleged evil of tax avoidance, the Court were to overstretch the language of the statute in order to subject to taxation people of whom it disapproved.'

Incidentally, if Lord Normand was correctly reported he was guilty of careless language in another part of his judgement, where he appears to have said:

> 'The first and most fundamental question concerns the proper approach to the construction of the statutory provisions dealing with attempts to *evade* (my italics) taxation . . . The hypothesis of both sections is that the documents to be construed are the instruments of a scheme of tax avoidance.'

[1] 1949 1 AER 1108; 1949 TR 149.

The Bench is likely to be the author of much error if it allows itself a slip of the tongue which confuses tax evasion with tax avoidance.[1]

II

Political Economy

In turning to political economy, we must first decide what we mean by tax avoidance. There are several varieties, but not all are generally regarded as avoidance, and certainly not all are considered by governments to present what may be called 'the problem' of avoidance. Whatever the variety, I suggest that an essential ingredient is an *intention* to act in such a way as to reduce liability to tax. An act or transaction which is exactly the same in all respects as an act or transaction of avoidance but lacks the intention to reduce tax liability is not in my opinion a case of avoidance. The exclusion from the category of avoidance of acts which lack the intention to avoid tax produces some difficult borderline cases, but it appears to me to give precision to the concept of avoidance.[2]

[1] The distaste of some judges for avoidance often displays itself even when they fully respect its legality. In the recent case of In re Weston's Settlements (1968 2 W.L.R. 1154, and *The Times*, 1 August, 1968), the judgements against an attempt at avoidance were undoubtedly correctly and solidly founded upon the law and the facts of the case, but the judges permitted themselves some observations on avoidance which would not be easy to justify. Lord Denning, presiding in the Court of Appeal, reached the remarkable conclusion that the benefit to children as yet unborn of freedom from tax on shares of trusts amounting to £800,000, which they would enjoy if they lived in Jersey, was less than that of being brought up 'in this our England, which was still the envy of less happy lands'. Incidentally, Lord Denning said: 'The avoidance of tax might be lawful, but it was not yet a virtue'. In fact in the context of this kind of case, which was an application under the Variation of Trusts Act, 1958 for the removal of a trust from England to Jersey, avoidance could be a virtue in the eyes of the law. For it is well-established that the aim of tax avoidance is acceptable to the Court as a valid reason for the variation of a trust.

[2] Cf. the post-cessation receipts referred to in the footnote on page 12. A barrister who leaves the Bar for reasons that in no way include a desire to enjoy free of tax fees which, but for the cessation of his practice, would be taxable, cannot be said to avoid tax; but if such a desire does enter into his calculations he is avoiding tax. So too a man who abstains from alcohol or tobacco for reasons unconnected with the element of tax in their price is not a tax avoider. Thus the man who is a teetotaller or non-smoker on principle is not a tax avoider. The man who abstains from alcohol or tobacco, or reduces his consumption of them, because the price is too high is hard to place in this respect. Clearly he intends to avoid a price which is as high as it is because there is a tax in it; but on the other hand, if the effect of the tax on the price does not enter into his mind, it strains language to say that he intends to avoid tax. It is best to apply the term avoidance only where there is an awareness of the tax and an intention to avoid it as such, and not simply to avoid a price which happens to include a tax.

The principal types may be classified as follows:

(i) The avoidance of income, capital, expenditure, employment or whatever else is taxed. The man who, *in order to avoid tax,* decides not to earn an income, or acquire capital, or buy taxed commodities, or take taxed employment,[1] comes into this category. This is not to be confused with the case where a man divests himself of income or capital he already possesses.

(ii) The acceptance of tax exemptions or tax privileges offered by a government, e.g. investment in tax-free government bonds; 'pioneer' manufacturing in underdeveloped countries or manufacturing in selected regions in developed countries, in return for tax privileges; and so on.

(iii) The pursuit of normal business purposes, but with an eye to the selection, where there is a choice, of that method which produces the least unwelcome tax result. Here tax avoidance is subsidiary to the main aim, but it may be an essential part of the approach to the aim. This category comprehends a wide range of practices, of which some are regarded by governments with equanimity, others with fierce hostility. Thus at one end of the scale is the avoidance of the 'tax trap'; at the other end is the use of controlled companies to carry on transactions not at arm's-length;[2] and there are numerous kinds in between. The 'tax trap', properly understood, is the case where a tax law is so drafted as to catch more than it was intended to catch (i.e. the opposite of the 'loophole', which arises where the law is so drafted as to catch less than was intended[3]). While governments rarely rush to help a victim caught in a tax trap, they do not normally seek to stop the avoidance of it. On the other hand, they are very fierce about the tax effects of transactions not at arm's-length (or transactions pre-

[1] The taxation of employment does not mean the taxation of income from employment. It means taxation on employment as such, e.g. SET and National Insurance contributions.

[2] I.e. not conducted as they would be by mutual strangers, each of whom might be presumed to act in his own interest. An arm's-length transaction is presumed to be a genuine bargain; one which is not at arm's-length may reasonably be supposed not to be.

[3] Difficulties in the concept of the intention of a law are discussed below, pp. 20-21.

sumed to be at arm's-length according to their often oppressive rules).

(iv) The pursuit of tax avoidance as the main or whole aim of a transaction. This category also has a wide range of practices, and (iii) above merges into it. Thus the deliberate creation of a controlled company to enable transactions to be not at arm's-length falls within this category, not within (iii); but in practice, motives often being mixed, it may be difficult to categorise a particular case with precision.

Most of the subject of tax avoidance is concerned with category (iv), so it is well to look at it more closely. The main types of actions here are:

(a) Divestment of one's income or capital; or splitting of income or capital between several taxpayers; or transfer of losses from one taxpayer to another (e.g. covenants, trusts, gifts and settlements, non-aggregable insurance policies, purchase of tax-loss companies, etc.).

(b) Conversion of income receipts into capital receipts; or of capital deductions into income deductions; or of one type of income or capital respectively into another type which is untaxed or taxed less than the first type (e.g. dividend stripping, bond washing, 'hobby' farming, purchase of timber, etc.).

(c) Assumption of residence and/or domicile outside the United Kingdom.

These types of actions (category (iv)) have developed in number and ingenuity with the increase in the tax burden and spread in tax coverage of recent decades. There has also been a constant stimulus to find new types in place of old as measures of anti-avoidance have been progressively developed by Chancellors of the Exchequer.

Extent of avoidance

What do we know about the extent of the practice of tax avoidance as distinct from the extension of its methods? By its nature it is incapable of even approximate estimation. This applies even to category (ii), where the amount of tax directly foregone can be assessed; for no-one knows to what extent the tax exemptions or privileges offered by the government in practice determine

the transactions carried out. For the other categories quantitative evidence must at best be fragmentary.

In category (i), evidence has often been sought on the effects of taxation on the will to work, save, invest and take risks, but of course it has always been elusive, as it always will be. Nor do observation and commonsense deduction give a completely clear indication, since taxation works in these matters in conflicting ways. In categories (iii) and (iv) rough estimates are available of the number and amount of covenants made by income-tax and surtax payers for the benefit of individuals and charities; of the number and value of certain types of life assurance policies associated with avoidance of estate duty; of the amount of tax by-passed in certain periods by dividend stripping and bond washing; of the amount of UK funds applied to the purchase of land and mortgages outside the UK during part of the period when such property was free of estate duty. But not only are these estimates often extremely rough; in addition, while excluding many transactions which are tax avoiding, they also probably include many which are not.

Yet it is clear that the tax effects of the transactions covered by these figures are very small, even if one assumes that the figures are heavily biased on the side of under-statement. The Royal Commission on Taxation, whose Final Report appeared in 1955, was informed by the Board of Inland Revenue that covenants in favour of individuals numbered about 75,000 and reduced the annual yield of surtax by about £7·5 million and of income tax by about £5 million; while covenants in favour of charities cost the Revenue about £3·75 million.[1] Since then there have been further estimates, but the total cost to the Revenue of these covenants is most unlikely to be outside the range of £20–£40 million, which must be set against an income-tax yield of about £4,400 million and a surtax yield of about £250 million. Even if the effect on surtax is to reduce it by £10–£20 million, which would be 4–8 per cent of the total, the amount is almost trifling by comparison with the total yield of taxes, of which surtax produces less than 2 per cent (which is within the margin of error of the annual estimates of total revenue).

[1] This is not to be confused with the total value to charities of their exemption from tax on property and investments, which the Royal Commission was told by the Board amounted to some £200 million a year.

As for devices such as dividend stripping and bond washing, there have been rough estimates suggesting that in the late 1950s the loss to the Revenue was of the order of less than £5 million a year from dividend stripping. The loss from bond washing, which has a longer history than dividend stripping, was probably contained by that time but may perhaps have been of a similar order of magnitude. We shall never know how large the loss might be because the legislation has stopped the really big transactions of this kind. We need only note that, except in the case of controlled companies which, but for the legislation, could distribute the accumulated profits of several years in stripping operations, the really widespread growth of dividend stripping and bond washing would call into play its own counter-forces. For a great extension of the manipulation of the differential between cum-dividend and ex-dividend prices of quoted securities would narrow the profit on avoidance and reduce its attraction. The nightmare of widespread and enormous dividend-stripping and bond-washing operations, which has caused apprehensive shudders among Chancellors of the Exchequer, proves on examination to be much less frightening than they have thought.

However, there are many transactions in categories (iii) and (iv) which are outside the catchment of available figures. No-one knows, for example, how many transactions are of a not-at-arm's-length character, or how many there would be in the absence of anti-avoidance measures. It is possible, therefore, that the total tax effect, and still more the total economic effect (i.e. effect on the production, use and distribution of resources), of categories (iii) and (iv) may be very considerable. But is it likely that their economic effects can match those of category (i)? Let us grant that the effects of taxes on work, saving, investment and risk-taking cannot be measured and are compounded of conflicting influences. Still, the catchment of taxes is now so extended and awareness of them so widespread that it is becoming more and more likely that their economic effects are both substantial and, on balance, harmful. Yet governments get far more excited about categories (iii) and (iv) than about category (i), which indeed they do not normally consider to be tax avoidance at all. It is categories (iii) and (iv), and especially the latter, which they denounce as immoral and contrary to the duties of good citizenship. Why?

III

Analysis of Anti-Avoidance Arguments

Six contentions

There are six possible contentions that we shall consider:

1. Avoidance is morally akin to evasion because their aims are essentially similar, i.e. to circumvent the intentions of the law. If successful they both bring the law into contempt.
2. Avoidance leads to evasion.
3. Avoidance is unfair and a dereliction of the citizen's duty because it loads an extra burden of taxation on those who do not choose to, do not know how to, or are unable to, practise it.
4. Avoidance is unfair because, whether it loads an extra burden on non-avoiders or not, it causes citizens who should be taxed similarly to be taxed differentially.
5. Avoidance thwarts efforts to produce an equitable distribution of income or capital.
6. Avoidance is wasteful because it misuses the scarce brain-power of tax advisers, and because it channels resources according to individual tax advantage instead of social economic advantage.

Let us consider these contentions.

1. *Effect of avoidance morally equivalent to evasion*

First, suppose that it were true that avoidance and evasion had the common purpose of circumventing the intentions of the law. That would not in itself render avoidance immoral or contrary to the canons of good citizenship. Evasion is wrong not because it thwarts the aims of the law but because law-breaking is wrong *per se* (apart from extreme situations, e.g. where tyrannicide is justifiable). Lawbreaking is in principle wrong whether the law which is broken is a just one or not; for civilised life is impossible without laws and obedience to them. But avoidance does obey the law, even if, as we suppose for the moment, it circumvents its intentions. Hence avoidance can be judged immoral on this ground only if the law whose intentions it circumvents is just, or if it is in breach of some extra-legal rule of morality. The tax avoider is therefore entitled to be heard on the claim that the law

whose intentions he circumvents is unjust. When one bears in mind that what he seeks to avoid is mostly the operation of progressive taxation, which may be not implausibly described as the despoliation of a minority by a political majority, his claim may be *prima facie* sustainable. The mere intent to circumvent the law therefore cannot convict him of immorality or bad citizenship.

Similar considerations apply to the complaint that avoidance brings the law into contempt. The law-abiding citizen is blameless if he brings particular laws into contempt unless they are just, and if they are unjust he may be blameworthy for not bringing them into contempt. But if the complaint is that avoidance brings law in general, or the idea of law, into contempt, this must mean that avoidance is evil because it produces or stimulates evasion. I deal with this complaint in (2) below.

As for extra-legal rules of morality, it is of course true that lawful acts may be in breach of them. Adultery and fornication are not unlawful, but most people even in our times would, I fancy, declare them to be in principle immoral (though they would also regard them as blameless in certain situations). But what are the extra-legal rules of morality which the tax avoider breaks? Unselfishness? A due regard for the interests of one's fellow-citizens? A readiness to share the burdens of citizenship fairly with others? Such rules would either pillory avoidance unfairly (for there are many instances of the pursuit of personal advantage which are regarded as blameless or even virtuous), or they would do so on the grounds set out in (3), (4), and (5) above, and discussed below.

But, secondly, what is meant by the intentions of the law and in what sense does avoidance circumvent them? Courts of law in our system seek to find the intention of a law in the words it uses. In this sense the avoider does not circumvent its intentions but abides by them. What the complainant against avoidance means by the intentions of a law is not what may be deduced from what it says, but what parliament intended it to say, or what parliament ought in the complainant's opinion to have intended it to say, or what in his opinion it would have been equitable for it to say. Now I do not say that this can never have substance. We all know that, quite apart from outright errors of draftsmanship, there is a distinction between the letter and the spirit of a law. But the

spirit of a law is elusive. It is tempting to believe that one has grasped the spirit of a law when in truth one is moved by prejudice or preconception. We ought to be extremely careful not to be free with moral censure for presumed breaches of the spirit of a law, lest we undermine law itself. A respect for the letter of the law is itself a moral virtue, and contempt for the 'mere letter' in favour of the presumed spirit leads to the justice of a cadi under his palm tree[1] or, worse, to the justice of People's Courts. Shylock, standing on the letter of the law, was more effectively defeated by the precise letter itself than he might have been by an appeal to the uncertain spirit of justice.

What especially puts the complainant against avoidance often in the wrong at this point is that he looks to the intention of one law and ignores that of other laws. When the tax avoider wriggles most sinuously through the interstices of the law, he is likely to rely on the construction of more than one statute as well as, perhaps, time-honoured principles of the common law. The intention of one statute, perhaps the main taxing statute concerned, may be hard to reconcile with that of another statute. The complainant against avoidance is himself offending against the spirit of the law if he ignores the complexity of its intentions.

My conclusion therefore is that the argument against avoidance on grounds of morality and the duties of citizenship wears thin under test. But that is not all. If we are concerned with moral and civic duties we must complete the picture by including the anti-avoidance measures of governments and parliaments, for there are rules of behaviour for them also. As Viscount Sumner said in Levene v. Inland Revenue Commissioners[2] (and it would now be an understatement),

> 'The way of taxpayers is hard,[3] and the Legislature does not go out of its way to make it any easier.'

I shall therefore return to this subject[4] after an examination of anti-avoidance policies and measures.

[1] We may be thankful that no British judge is likely to say what Mr Justice William O. Douglas, that paladin of social justice and all causes dear to modern social reformers, is reported to have said once in the United States Supreme Court, viz. 'I feel in my bones that I am right'.
[2] 1928 13 TC 486.
[3] This at a time when income tax was 4s in the £ and surtax was low in proportion!
[4] Below, pp. 28-33.

2. *Avoidance leads to evasion*

The contention that avoidance leads to evasion may mean either that tax avoiders themselves graduate to evasion, or that their example inspires others to try evasion (presumably because they cannot try avoidance). In the first interpretation avoidance is to evasion as hashish is to heroin. In the second they are more or less parallel malpractices.

There is no evidence known to me to support the first interpretation. It is, I believe, far-fetched. Even if avoidance goes with contempt for the spirit of the law, it surely also goes with respect for the letter. Furthermore, if there were anything in this contention, the incidence of evasion should be positively correlated with that of avoidance. Thus one would expect to find a stronger propensity to evasion in Canada than in the United States, to take two closely comparable countries. For tax law in Canada is very similar to British law and avoidance is widely possible there; whereas there are provisions in American law which make it difficult. But the evidence does not bear this proposition out.

The second interpretation rests upon the proposition that avoidance brings the law into contempt, so that the view spreads that what is popularly known as 'tax-fiddling' succeeds. To the ordinary man one 'tax-fiddle' is the same as another, and the presumed success of the avoidance 'fiddle' justifies the attempt at an evasion 'fiddle'.

Of course there is no way of proving or disproving this proposition, but it surely sounds uncommonly like an evader's rationalisation. Tax evaders are attracted by the fruits of evasion and believe that they will not be caught. I take leave to believe that what avoiders do has nothing to do with it.

3. *Avoidance imposes unfair tax burden on non-avoiders*

We now come to Lord Simon's assertion on the shift of tax burdens from the avoider to the non-avoider. At first sight it seems to be obviously correct. What the avoider does not pay the non-avoider must apparently make good. But the matter is not so simple. Consider how tax rates emerge. The Chancellor first decides how much he needs to take out of the taxpayers' pockets, in former times simply to meet the government's expenditure, nowadays to do that but also to regulate the level of economic

activity. He then sees what taxes he needs to produce this amount, and the rates of such taxes will in part be determined by past avoidance. Thus experience may show that the standard rate of income tax needs to be 8s 3d, but if there had been no avoidance experience might indicate a rate of 8s. Suppose that avoidance were ended. Would the Chancellor perforce decide on a rate of 8s? Of course not. His estimate of the amount which he needs to take out of the taxpayers' pockets is elastic. The spending departments always demand more than he can give them. If his original figure can be met by 8s but 8s 3d is politically tolerable, he is at least as likely to revise his figure upwards and go for 8s 3d as he is to rest at 8s. Conversely, suppose that experience, being partly governed by past avoidance, indicates a need for 8s 6d, but suppose also that this is politically intolerable. The Chancellor is at least as likely to revise his figure downwards and rest at 8s 3d as he is to risk the odium of imposing 8s 6d.

Thus, the idea that the avoider causes a shift of tax *pro tanto* on to the shoulders of the non-avoider is clearly too *simpliste*. Tax avoidance of course narrows the base of taxation. To this extent it is true that it tends to push tax rates up at the expense of the non-avoider. But what is also true is that tax rates are determined by other factors in addition to the presumed need for revenue *and that these factors are in general of more influence upon the outcome than avoidance*. Hence I conclude not only that there is not a *pro tanto* shift but also that the shift, if any, is likely to be considerably less than the amount of tax avoided. I know very well that in the examples I have given the Chancellor's choice is not limited to income tax at 8s 3d and 8s, or 8s 3d and 8s 6d, for he will have other taxes, and perhaps new taxes, in mind. The narrowing of the tax base caused by avoidance may therefore produce changes in the rates of taxes other than those avoided. But this does not affect the essence of the analysis.

It may be contended that Lord Simon's complaint against the tax avoider would have been well-founded if he had brought the benefit from government expenditure into the account, and it can be argued that this was implicit in what he said. Thus suppose that avoidance in a particular case does not raise tax rates against non-avoiders. Then it must reduce government revenue, and if so it must reduce the benefit accruing to non-avoiders from government expenditure. Hence one way or another the tax avoider must

shift some burden on to the non-avoider, either by raising his taxes or by reducing his government-provided benefits.

In some measure this is certainly persuasive. But take into account the following facts. Avoidance is significant only under a regime of a high-taxing, high-spending state. Such a state is notoriously wasteful both in its administration and in the choice of purposes for which it spends its revenue at the margin. Hence the value to the taxpayer of the benefits from a marginal addition to government expenditure may be a doubtful quantity.

However, since I admit that avoidance may shift some burden or benefit adversely to non-avoiders, I may be thought to concede that it is therefore unfair. This is not so. Such a shift is unfair only if the cause is unfair, and for reasons other than the shift itself. Otherwise every shift of tax (e.g. that caused by Lord Simon's non-avoiding enjoyment of tax-free post-cessation receipts) could be called unfair. The shift, if any, caused by avoidance would be unfair only if avoidance were adjudged on other grounds to be immoral, or if it were in some undesirable way an advantage available to, or seized by, only some citizens and not others. I have considered the first possibility at some length.[1] I now turn to the second.

4. *Avoidance leads to differential taxation*

Whether tax avoidance causes a shift of tax burden to non-avoiders or not, it is true that an avoider and a non-avoider in the same income or capital position do not pay the same tax. Is this unfair? As Lord Simon put it, the 'good' citizens do not desire, or do not know how, to adopt the avoider's manoeuvres. We may add the case where the non-avoider does not avoid tax simply because, quite apart from choice or knowledge, he is unable to do so.

The man who *chooses* not to avoid tax cannot complain that avoidance is unfair unless he can show that it is immoral or unworthy in a citizen, which brings us back to the main argument already examined. Even so, this would not be a sufficient reason for action against avoidance. The virtuous man may object to the vices of others, in which he could freely join if he wished, on the ground that they are vices, but not on the ground that it is unfair that he in his virtue does not enjoy them while others do.

[1] Above, pp. 19-21.

That some do not *know* how to avoid taxes also can hardly be cause for complaint on the ground of unfairness. Except in the minds of the extreme egalitarians, the unequal distribution of knowledge has never been considered unfair. Of course there may be unfairness in the cause of the unequal distribution of knowledge, but we should all be surprised if current agitation about equality of educational opportunities were to be extended so as to embrace equality of knowledge on tax avoidance. There is clearly nothing here which need detain us further.

The case of the non-avoider who is *unable* to avoid tax at first sight appears to have more substance. One man's income is wholly earned under Schedule E[1] and he has no capital. Another man has a Schedule D[1] income and also capital. A third man is able to conduct his affairs as satisfactorily in the Channel Islands or the Bahamas as in Britain. Man for man the tax burden of the first will be higher than that of the other two, and the first man will be unable to redress the balance however much he knows about the ways of tax avoidance. But why is this unfair? There are many kinds of differential situations in which one man has an advantage over another, which yet cannot be called unfair except on a fanciful basis. The difference in the ability to avoid tax is a differential of this kind; or alternatively the unfairness is in the tax system itself, not in the ability to avoid it.

5. *Avoidance thwarts more equitable income distribution*

The complaint that tax avoidance thwarts efforts to produce an equitable distribution of income or capital rests upon the supposition that an equitable distribution means a more equal distribution than we now have. Of course tax avoidance does thwart the efforts of egalitarians. It is perhaps the main defence of the rich[2] against what some would call their due and proper taxation but what others would call their despoliation. For the non-egalitarian, it

[1] Schedule E applies to income earned by employees; Schedule D to income earned by the self-employed in trades, professions and vocations. The rules of these Schedules differ, notably in the case of expenses chargeable against income, the Schedule E rules being in this respect tighter than the Schedule D rules.

[2] By no means does this mean that avoidance is the preserve of the rich. Even in its narrow popular sense it is not unknown to many in modest income ranges. In its widest sense, of course, it is perhaps as important at low income levels as anywhere else.

should be heartening to see how many of the rich have managed to retain a goodly portion of their wealth or to spread it within their family circles or among the charities of their choice rather than amongst their rapacious fellow-citizens. But the egalitarian becomes baffled and enraged when he sees this.[1] A judgement upon avoidance under this head clearly rests upon the view which is taken of the merits of a more equal distribution of income and capital. I return to this below when I come to the fiscal behaviour of the modern state (pp. 29–35).

6. *Avoidance wastes resources*

What of the complaint that tax avoidance causes waste? First, consider the alleged misuse of the scarce brainpower of tax advisers. Of course there would be a gain to the economy if they were able to devote themselves to other subjects because there were no tax problems for them to advise upon. Otherwise to regard their activities as wasteful is to treat tax problems as if they were a less worthy object for professional advice and opinion than, say, problems in company law, the law of contract, divorce law, and so on. What the complainant here really has in mind is something like the following. It is right and proper for tax advisers to give advice on the computation of their clients' taxes and even on the bearing of the tax system on their clients' business activities (perhaps, for example, showing how 'tax traps' may be avoided); but it is wrong for them to devote their talents to devising stratagems and 'artificial' transactions for defeating the intentions of taxation laws. It is necessary only to state this position in order to show how untenable it is. In practice it is impossible to draw a line between these types of professional activities;[2] and in theory the difference between them rests upon the proposition that there

[1] Professor Titmuss's *Income Distribution and Social Change* (*op. cit.*) attempts to describe not only all the avoidance devices which thwart a more equal distribution of income and capital but also any circumstances which hinder it and which can conceivably be tarred with the avoidance brush. It is clear that in his view it is the duty of the rich to lay their heads on the block and to ask at most for a clean cut.

[2] The Royal Commission said of so-called 'artificial' transactions '. . . a transaction is not well described as "artificial" if it has valid legal consequences, unless some standard can be set up to establish what is "natural" for the same purpose. Such standards are not readily discernible'. (*Final Report, op. cit.*, para. 1024.)

is something immoral or unworthy about avoidance which we have already found unconvincing.

Secondly, there is the alleged divergence between individual tax advantage and social economic advantage. Here we are in the field of the relation between private and social costs and returns. We are all now familiar with the problems of the divergences between private and social costs and returns, though it is amusing to see how those who have only just begun to notice them exaggerate the difficulty of these problems and are unaware of the extent to which they are, or can be, resolved by normal market processes.[1]

However, for the purpose of considering the alleged distorting or wasteful effects of tax avoidance, we must either assume that private costs and returns *before tax* are in accord with social costs and returns, or take the divergence between them *before tax* as given. In short we are concerned only with the effects of divergence caused from the *before tax* position by avoidance. Once this is made clear the case against avoidance melts away. Of course it is true that avoidance may promote, deter, or change the character of particular investments, outputs, sales or other business activities, and so produce a divergence from the pre-avoidance or non-avoidance situation. But so too does taxation itself produce a divergence between the before-tax and after-tax situations, or between the with-tax situation and a hypothetical without-tax situation. There is no reason to believe that the divergence caused by the avoidance of tax has a more distorting effect on business activity than that caused by taxation. On the contrary, there are circumstances in which avoidance obviously mitigates the distorting effect of taxation.[2] The balance between the distorting effect of avoidance and that of taxation cannot be assessed, but there is no reason to believe that the former is greater than the latter.

Where avoidance is effected by taking up residence or domicile outside the United Kingdom, with the result that income or

[1] Professor R. H. Coase, 'The Problem of Social Cost', *Journal of Law and Economics* (University of Chicago), 1960; G. H. Peters, *Cost-Benefit Analysis and Public Expenditure,* Eaton Paper 8 (Second Edition), IEA, 1968.

[2] Consider for example the effect of estate duty on family businesses. There are many cases where, but for timely measures of avoidance, such businesses would have had to be disintegrated, with damaging and distorting effects upon the use of economic resources.

capital emigrates, it may be (though it is not inevitable) that there is an economic loss to the country. In this case the proximate cause of the loss is avoidance. But the ultimate cause is the level of taxation which propels a taxpayer overseas; and it is not correct to say that avoidance is the true cause unless one concludes that all efforts to improve one's economic situation by emigration (i.e. geographical mobility) are in principle wrong. Unless very severely qualified, such a proposition is utterly totalitarian in character.

IV

MORALITY OF GOVERNMENT ANTI-AVOIDANCE

I have suggested that we cannot complete our picture without an examination of what governments and parliaments do about avoidance. Let us therefore consider the propriety and morality of anti-avoidance.

In principle governments clearly have an inexpugnable right to take measures of anti-avoidance. They have a right to vary existing taxes and to introduce new taxes. Hence in principle they have a right to tax what has not been taxed, and so they have a right to close doors which have been opened for avoidance. The tests which are to be applied to measures of anti-avoidance are therefore the same as those which ought to be applied to any taxing measures. Are they equitable? Are they efficient? Are they reasonably understandable by the taxpayers? Are they conducive to economic advancement? Above all, are they consistent with the Rule of Law?

I shall take up only the last question because it will suffice for the argument I propose to develop, but I believe that a consideration of the other questions would not produce conclusions in conflict with my argument. However, first, what types of avoidance deserve to be met by anti-avoidance? The Royal Commission on Taxation was a wise guide here. It suggested that the principal type of avoidance which merited attack was that which enabled a man to divest himself in law of income or capital and yet to retain some control over it. The discretionary trust is the most familiar example. This is not to concede that such avoidance is clearly immoral or contrary to the canons of good citizenship,

but it recognises that one who retains some control over property after legally divesting himself of it comes closest to a case of offending against the spirit of the law while obeying the letter. To anti-avoidance in this kind of case we may properly add anti-avoidance in all those cases where it is possible to conduct transactions not at arm's length. Hence it is right to set up a legal presumption that transactions not at arm's-length are carried out on terms more favourable to the taxpayer than transactions at arm's-length would be, and to apply tax measures against them; though the taxpayer should always have the right to rebut the presumption if he can.[1] Apart from these two broad categories of actual or possible avoidance, there are few or no categories which call for anti-avoidance measures. These two categories have of course a wide catchment. Thus, for example, the type of dividend-stripping which is clearly objectionable arises in the case of controlled companies, to which special rules may properly be applied on the footing that controlled companies are managed in circumstances which are not at arm's-length.

Application of anti-avoidance measures

Let us now look at the ways in which anti-avoidance may be applied. The Canadian Royal Commission listed four approaches to the application of anti-avoidance:

'1. The "sniper" approach, which contemplates the enactment of specific provisions which identify with precision the type of transaction to be dealt with and prescribes with precision the tax consequences of such a transaction.

'2. The "shotgun" approach, which contemplates the enactment of some general provision which imposes tax on transactions which are defined in a general way.

'3. The "transaction not at arm's-length" approach, which applies where the parties to particular types of transactions are not dealing with each other at arm's length and provides that the tax consequences will be different than they otherwise would be.

[1] The Canadian Royal Commission (the 'Carter Commission') took the view that the presumption that transactions are not at arm's-length should be irrebuttable in the cases of controlled companies and of husbands and wives and their children. Lest this appears to be in conflict with what I have said, I should make it clear that the Commission referred to the presumption that trading is not at arm's-length. I am referring to a presumption that trading which is not at arm's-length is more favourable to the taxpayer than it would be if it were at arm's-length.

'4. The "administrative control" approach, which contemplates the grant of wide powers to an official or an administrative tribunal in order to counter tax-avoidance transactions.'[1]

This classification is not entirely logical. The 'sniper', 'shotgun and 'administrative control' approaches are descriptive of methods of dealing with all kinds of avoidance. The 'transaction not at arm's-length' approach is in reality a way of applying one or more of the other three methods, in practice principally the 'shotgun', to a selected type of avoidance situation. However, it is in practice desirable to treat the 'not-at-arm's-length' situation as a case apart from all others, for there are measures which are justifiable in dealing with it which are unjustifiable in dealing with other cases.

The 'sniper' approach is the way of those who respect the Rule of Law. The 'shotgun' and 'administrative control' approaches in general are not. It is right that the taxpayer should know precisely what type of transaction the law is concerned with and precisely what its tax consequences are. The 'shotgun' approach and, *a fortiori*, the 'administrative control' approach, offend against this principle. The only qualification to this which is admissible, I submit, is that the 'shotgun', but not 'administrative control', is in some measure a just approach in some not-at-arm's-length cases. For where only the taxpayer himself can say what would be done at arm's-length, broad rules of the 'shotgun' kind are consistent with due precision in the law. Thus, for example, close company rules are in principle justifiable (which is not at all to say that the particular close company rules of the Finance Act, 1965, are justifiable).

Now the tendency of our tax laws is more and more away from the 'sniper' approach to the 'shotgun' approach. The tradition of our law of course prescribes the 'sniper' approach, as does the Rule of Law itself. But, baffled by the ingenuity of tax avoiders, who find some new hole in the fence after every attempt is made to corral them by precise amendments of the law, Chancellors and parliaments have more and more had recourse to general provisions of the 'shotgun' type. The notorious Section 28 of the Finance Act, 1960, is perhaps the most outstanding example, but there are others. Thus we have now travelled quite far on the

[1] *Ibid.*, Vol. 3, p. 552.

slippery slope away from true law towards the unpredictability and arbitrariness of judicial or administrative discretion.

The critic of tax avoidance claims that this development is inevitable. 'Sniper' provisions, it is said, cannot do the work needed. First, the 'sniper' draftsman cannot foresee completely what stratagems the ingenuity of the avoider will devise. Hence he is always a step behind the avoider. Secondly, he actually helps the avoider; for by setting out with precision where the taxpayer may *not* walk he automatically shows him where he *may* walk. Thirdly, the attempt to define the law precisely leads to the most tortuous legal draftsmanship and thus produces the very uncertainty and unpredictability complained of in the 'shotgun' case.

There is substance in these contentions, but they are misleading if they provoke the conclusion that the 'sniper' approach should be wholly or partly abandoned in favour of the other approaches. The essential question is: Which is more important, that avoidance should be stamped out (as if that were possible) or that the citizen should know where he stands with the law? Our review of the arguments against avoidance suggests that to befuddle the law in order to stamp out avoidance is to achieve an object of at best dubious value at monumental cost. As for the uncertainty which arises from the tortuous draftsmanship of attempts at extreme refinement of the law, the answer is that the draftsman should eschew such attempts. If it appears that some form of avoidance can be countered only by drafting of such extreme obscurity that it baffles the most acute legal minds, it is better to let the avoidance be. Are the purity, reasonableness and precision of the law to be sacrificed to the mere passing need for revenue or to the largely ill-founded animus against the morality of avoidance?

Retrospective legislation

This is not all. The degeneration of the law in this respect is as yet a minor matter compared with the now well-established recourse to retrospective legislation. Retrospective legislation, in the sense that an act which had one effect for tax purposes when done is subsequently declared to have had another effect, can *never* be just, and no presumed need to safeguard the Revenue can ever make it just. It is a dark stain on our modern political

behaviour, and its acceptance shows how far we have slid from the Rule of Law to the practices of totalitarianism.

Retrospective legislation is sometimes defended in the following circumstances. A Chancellor declares, when introducing his Budget, that he intends to deal with a certain type of avoidance but is unable to do so for the time being. He therefore declares that he will do so in the following year when the legislation will be made retrospective to the current year. Tax avoiders are therefore warned that if they carry on with the type of activities denounced, they do so at their peril. Thus, for example, in 1938 Sir John (later Lord) Simon said:

> 'I intend to continue to keep a close watch on this subject and I have taken measures to ensure that any developments will be kept closely under review, so that if methods of avoidance emerge which are not already sufficiently or effectively dealt with, further measures for their suppression may be promptly devised and put into execution. In view of the warning which I am now giving, the would-be avoider must reckon with the possibility that these measures may be so arranged as to operate with retrospective effect.'[1]

In the following year Sir John said this:

> 'Finance Acts of recent years have contained many provisions relating to the avoidance of taxation, and I have made it my business to examine as closely as I could the working of those provisions. I am glad to be in a position to tell the Committee that in general they have worked with effect and have checked to a considerable extent the abuses against which they were directed. While that is the case experts in tax avoidance still continue to devise schemes to get round the law and to render nugatory the clear intentions of the provisions which parliament has passed. The extent to which such schemes are being employed is diminishing but the evil still persists, and I find it necessary to propose further provisions on the subject this year. . . . The avoidance against which they are directed is that which occurs through the ingenious use of one-man companies. These schemes of tax avoidance are so flagrant and are so deliberately devised to get round the legislation of 1936 and 1937 that I shall have no hesitation in recommending that retrospective effect shall be given to them, as far as necessary, in accordance with the very clear warning I gave last year.'[2]

[1] *Hansard*, 26 April, 1938, col. 55.
[2] *Hansard*, 25 April, 1939, col. 992-993.

Consider the iniquity of all this. The vague warning of the Chancellor in 1938 became retrospectively the law of 1938 without at that time going through any of the processes of law-making, and without defining the matters of which the tax avoider was warned to beware. Thus the Chancellor arrogated to himself the right to make law by simply declaring his intentions. Suppose that in 1938 he had defined the matter in hand as precisely as he would have done if he had dealt with it in the Finance Bill. It would have made the case essentially no better, for he would have avoided the debate in the Committee and the House, and the other processes of law-making which might have caused him to abandon or amend his proposals. We are of course now more familiar with attempts of this kind to legislate by the mere say-so of a government, as we have witnessed in recent years the bland promotion of White Papers as if they had the force of Acts of Parliament. Unfortunately in fiscal measures familiarity has bred acceptance and, while adhering to the letter of the rules relating to the need for statutory authority for taxation, governments have in retrospective legislation completely betrayed their spirit.

Incidentally, we may be permitted to smile at Sir John Simon's posturing in these two speeches. He presents himself as a faithful night-watchman, guarding the interests of the good citizens while they sleep and generally defeating the wiles of marauders, but occasionally finding it necessary to exert special efforts to catch them in their slipperiness. But the use of the one-man company for tax avoidance was as well known in 1938 as in 1939, and his smoke-screen about keeping developments closely under review in case new methods of avoidance emerged meant only that he and his advisers had not yet made up their minds about how to deal with the matter before them.

V

Conclusion

We are now in a position to consider which is the evil that afflicts us. Is it avoidance, or is it anti-avoidance? The worst we can say against avoidance is that there are instances which can with fair reason be said to offend against the spirit of the law while obeying its letter. But even in such instances our judgement is partial if we do not take account of the fact that the Inland Revenue itself normally presses home its demands according to the strict letter of the law and without regard to its spirit.[1] As Lord Clyde said,[2] 'The Inland Revenue is not slow . . . to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket'.

If this is the worst that can be said about avoidance, the best that can be said about anti-avoidance is that, done with respect for law and the rights of the citizen, it is a proper exercise of the powers of governments and legislators. But in practice anti-avoidance has gone far beyond this. On the presumption that avoidance is inherently evil and that the needs of the Revenue are paramount, anti-avoidance has become an instrument for the erosion of law and for the stimulation of totalitarian attitudes and practices. If it is an evil at all, avoidance is a minor one. Anti-avoidance has become a major one.

[1] It is true that there are certain extra-statutory concessions, but these are an excrescence on the system and exist at least as much for the convenience of the Revenue as for the benefit of the taxpayer. The Law Reports are full of cases where the Revenue has pressed its demands against all equity right up to the House of Lords, as it is lawfully entitled to do. The following are examples: IRC v. Luke, 1962 TR 153; Duple Motor Bodies v. Ostime, 1961 39 TC 537; Abbott v. Philbin, 1961 AC 352; ICI v. Caro, 1960 39 TC 374; Hochstrasser v. Mayes, 1960 AC 376; Tootal, Broadhurst and Lee v. IRC, 29 TC 352; Harrison (Watford) v. Griffiths, 1962 2 WLR 909. Or consider the 'doctrine of discovery'. The Revenue is of course rightly entitled to make a new assessment in respect of a past year where there has been a fraudulent or an inaccurate return of income by the taxpayer. But the 'doctrine of discovery' entitles an Inspector, even where the taxpayer has made a full and accurate return, to make a new assessment on the ground that he, the Inspector, had himself, or his predecessor had, failed to take note of a relevant fact or a relevant proposition of law. This can enable an assessment to be re-opened years after it had apparently been closed, even though the fault, if any, was wholly the Inspector's and not the taxpayer's. (Cenlon Finance Company v. Ellwood, 1962 2 WLR 871.)

[2] Above, p. 8.

Why should this surprise us? After all, it is now almost a commonplace that Western democracy has become semi-totalitarian. The rule that the will of the majority shall prevail, which no doubt is the most beneficent rule of political mechanics yet devised since it is the most consistent with peaceful agreement on political decisions, has become perverted to give majorities coercive power over the rights of minorities. This destructive and explosive development first showed itself, and perhaps has gone furthest, in fiscal policy. Its embodiment is progressive taxation, steeply graduated and confiscatory. Hence, though it can be in some respects a vice, tax avoidance is now much more a virtue. In our semi-totalitarian democracy the tax avoider renders us all two services. He upholds the Rule of Law, and he undermines policies of confiscation. Does he not deserve at least some modest applause?

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