UNIVERSITY OF LONDON

CHEATING THE PUBLIC REVENUE: THE NATURE AND MEANING OF 'TAX AVOIDANCE' AND 'TAX EVASION' IN ENGLISH LAW

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DECLARATION

I declare that the work presented in this thesis is my own.

ABSTRACT

This thesis establishes the nature and meaning of 'tax avoidance' and 'tax evasion' in the law of England and Wales where they originated using a Common Law principle common to all jurisdictions. According to Baker:

> "Key terms like 'tax avoidance' and 'tax evasion' – which are some of the most important basic building blocks for discourse about domestic and international taxation – are not sufficiently clearly understood or defined, and that is wrong."[1]

The thesis, therefore, proposes the meaning of "the elusive concept of 'tax avoidance'"[2] in English law as the antidote to "the judge-induced disease of 'tax avoidance'"[3] in all jurisdictions. According to the 1955 Royal Commission on the Taxation of Profits and Income:

> "Avoidance of tax is a problem that faces every tax system. Not all systems attempt to solve the problem in the same way, nor is there necessarily any large measure of agreement as to what is involved in the idea of tax avoidance. But until some certainty is reached upon this question of definition, the question as to what sort of steps should be taken to prevent or correct it remains an aimless one."[4]

The meaning of 'tax avoidance' and 'tax evasion' in English law is cheating the public revenue, which corresponds to tax fraud in all jurisdictions. According to Justice Hardy in *R v Less*:

> "The common law offence of cheating the Public Revenue can include any form of fraudulent conduct by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so."[5]

'Tax evasion' is cheating the public revenue by a taxpayer who deliberately fails to make a return of the relevant tax liability or who deliberately makes a false return of the relevant tax liability without using a tax scheme.

In *R v Mavji* the taxpayer cheated by deliberately failing to make returns of VAT liability. According to Judge Davies:

[1] 'Tax Avoidance, Tax Evasion & Tax Mitigation', p.1.
[2] Lord Nolan, *IRC v Willoughby* [1997] S.T.C. 995, 1003.
[3] Avery Jones, 'Tax Law: Rules or Principles?' (1996) *Fiscal Studies*, p.71.
[4] Final Report, p.304.
[5] *The Times,* March 30, 1993.

> "This appellant had a statutory duty to make value added tax returns and to pay over to the Crown the value added tax due. He dishonestly failed to do either. Accordingly, he was guilty of cheating the public revenue."[6]

In *R v Hudson* the taxpayer cheated by deliberately making false returns of income tax liability without using a tax scheme. According to Lord Goddard:

> "The offence here consisted of sending in documents to the inspector of taxes which were false and fraudulent to the appellant's knowledge for the purpose of avoiding the payment of tax. That is defrauding the public."[7]

'Tax avoidance' is cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax schemes ('the professional enablers') in which the taxpayer using an individual scheme ('the participating taxpayer') may or may not be complicit.

In *R v Charlton, Cunningham, Kitchen and Wheeler*, where the professional enablers were successfully prosecuted, Lord Justice Farquharson stated:

> "These Appellants were convicted on an indictment containing 14 counts of cheating the public revenue. Kitchen and Wheeler are qualified accountants. Charlton has practised for many years as an accountant, as a partner in a firm called Charltons, but was not professionally qualified. Cunningham is a barrister practising at the Revenue Bar. The case for the prosecution was that Charlton had devised a dishonest, tax-avoidance scheme for the benefit of some of the firm's clients and that the Appellants were involved with the implementation of the schemes or the concealment from the Revenue of the existence of the fraud."[8]

The solution to 'tax avoidance' is, therefore, to judge every scheme in all jurisdictions based on whether the professional enablers and the participating taxpayer cheated the public revenue in law. According to Lord Farquharson in *Charlton*:

> "It is a feature of the tax or Revenue law of any country that it must, to a large extent, in its tax-gathering activities, rely on the truthfulness of the taxpayer in indicating the extent of his income or whatever other matter is relevant to the particular statute being considered. It follows also that the Revenue not only have to rely on the taxpayer's good faith, but more especially on the professional advisors they appoint to act for them."[9]

[6] [1987] 1 W.L.R. 1388, 1391-1392.
[7] [1956] 2 Q.B. 252, 261-262.
[8] [1996] S.T.C. 1418, 1420-1421.
[9] Ibid, p.1442.

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ABBREVIATIONS

ARC	Association of Revenue and Customs
CFC	Controlled Foreign Companies
ECHR	European Convention on Human Rights
ECtHR	European Court of Human Rights
FTT	First-Tier Tribunal
GAAR	General Anti-Avoidance Rule
HMG	Her Majesty's Government
HMRC	The Commissioners for Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
ICTA	Income and Corporation Taxes Act
IFS	Institute for Fiscal Studies
IRS	The Internal Revenue Service
OECD	The Organisation for Economic Co-operation and Development
PAC	The Committee of Public Accounts of the House of Commons usually described as the Public Accounts Committee
PSI	The Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the United States Senate
TP	Transfer Pricing
UK GAAR	The General Anti-Abuse Rule
UK	The United Kingdom of Great Britain and Northern Ireland
US	The United States of America

Additional Notes

1. The term "the Revenue" is used to describe tax authorities, particularly the Inland Revenue and HMRC.
2. The masculine is used for simplicity.

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DEDICATION

This thesis is dedicated to my late father – John; my mother – Ngozi; my sisters – Chidiebere, Ukamaka, Nkiruka, Amuchechukwu and Nkemjika; my brothers – Nnajiofo, Chinonso, Onyebuchi, Arinzechukwu, and Chisom; my brothers-in-law – Monday, Ikechukwu and Lambert; my nieces Amarachi, Chioma, Ezichi and Olachi; and my nephews – Somadina, Onyedikachi and Victor.

PROLOGUE

The Goose and the Common

The law locks up the man or woman
Who steals the goose from off the common
But leaves the greater villain loose
Who steals the common from off the goose

The law demands that we atone
When we take things we do not own
But leaves the lords and ladies fine
Who take things that are yours and mine

The poor and wretched don't escape
If they conspire the law to break
This must be so but they endure
Those who conspire to make the law

The law locks up the man or woman
Who steals the goose from off the common
And geese will still a common lack
Till they go and steal it back

Author unknown
Circa 1700s

PART ONE

INTRODUCTION

INTRODUCTION

INQUIRY INTO THE NATURE AND MEANING OF 'TAX AVOIDANCE' AND 'TAX EVASION' IN LAW

The Nature of Legal Nonsense

It would be tedious to prolong our survey; in every field of law we should find the same habit of ignoring practical questions of value or of positive fact and taking refuge in 'legal problems' which can always be answered by manipulating legal concepts in certain approved ways. In every field of law we should find peculiar concepts which are not defined either in terms of empirical fact or in terms of ethics but which are used to answer empirical and ethical questions alike, and thus bar the way to intelligent investigation of social fact and social policy.

Felix Cohen, 'Transcendental Nonsense and the Functional Approach' (1935) *Columbia Law Review*, 809, page 820.

I. OBJECTIVES

It is very important to remember that the terms 'tax avoidance' and 'tax evasion' are not legal concepts but classic examples of legal nonsense or "peculiar concepts which are not defined either in terms of empirical fact or in terms of ethics but which are used to answer empirical and ethical questions alike, and thus bar the way to intelligent investigation of social fact and social policy."

The overarching objective of this thesis is, therefore, to establish their nature and meaning in the law of England and Wales where they originated using a common law principle common to all jurisdictions. According to Rhodes et al:

> "[T]he terms 'tax avoidance' and 'tax evasion' have been created by the legal and accountancy professions as convenient generic terms to distinguish what is legal from what is illegal, and the fact that they have also been adopted by the courts should not blind us to what they actually are."[10]

As a matter of historical fact, "the terms 'tax avoidance' and 'tax evasion' have been created by the legal and accountancy professions as convenient generic terms" or legal nonsenses to disguise the fraudulent nature of "the judge induced disease of 'tax avoidance'"[11] and the resultant tax avoidance industry. According to Bennion's cryptic summary expounded in chapter eleven:

> "The large amounts of money at stake in the tax field have led to some confusion over nomenclature. Earlier it was clearly established that escaping a statutory obligation was termed 'evasion' when it constituted a

[10] 'Regina v Charlton, Cunningham, Kitchen and Wheeler' (1999) *JMLC*, 197, 203-206.
[11] Avery Jones, 'Tax Law: Rules or Principles?' (1996) *Fiscal Studies*, p.71.

> breach of the obligation (and was therefore unlawful) and 'avoidance' when it meant that the obligation was never incurred because the case narrowly missed fitting the statute (and was therefore lawful). This is a convenient distinction, which still generally obtains. In the tax field however the term avoidance is now equivocal. This is because the huge sums at stake in a vast number of cases have led to the emergence of what is sometimes called the tax avoidance industry. Professional experts devise elaborate schemes designed to allow taxpayers to escape tax in cases where Parliament intended tax to be charged. When this happens on a large scale in relation to a particular charging enactment it may lead to counter measures in the form of an equally elaborate anti-avoidance provision inserted in a Finance Act. The experts then seek to devise ways around the provision, and so the chase goes on. In these circumstances, the term 'avoidance' has come to be used in two senses in the tax field. What may be called unacceptable tax avoidance ... is countered by the application of the *Ramsay* principle. The rest, that is 'acceptable' avoidance, is now sometimes called tax mitigation."[12]

The invention of 'tax mitigation' continued the use of legal nonsenses to legitimise "the judge induced disease of 'tax avoidance'"[13] and the resultant tax avoidance industry. In the words of Lord Oliver:

> "What ... the Courts have succeeded in doing is to trespass into the legislation field by creating, almost arbitrarily, two categories of tax avoidance; permissible tax avoidance and impermissible tax avoidance. And they have done it without at the same time establishing any reliable criteria for distinguishing between the two. ... So the citizen and the Courts themselves are left without any readily intelligible reference points."[14]

By establishing the nature and meaning of 'tax avoidance' and 'tax evasion' in the law of England and Wales where they originated using a common law principle common to all jurisdictions, therefore, the thesis proposes internationally applicable definitions of 'tax avoidance', 'tax evasion' and 'tax mitigation'. As Baker stated in his seminal paper:

> "The fundamental thesis behind this paper is that key terms like 'tax avoidance', 'tax evasion' and 'tax mitigation' – which are some of the most important basic building blocks for discourse about domestic and international taxation – are not sufficiently clearly understood or defined, and that is wrong. We need to have these terms better understood and clearly defined, particularly at governmental and inter-governmental levels. Increasingly these terms are appearing on the agenda of governments and inter-governmental agencies, but without any precise explanation of their meaning. ...

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[12] *Bennion on Statutory Interpretation* (2008) pp.1017-1018.
[13] Avery Jones, 'Tax Law: Rules or Principles?' (1996) *Fiscal Studies*, p.71.
[14] 'Judicial Approaches to Revenue Law' in Gammie (ed), *Striking the Balance: Tax Administration, Enforcement and Compliance in the 1990s* (London: IFS, 1996) p.186.

> It seems perfectly reasonable, if these concepts are to remain on the international agenda (which seems likely), that the bodies which use them should take steps towards developing internationally accepted definitions of the concepts. Given the amount of other work on taxation in which the OECD is engaged, perhaps that body is best placed to work towards internationally accepted and clear definitions of these concepts based upon bright line distinctions. It seems quite reasonable to expect the OECD to clarify these terms before it proceeds further with initiatives such as that on harmful tax competition."[15]

As explained above, "key terms like 'tax avoidance', 'tax evasion' and 'tax mitigation' … are not sufficiently clearly understood or defined" because they are not legal concepts but legal nonsenses. Regrettably, however, the OECD not only failed to define them in law before it proceeded further with initiatives such as that on harmful tax competition, but used the new initiatives to introduce new terms. The 2008 *Study into the Role of Tax Intermediaries*[16] introduced 'aggressive tax planning' while the 2013 study commissioned by the G-20 – *Addressing Base Erosion and Profit Shifting*[17] – invented 'Base Erosion and Profit Shifting (BEPS)', but without any precise explanation of their meaning.

By establishing the nature and meaning of 'tax avoidance' and 'tax evasion' in the law of England and Wales where they originated using a common law principle common to all jurisdictions, the thesis also proposes the meaning of "the elusive concept of 'tax avoidance'"[18] in law as the antidote to "the judge induced disease of 'tax avoidance'"[19] in all jurisdictions. As the 1955 Royal Commission on the Taxation of Profits and Income pointed out:

> "Avoidance of tax is a problem that faces every tax system and is likely to continue to do so when rates are high and the burden of tax is seen to have a major influence upon the affairs of business and upon every aspect of social and personal life. Not all systems attempt to solve the problem in the same way, nor is there necessarily any large measure of agreement as to what is involved in the idea of tax avoidance. But until some certainty is reached upon this question of definition, the question as to what sort of steps should be taken to prevent or correct it remains an aimless one."[20]

[15] 'Tax Avoidance, Tax Evasion & Tax Mitigation', pp.1&14.
[16] OECD (2008).
[17] OECD (2013).
[18] Lord Nolan, *IRC v Willoughby* [1997] STC 995, 1003.
[19] Avery Jones.
[20] *Final Report* (London: HMSO, 1955) p.304.

The rest of this introductory chapter seeks to achieve the two specific objectives set out above by explaining the proposed definitions of tax evasion, tax avoidance and tax mitigation in law and the proposed antidote to tax avoidance. It starts by explaining the methodology and research questions, and concludes by summarising the rest of the chapters.

II. METHODOLOGY

The thesis is qualitative rather than quantitative. It combines legal and constitutional theory with legal and administrative practice, and includes historical, comparative and empirical approaches. It uses a comprehensive exposition of the origins, developments and applications of the common law offence of cheating the public revenue, which corresponds to tax fraud in all jurisdictions, to show that tax avoidance involves one form of cheating the public revenue or tax fraud while tax evasion involves another form.

The main focus of the inquiry is English law and practice but the relevant laws and practices of other common law jurisdictions, such as the US, Canada, New Zealand, Australia and Ireland, and civil law jurisdictions, such as France and the Netherlands, are also used to demonstrate the universality of the problems and the universal applicability of the proposed solutions. The thesis also explores wider issues of tax fraud common to all jurisdictions, as well as some of the international tax issues that arise in the context of tax fraud. ‘Law’ and ‘English Law’ are used synonymously on the basis that the meaning of ‘tax avoidance’ and ‘tax evasion’ in English law where they originated is their true meaning in law.

The thesis uses library materials, including online resources. The materials used include primary sources from legislation and case law, secondary sources from criminal information and indictments in unreported cases, reports of Parliamentary and other legislative inquiries and Royal Commissions, quasi-judicial administrative decisions, administrative practices, policies and official guidance, doctrinal writings, scholarly commentaries, research reports and media reports.

III. RESEARCH QUESTIONS

III.I. Legal Nonsense

What Lord Nolan described aptly as "the elusive concept of 'tax avoidance'"[21] is the paradigm of legal nonsense which Cohen defined aptly as "peculiar concepts which are not defined either in terms of empirical fact or in terms of ethics but which are used to answer empirical and ethical questions alike, and thus bar the way to intelligent investigation of social fact and social policy." According to Tiley:

> "Politicians, tax officials and practitioners spend a lot of time and energy on the problem of tax avoidance. No one seems to have a very precise idea of what is meant by the term, but it is to be distinguished from evasion, which is illegal."[22]

In other words, the dogma that "tax evasion is illegal but tax avoidance is legal" (hereafter referred to as "the tax dogma"), which is universally accepted as an article of faith in the existing body of knowledge, serves to "bar the way to intelligent investigation" of the nature and meaning of tax avoidance in law because it involves the circular proposition that nobody knows its precise meaning but everybody knows the precise difference between it and tax evasion.

In its 1997 study, therefore, the Tax Law Review Committee of the Institute for Fiscal Studies (IFS) chaired by Aaronson similarly stated:

> "We are concerned in this Report only with the issues of legal tax avoidance. We have not addressed the prevention and control of the illegal evasion of taxes. We think it impossible to define the expression 'tax avoidance' in any truly satisfactory manner."[23]

If it is "impossible to define the expression 'tax avoidance' in any truly satisfactory manner", how can it be distinguished from "illegal evasion of taxes" in any truly satisfactory manner, let alone by merely asserting that avoidance is "legal" and without considering evasion?

The acceptance of the dogma that "tax avoidance is legal" as gospel truth in the existing literature, however, involves the equation of tax evasion (which is a legal nonsense) with tax fraud (which is a legal concept), and the exclusion of tax evasion (and thus tax fraud) from consideration, which automatically excludes the consideration of the

[21] Lord Nolan, *IRC v Willoughby* [1997] STC 995, 1003.
[22] *Revenue Law* (Oxford: Hart Publishing, 2000) p.85.
[23] *Tax Avoidance* (London: IFS, 1997) p.ix. Emphasis supplied.

possibility that tax avoidance could be tax fraud. As Bowler put it in her 2009 study for the IFS:

> "Defining what is meant by tax avoidance is far from easy. It can be distinguished from tax evasion, which is the illegal means to reduce tax liabilities such as making false statements on tax returns. **This paper is not concerned with tax evasion**.
>
> Tax avoidance, in contrast, is a legal means of reducing the tax payable, the question being whether the action works technically or not. However, increasingly the distinction between tax avoidance and tax evasion has been blurred, at least by the tax authorities, and tax avoidance has been treated with some of the disapproval previously reserved for tax evasion.
>
> This still leaves the question of just what it is that so much effort has gone into to counteract."[24]

III.II. Legal Fiction

As demonstrated below and throughout, "the question of just what it is that so much effort has gone into to counteract" in tax avoidance remains elusive precisely because "whether the action works technically or not" as a matter of statutory construction (hereafter referred to as "the constructional approach") tells us little or nothing about its nature and meaning as a matter of law.

In the words of Lord Diplock's theory of retrospective judicial legislation which shows that the constructional approach is the recipe for "the judge induced disease of tax avoidance"[25]:

> "Whenever the Court decides that kind of dispute it legislates about taxation. It makes a law taxing all gains of the same kind or all documents of the same kind. Do not let us deceive ourselves with the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant. Anyone who has decided tax appeals knows that most of them concern **transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all**. Some of the **transactions are of a kind which had never taken place before the Act was passed**: they were **devised as a result of it**. The Court may describe what it is doing in tax appeals as interpretation. So did the priestess of the Delphic oracle."[26]

[24] Bowler (2009) p.10. Emphases supplied.
[25] Avery Jones.
[26] *The Courts As Legislators* (University of Birmingham, March 26, 1965) p.6. Emphases supplied.

As expounded in chapter two, **a tax avoidance scheme** is by definition **two or more interrelated "transactions … of a kind which had never taken place before the [tax] Act [it was devised to cheat or defraud] was passed … devised as a result of it**"; and can, therefore, amount to **two or more interrelated "transactions which Members of Parliament and the draftsman of the [tax] Act had not anticipated, about which they had never thought at all.***"*

Tax avoidance schemes can, therefore, only be judged legitimately and countered effectively in accordance with the rule of law and tax justice by applying overriding principles that operate on a juristic basis independent of the tax Acts they are devised to cheat and fraud, such as the pre-existing common law of cheating the public and fraud, rather than by "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant." In the words of "Watchful":

> "This is not quite the paradox it seems if we remember that the Tax Acts are but a part of the general law of the land. Just as, on the one hand, nobody can be taxed otherwise than in accordance with the law, so it can and should be insisted that the whole of that law is relevant in any question concerning taxation."[27]

Significantly, in the overwhelming majority of cases that are dealt with administratively, the Revenue replicates "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant." As Gribbon (then Director of the Inland Revenue's Compliance Division) put it:

> "In relation to tax avoidance the ... Revenue's role involves ascertaining the facts (which may require full and detailed investigation) and exercising first judgment as to the interpretation of law and its application to those facts. The determination of the facts and law is, of course, ultimately for the ... Courts, but it is very much the minority of cases that come before ... the Courts and in practice, therefore, they operate as a check on the ... Revenue's function. Just as the Courts, in interpreting legislation, will not confine themselves to a close literal interpretation, so the ... Revenue will seek to ascertain the intention of Parliament when applying legislation to **novel situations**."[28]

By purporting "to ascertain the intention of Parliament when applying legislation to novel situations" or more accurately "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it" and "transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which

[27] 'Common Law Prosecutions for Revenue Fraud' [1956] *BTR* 119, p.119.
[28] 'A Sterile Activity', *Tax Journal* (1997) p.4. Emphases supplied.

they had never thought at all", therefore, the Revenue perpetuates "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant", which means that "[w]henever the [Revenue] decides that kind of dispute it legislates about taxation."

This thesis is, therefore, not concerned with the question whether a tax avoidance scheme 'works' or 'is effective' as a matter of statutory construction, and the case law and administrative practice on that subject are of very limited use to this thesis. This is because, as demonstrated above and throughout, a decision of a court that a scheme 'works' by applying "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant" to "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it" and a decision reached by the Revenue that a scheme 'works' when it purports "to ascertain the intention of Parliament when applying legislation to novel situations" tell us little or nothing about its nature and meaning in law.

The dogma that a tax avoidance scheme is "legal" or cannot be illegal because it 'works' or 'is effective' as a matter of statutory construction is, therefore, emphatically rejected.

Dixon's statement in his article, which nevertheless accepted the tax dogma that 'tax avoidance is legal' and excluded tax evasion from consideration, shows that a question framed in terms of legal nonsense (tax evasion, tax avoidance and tax mitigation) and legal fiction ("whether the action works technically or not") cannot produce a meaningful answer in law and in fact:

> "There is another fundamental difficulty with defining tax avoidance in terms of the legal construction of the statutory provisions that are being 'avoided'. The classic trichotomy for analysing different ways of reducing how much tax a person pays is, (a) tax evasion (failures to comply with the law, often criminal), (b) tax avoidance (legal, but morally controversial), and (c) tax mitigation (legal, and morally supportable). However, what should be immediately apparent is that there is no legal difference between a successful tax avoidance scheme and successful tax mitigation planning – each reduces the taxpayer's liability to tax. Equally, there is no difference between unsuccessful tax mitigation and unsuccessful avoidance – both fail to reduce the liability to tax. So, how can the concept of tax avoidance be analysed through statutory provisions when those statutory provision will produce the same outcome regardless of whether it is called avoidance or mitigation?"[29]

[29] *'Defining Tax Avoidance'* (2014) *KSLR*, 16, 19-20.

A consideration of tax evasion produces similar nonsensical propositions. First, there is simultaneously no legal difference between unsuccessful avoidance and unsuccessful evasion (because both fail to reduce the tax liability) and a legal difference between the two (because avoidance is 'legal' and evasion is illegal). Secondly, there is no legal difference between a successful avoidance and an unsuccessful avoidance because both are 'legal'. In the words of Cohen in his article of 'Legal Nonsense' cited above:

> "Legal arguments couched in these terms are necessarily circular, since these terms are themselves creations of law, and such arguments add precisely as much to our knowledge as Moliere's physician's discovery that opium puts men to sleep because it contains a dormitive principle. Now the proposition that opium puts men to sleep because it contains a dormitive principle is scientifically useful if 'dormitive principle' is defined physically or chemically. Otherwise it serves only to obstruct the path of understanding with the pretense of knowledge."[30]

Freedman's restatement of the tax dogma in the 2004 article that emerged from her Inaugural Lecture, which Bowler mirrored, demonstrates how the proposition that "Tax avoidance … is a legal means of reducing the tax payable, the question being whether the action works technically or not" similarly "serves only to obstruct the path of understanding with the pretense of knowledge":

> "For many tax advisers and taxpayers, the line that is seen to matter is that to be drawn between avoidance and evasion, with only evasion being illegal. <u>All forms of avoidance, be they described as aggressive, acceptable or unacceptable, are legal and for the adviser the question is whether or not they work technically</u>. ...
>
> <u>The complexity of the tax system is such that there may well be reasonable different views on whether a scheme will work</u>. How definite must advisers be that there is a reasonable case? *BMBF*, was decided against the taxpayers by the Special Commissioners and a very experienced High Court Judge but the decision was reversed by an equally experienced Court of Appeal. How should a company director or even a tax adviser decide whether there is a respectable technical case in these circumstances?"[31]

The invariably "different views on whether a scheme will work" as a matter of statutory construction, which was underscored by *BMBF*, undermine the dogma that: "All forms of avoidance ... are legal ... the question is whether or not they work technically."

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[30] Ibid.

[31] Freedman [2004] pp.335-348. Emphases supplied.

This analysis shows that the tax dogma is a logical fallacy or *petitio principii* (which is a fallacy in which a conclusion is taken for granted in the premises) because the conclusion ("tax avoidance is legal and tax evasion is illegal") is the same premise that purports to prove it ("tax avoidance is different from tax evasion").

This thesis, therefore, abandons the sanctity of the tax dogma, which begs the question and "serves only to obstruct the path of understanding with the pretense of knowledge", for the reality of tax behaviours in law and in fact. As Wisselink pointed out:

> "In the field of economics there is perhaps less conceptual difficulty because economists usually consider the effects of the 'legitimate' and 'illegitimate' variants of domestic and international tax avoidance and of domestic and international tax evasion as one and the same phenomenon which can be analysed for economic purposes without the need to make distinctions."[32]

III.III. The Fraud-Negligence-Honesty Trichotomy

The three legal "concepts which are ... defined ... in terms of empirical fact [and] ethics [and] which ... answer empirical and ethical questions alike"[33] in taxation in all jurisdictions are:

(1) cheating or fraud or dishonesty;
(2) negligence or carelessness or failure to take reasonable care; and
(3) honesty, which can be honest compliance or honest non-compliance because of ignorance or error.

Every tax behaviour must, therefore, fall within the fraud-negligence-honesty trichotomy, depending on the knowledge, abilities and circumstances of the taxpayer and any professional adviser involved.

The research questions are, therefore, simply where 'tax evasion', 'tax avoidance' and 'tax mitigation' fall under the fraud-negligence-honesty trichotomy.

[32] Wisselink, *International Tax Avoidance* (Deventer: Kluwer, 1979) p.193.
[33] Cohen.

III.IV. Cheating the Public Revenue

Dishonesty is the essence of the common law offence of cheating the public revenue. According to *Smith and Hogan's Criminal Law*:

> "The *actus reus* of the offence has become so wide that the definition is almost best stated in negative terms. There need not be a dishonest act; an omission will suffice. The act or omission must be intended to prejudice the HMRC or Department of Work and Pensions. The offence cannot be committed in respect of a local authority[34], nor, it is submitted, against the EU. There is no requirement of an operative deception[35], nor of a need to prove actual loss to the revenue[36], or to any other. It is not necessary to prove that the accused's conduct resulted in any gain to himself.[37] ... It is difficult to see how the offence could be stated in more expansive terms. The offence is of course even broader when charged as a conspiracy to cheat, as it often is. The breadth of the offence means that often the only live issue at trial will be dishonesty."[38]

III.V. Negligence

According to Baron Alderson's classic common law definition of negligence in *Blyth v Birmingham Waterworks*:

> "Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do."[39]

Negligence under section 95 of Taxes Management Act 1970 equates to **carelessness** or "**failure to take reasonable care**" under Schedule 24 of Finance Act 2007. In *Anderson v HMRC* Judge Berner stated:

> "The test to be applied, in my view, is to consider what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done."[40]

In *Bingham v HMRC* Judge Whitehead confirmed that ignorance of technical aspects of tax legislation does not amount to negligence under section 95:

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[34] *Lush v Coles* [1967] 1 W.L.R. 685.
[35] *R v Mavji* [1987] 1 W.L.R. 1388.
[36] *R v Hunt* [1994] S.T.C. 819.
[37] Ibid.
[38] (Oxford: OUP, 2011) p.940.
[39] (1856) 11 E.R. 781, 784.
[40] [2009] UKFTT 206 [22].

> "Section 95 TMA requires the Revenue to establish negligence on the part of the taxpayer. For the reasons given above the Tribunal does not make such a finding. Mr Bingham has been wrong in his appreciation of the true position but that position involves the application of quite technical rules concerning settlements which the Tribunal considers would be outside the normal considerations which a taxpayer would have in mind when making a return to the Revenue. What he did was known to his accountants who did not, it appears, take issue with him or in any way alert him to the problems he might, and indeed, did, face."[41]

III.VI. Honesty

The seminal exposition of the *objective* civil law test of dishonesty by Lord Nicholls in *Royal Brunei Airlines v Tan* provides an authoritative legal definition of honesty:

> "Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonesty are mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. <u>In most situations there is little difficulty in identifying how an honest person would behave</u>."[42]

The simple legal and moral test of "how an honest person would behave" corresponds to the simple legal and moral duty of honesty imposed by the common law of cheating. In the words of the Law Commission:

> "Dishonesty necessitates a moral as well as a factual enquiry."[43]

III.VII. Cheating, Fraud or Dishonesty

The *objective* civil law test of dishonesty expounded by Lord Nicholls in *Royal Brunei* was applied by Lord Hoffmann in *Barlow Clowes v Eurotrust* thus:

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[41] [2013] UKFTT 110 [110].
[42] [1995] 2 AC 378, 389. Emphasis supplied.
[43] (2002) 39.

> "Although a dishonest state of mind is a subjective mental state, the standard by which the law determines whether it is dishonest is objective. If by ordinary standards a defendant's mental state would be characterised as dishonest, it is irrelevant that the defendant judges by different standards."[44]

According to the *subjective* criminal law test of dishonesty propounded by Lord Lane C.J. in *R v Ghosh*:

> "In determining whether the prosecution has proved that the defendant was acting dishonestly, a jury must first of all decide whether according to the ordinary standards of reasonable and honest people what was done was dishonest. If it was not dishonest by those standards, that is the end of the matter and the prosecution fails. If it was dishonest by those standards, then the jury must consider whether the defendant himself must have realised that what he was doing was by those standards dishonest."[45]

In the recent landmark cheating in gambling case of *Ivey v Genting Casino*, the Supreme Court overruled *Ghosh* and held that the objective civil law test should apply in both civil and criminal proceedings. Equating 'tax evasion' to tax fraud, Lord Hughes stated:

> "There is no reason why the law should excuse those who make a mistake about what contemporary standards of honesty are, whether in the context of insurance claims, high finance, market manipulation or tax evasion. The law does not, in principle, excuse those whose standards are criminal by the benchmarks set by society, nor ought it to do so. On the contrary, it is an important, even crucial, function of the criminal law to determine what is criminal and what is not; its purpose is to set the standards of behaviour which are acceptable. ... These several considerations provide convincing grounds for holding that the second leg of the test propounded in *Ghosh* does not correctly represent the law and that directions based upon it ought no longer to be given.
>
> The test of dishonesty is as set out by Lord Nicholls in *Royal Brunei* and by Lord Hoffmann in *Barlow Clowes*. When dishonesty is in question the fact-finding tribunal must first ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence (often in practice determinative) going to whether he held the belief, but it is not an additional requirement that his belief must be reasonable; the question is whether it is genuinely held. When once his actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct was honest or dishonest is to be determined by the fact-finder by applying the (objective) standards of ordinary decent people. There is no requirement

[44] [2006] 1 WLR 1476, 1479-1480.
[45] [1982] Q.B. 1053, 1064.

> that the defendant must appreciate that what he has done is, by those standards, dishonest."[46]

The substitution of a common test of dishonesty unites the common law offence of cheating the public revenue, which discharges the "function of the criminal law to determine what is criminal and what is not", with the pre-existing common law of cheating or fraud, which applies in civil proceedings. In the words of Lord Hughes:

> "There will be a difference in standard of proof as between civil and criminal proceedings, but that does not affect the meaning of cheating."[47]

The common law offence of cheating the public revenue, like the fraud offence under the Fraud Act 2006, "acts upon the offender, and inflicts a penalty"[48] in criminal proceedings. According to Lord Atkin's classic statement in *Proprietary Articles Trade Association v AG for Canada*:

> "Criminal law connotes only the quality of such acts or omissions as are prohibited under appropriate penal provisions by authority of the State. The criminal quality of an act cannot be discerned by intuition; nor can it be discovered by reference to any standard but one: Is the **act prohibited with penal consequences**? Morality and criminality are far from co-extensive; nor is the sphere of criminality necessarily part of a more extensive field covered by morality - unless the moral code necessarily disapproves all acts prohibited by the State, in which case the argument moves in a circle. It appears to their Lordships to be of little value to seek to confine crimes to a category of acts which by their very nature belong to the domain of 'criminal jurisprudence'; for the domain of criminal jurisprudence can only be ascertained by examining what acts at any particular period are declared by the State to be crimes, and the only common nature they will be found to possess is that they are prohibited by the State and that those who commit them are punished."[49]

In his famous article, "The Definition of Crime", Glanville Williams followed the same process of reasoning and concluded:

> "We have rejected all definitions purporting to distinguish between crimes and other wrongs by reference to the sort of thing that is done, or the sort of physical, economic or social consequences that follow from it. Only one possibility now remains. A crime must be defined by reference to the legal consequences of the act. We must distinguish, primarily, not between crimes and civil wrongs but between criminal and civil proceedings. A crime then becomes **an act that is capable of being followed by criminal**

[46] [2017] UKSC 67 [59]&[74]. Emphases supplied.
[47] [2017] UKSC 67 [38].
[48] Blackstone, *Commentaries on the Laws of England in Four Books*, vol. 1, p.89.
[49] [1931] A.C. 310, 324. Emphasis supplied.

> **proceedings**, having one of the types of outcome (punishment, etc.) known to follow these proceedings."[50]

The pre-existing common law of cheating the public revenue "acts upon the offence, by setting aside the fraudulent transaction"[51] in civil proceedings. In the words of Lord Denning's classic statement in *Lazarus Estates v Beasley*:

> "Fraud unravels everything. The court is careful not to find fraud unless it is distinctly pleaded and proved; but once it is proved, it vitiates judgments, contracts and all transactions whatsoever."[52]

No distinction is drawn for the purposes of this thesis, therefore, because none exists in *substance* and in *principle*, between cheating or fraud or dishonesty in civil and criminal law. As Judge Heath stated in *Hartshorn v Slodden*:

> "Fraud indeed changes the complexion of things both in civil and criminal cases."[53]

IV. THE MEANING OF TAX AVOIDANCE AND TAX EVASION IN LAW

IV.I. Cheating the Public Revenue

The overarching thesis is that the nature and meaning of 'tax avoidance' and 'tax evasion' in English law is cheating the public revenue contrary to the common law, which corresponds to tax fraud under the common law and under the Fraud Act 2006, and to tax fraud in all jurisdictions.

The common law offence of cheating the public revenue encompasses tax fraud in all jurisdictions because it boils down to dishonesty as explained above.

Justice Hardy's classic definition of "what in law is cheating the Public Revenue"[54] in *R v Less* shows that the ambit is wider than the civil law and ordinary meanings of cheating and fraud and thus covers every case of tax avoidance and tax evasion:

> "To cheat ... is defined by the concise Oxford Dictionary as: 'To deceive, or trick, a person into or out of a thing.' The common law offence of cheating

[50] *Current Legal Problems* (1955) 107, 123. Emphasis supplied.
[51] Blackstone, p.89.
[52] [1956] 1 Q.B. 702, 712.
[53] (1801) 126 E.R. 1452, 1454.
[54] *The Times,* March 30, 1993.

> the Public Revenue does not necessarily require a false representation either by words or conduct. **Cheating can include any form of fraudulent conduct** which results in diverting money from the Revenue and in depriving the Revenue of the money to which it is entitled. It has, of course, to be fraudulent conduct. That is to say, deliberate, dishonest conduct **by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so**."[55]

The seminal statement of dishonesty by Lord Hughes in *Ivey*, therefore, applies to cheating the public revenue as demonstrated above:

> "Dishonesty is by no means confined to the criminal law. Civil actions may also frequently raise the question whether an action was honest or dishonest. ... There can be no logical or principled basis for the meaning of dishonesty (as distinct from the standards of proof by which it must be established) to differ according to whether it arises in a civil action or a criminal prosecution. Dishonesty is a simple, if occasionally imprecise, English word. It would be an affront to the law if its meaning differed according to the kind of proceedings in which it arose. <u>It is easy enough to envisage cases where precisely the same behaviour, by the same person, falls to be examined in both kinds of proceeding</u>."[56]

IV.II. Revenue Discretion

Cheating the public revenue is the archetype of what Lord Hughes described as "cases where precisely the same behaviour, by the same person, falls to be examined in both kinds of proceeding." This is because in all jurisdictions, albeit to varying degrees, when a tax fraud is discovered:

> "[I]t is entirely within the discretion of the tax authorities whether they take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-fraud penalties or simply establishing tax liability without fines or penalties, applying doctrines such as substance over form."[57]

Under the "highly selective" prosecution policy that applies in the UK, the Revenue deals with tax fraud *usually* by "imposing only civil tax-fraud penalties", *occasionally* by "establishing tax liability without fines or penalties" and *exceptionally* by "bringing a criminal tax-fraud case". According to the Inland Revenue's evidence to the 1978 Royal Commission on Criminal Procedure:

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[55] Ibid. Emphasis supplied.
[56] *Ivey* [62]-[63]. Emphasis supplied.
[57] Wisselink, p.203.

> "When a tax fraud is discovered, the Board are not bound to prosecute but may effect a pecuniary settlement instead. ... Moreover in the majority of cases the amount of the penalty is agreed informally between the Department and the taxpayer without recourse to formal proceedings. It follows that criminal prosecution for tax fraud is undertaken only in a small minority of cases."[58]

HMRC inherited the "highly selective" prosecution policy. According to *HMRC Criminal Investigation Policy*:

> "It's HMRC's policy to deal with fraud by use of the cost effective civil fraud investigation procedures under Code of Practice 9 wherever appropriate. Criminal investigation will be reserved for cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate."

The Profit Diversion Compliance Facility published on January 10, 2019 (which is an "amnesty" for multinational companies that used Transfer Pricing (TP) and other devices to cheat the public revenue by diverting profits taxable in the UK to offshore jurisdictions) shows that the multi-billion pound **offshore tax avoidance** is not included in the "cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate." In the *Profit Diversion Compliance Facility Guidance* HMRC stated:

> "Our investigations into Profit Diversion to date have established that in a large number of cases the factual pattern outlined to HMRC at the start of an enquiry does not stand up to scrutiny once tested. That may be a result of a careless error (for example individuals within a group being unaware of what the actual facts are) but it may also be a result of a deliberate behaviour, that is a group knowingly submitting a TP methodology in a Corporation Tax Return based on a false set of facts. A common issue is an overstatement of functions performed, assets used and risks assumed in entities taxed at lower rates, and an understatement of the functions performed, assets used and risks assumed in the UK.
>
> Where HMRC suspects there has been an attempt by a group to deliberately mislead, then we will refer the issue to Fraud Investigation Service for consideration of a criminal investigation or civil investigation into fraud."[59]

As a matter of law, "knowingly submitting a TP methodology in a Corporation Tax Return based on a false set of facts" is cheating the public revenue and "to deliberately mislead" is to defraud the public revenue.

[58] EV No 145.
[59] Para. 4.4.1. Emphases supplied.

The Liechtenstein Disclosure Facility that ran from September 1, 2009 to December 31, 2015 (which is an "amnesty" for taxpayers and their professional advisers that cheated the public revenue by concealing incomes and gains taxable in the UK in Liechtenstein and other offshore jurisdictions) and the UK-Swiss Agreement signed on October 6, 2011 (which is an "amnesty" for HSBC and the customers it helped to conceal incomes and gains taxable in the UK in Switzerland) also show that the multi-billion pound **offshore tax evasion** is not included in the "cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate." In the *Side Letter of the Competent Authority of the United Kingdom on Criminal Investigation* under the UK-Swiss Agreement, HMRC stated:

> "Provided that a relevant person agrees either to make a one-off payment in accordance with Article 9 of this Agreement or to make a voluntary disclosure in relation to his/her relevant assets in accordance with Article 10 of this Agreement and fully cooperates with HMRC, that person is highly unlikely to be subject to a criminal investigation by HMRC for a tax-related offence for past liabilities in respect of relevant assets from the date he or she irrevocably opted for one of the options. ...
>
> Whilst it is never possible to provide an absolute assurance against a criminal investigation, it is highly unlikely to be in the public interest of the United Kingdom that professional advisers, Swiss paying agents and their employees will be subject to a criminal investigation by HMRC."[60]

V. THE MEANING OF TAX EVASION IN LAW

V.I. Cheating by a Taxpayer

Tax evasion is cheating the public revenue by a taxpayer who deliberately fails to make a return of the relevant tax liability or by a taxpayer who deliberately makes a false return of the relevant tax liability without using a tax scheme.

This statement of tax evasion by the 1920 Royal Commission on Income Tax shows that the use of legal nonsense to legitimise tax fraud is not limited to tax avoidance:

> "That evasion of Income Tax exists at the present time is beyond question. The citizen who is deficient in public spirit has always aimed at paying less than his fair share of the nation's expenses, and it is safe to assume that he will always continue to do so. This may be said of every tax, but it is

[60] Emphases supplied.

> especially true of the Income Tax because there are many cases where a knowledge of the amount of the taxpayer's profit is confined to himself or shared only by his confidential employees or his professional advisers. Although a taxpayer is obliged by law to make a return of his income, in many cases that return is, in the nature of things, capable of only a partial or imperfect check, and when this is known or suspected by the taxpayer he is tempted to speculate on the chance of escaping detection if the return is inaccurate. He may not always be guilty of fraud**;** he may be culpably careless; he may decide every doubtful point in his own favour by deliberately refraining from inquiry; he may cultivate a profitable ignorance or a negligence that is not free from guile. His conduct may, in short, occupy any position in the scale, from something less than complete honesty down to absolute fraud. **The one common feature in all such cases is that the Revenue suffers, which is only another way of saying that the evader contrives to make his fellow-citizens pay something that ought to have come out of his own pocket**."[61]

Cheating the public revenue, which boils down to dishonesty, encompasses all the underlined expressions and extends "from something less than complete honesty down to absolute fraud", precisely because of the highlighted last sentence which effectively defines it. According to "Clericus":

> "In all cases an intent to defraud is an essential element in the common law offence. ... At all events, it is not easy to think of a wilfully false statement made on a material matter to the Revenue where it is not apparent from the circumstances that it was made with intent to defraud. Given such an intent, false statements made to the Revenue constitute a clear exception to the generalisation that it is not a crime to tell a lie."[62]

V.II. Revenue Discretion

The restatement of the dogma "tax evasion is illegal but tax avoidance is legal" by equating tax evasion to tax fraud is fundamentally flawed because tax evasion (or cheating the public revenue by a taxpayer who deliberately fails to make a return of the relevant tax liability or who deliberately makes a false return of the relevant tax liability without using a tax scheme) can amount to a criminal offence or a civil fraud or an administrative fraud depending on whether "the tax authorities … take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-fraud penalties or simply establishing tax liability without fines or penalties."[63]

V.III. Criminal Offence

[61] (London: HMSO, 1920) p.135. Emphases supplied.
[62] 'Revenue Frauds at Common Law' [1954] *CLR*, 354, 359.
[63] Wisselink, p.203.

In the criminal prosecution in *R v Mavji*, the taxpayer was convicted of cheating the public revenue by **deliberately failing to make returns of VAT liability**. According to Davies J:

> "This appellant was in circumstances in which he had a statutory duty to make value added tax returns and to pay over to the Crown the value added tax due. He dishonestly failed to do either. Accordingly, he was guilty of cheating HM The Queen and the public revenue."[64]

In the criminal prosecution in *R v Hudson* the taxpayer was convicted of cheating the public revenue by **deliberately making a false return of income tax liability without using a tax scheme**. Goddard CJ stated:

> "We think that the offence here consisted of sending in documents to the inspector of taxes which were false and fraudulent to the appellant's knowledge ... for the purpose of avoiding the payment of tax. That is defrauding the Crown and defrauding the public."[65]

In other words, what matters is where the taxpayer's conduct falls under the fraud-negligence-honesty trichotomy rather than whether it is described as "avoiding the payment of tax" or "evading the payment of tax" (which are legal nonsenses). According to "Watchful":

> "At Hudson's trial at Nottingham Assizes Slade J at one point asked Mr Richard Elwes QC, appearing for the prosecution, whether he could imagine any false statement to the Revenue made knowingly and wilfully which would not involve intent to defraud. Mr Elwes replied 'I cannot, my Lord, I must say.' To which the learned judge said, 'Nor can I.'"[66]

V.IV. Civil Fraud and Administrative Fraud

In *R v IRC, ex parte Knight*, the taxpayer cheated the public revenue by making a deliberately false return of the relevant tax liability without using a tax scheme, like the taxpayer in *Hudson*. As the Inland Revenue stated in its evidence to the 1978 Royal Commission on Criminal Procedure:

> "In the main, however, the Department deals with the tax evader not by prosecution but by imposing money penalties graded according to the

[64] *Mavji*, pp.1391-1392.
[65] [1956] 2 QB 252, 261-262.
[66] 'Watchful', p.124.

> gravity of the offence. Moreover in the majority of cases the amount of the penalty is agreed informally between the Department and the taxpayer without recourse to formal proceedings."[67]

Knight is, therefore, one of "the [minority] of cases [where] the amount of the penalty [was not] agreed informally between the Department and the taxpayer without recourse to formal proceedings." According to Russell LJ:

> "This is an appeal from ... penalties under s 95 of the Taxes Management Act 1970 on the ground that the taxpayer, in submitting ... accounts of his trade ... had fraudulently or negligently submitted incorrect accounts. ... These assessments, being otherwise out of time, were based on allegations of fraud or wilful default by the taxpayer.
>
> On an appeal by the taxpayer, the Special Commissioners found wilful default. They made ... no finding one way or the other as to fraud. ... Then it is said ... that wilful default is not within s 95; it is neither fraud nor negligence. I think ... that when s 95 refers to fraud or negligence, it cannot sensibly be thought to exclude wilful default in that bracket. It would be ... quite absurd to hold under s 95 that it embraces careless breach of duty – that is to say, negligence – but not careful breach of duty – that is to say, wilful default."[68]

The taxpayer's contention shows that the supposed distinction between 'wilful default' (a legal nonsense) and fraud (a legal concept) is a distinction with no legal difference, and demonstrates why tax evasion (a legal nonsense) should not be used to describe tax fraud (a legal concept).

VI. THE MEANING OF TAX AVOIDANCE IN LAW

VI.I. Cheating by Professional Advisers

The fundamental thesis is that tax avoidance is cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes (hereafter referred to as "the professional enablers" or "the enabling professional advisers" or "the tax avoidance industry") in which the taxpayer using an individual scheme (hereafter referred to as "the participating taxpayer" or "the taxpayer") may or may not be complicit.

[67] EV No 145.
[68] *Knight*, pp.566-571.

In *R v Charlton, Cunningham, Kitchen and Wheeler*[69] the professional enablers were convicted of cheating the public revenue by devising, marketing, implementing and otherwise facilitating the use of tax avoidance schemes. According to Lord Justice Farquharson:

> "On 1 August 1994 these Appellants were convicted at Nottingham Crown Court on an indictment containing 14 counts of cheating the public revenue. ... Kitchen and Wheeler are qualified accountants. Charlton has practised for many years as an accountant, as a partner in a firm called Charltons, but was not professionally qualified. Cunningham is a barrister practising at the Revenue Bar, with chambers in Lincoln's Inn. He also works in Glasgow in the same field as well as having an association with a firm of lawyers in Madrid. Another defendant, Lawlor, pleaded guilty to four counts of the indictment. He, too, was a qualified accountant working at the relevant time for Charltons. In imposing a suspended sentence of imprisonment upon him the Judge said that '... the whole Charltons empire was riddled with dishonesty'. The firm had offices in Derby, Birmingham, Manchester and Jersey.
>
> The case for the prosecution was that Charlton had devised a dishonest, tax-avoidance scheme for the benefit of some of the firm's clients and that the Appellants were involved with the implementation of the schemes or the concealment from the Revenue of the existence of the fraud."[70]

No criminal proceedings were brought against the participating taxpayers that used the schemes.

VI.II. Taxpayer's Immunity

Paragraph 18 of Schedule 24 to Finance Act 2007, which deals with the liability of a taxpayer to penalties for negligence or fraud where professional advisers are acting on his behalf, was considered in *Hanson v HMRC*. Judge Cannan confirmed the well-established law and practice thus:

> "What is reasonable care in any particular case will depend on all the circumstances. In my view this will include the nature of the matters being dealt with in the return, the identity and experience of the agent, the experience of the taxpayer and the nature of the professional relationship between the taxpayer and the agent. In my view, **if a taxpayer reasonably relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable to a penalty under Schedule 24**."[71]

[69] 67 TC 500.
[70] *Charlton*, pp.504-505. Emphasis supplied.
[71] [2012] UKFTT 314 at [21]. Emphasis supplied.

The corollary of the highlighted principle is that the participating taxpayer that uses a tax avoidance scheme, which is invariably devised and implemented by the professional enablers, to misrepresent or conceal his tax liability in a tax return submitted to the Revenue is more likely to do so honestly than negligently or fraudulently.

HMRC's written submission to the PAC for the purposes of its hearing on February 11, 2016 on the controversial Google settlement, which confirmed that it was effected under "HMRC's policy to deal with fraud by use of the cost effective civil fraud investigation procedures under Code of Practice 9"[72], stated:

> "HMRC formally opened an enquiry into Google UK Ltd (GUK)'s returns in March 2010 after having carried out a detailed risk review. We concluded our enquiry in January 2016, when we reached agreement with GUK about additional tax that was due. ...
>
> For each year covered by the enquiry, we secured additional tax reflecting the full value of the economic activities carried on by Google in the UK."[73]

In fact, Google UK Ltd misrepresented its tax liability by at least £130 million. As it stated in a letter to the *Financial Times*:

> "After a six-year audit we are paying the full amount of tax that HM Revenue & Customs agrees we should pay, including £130m in additional back tax."[74]

Despite the fact that Google UK Ltd misrepresented its tax liability by at least £130 million, HMRC did not impose any penalty for negligence, let alone fraud, as this exchange between a member of the PAC and HMRC's head of business tax at the Committee's hearing shows:

> "**Q195 Caroline Flint***:* Does the fact that Google have paid £130 million, of which £18 million is interest, reflect that they did not pay enough tax?
>
> **Jim Harra***:* Yes, it clearly does. If you look at their accounts from 2005 to 2015, the total charge they have taken for corporation tax and interest is £196.4 million. They have acknowledged that £130 million of that is as a result of our investigation. That is a very significant uplift in their liability. ...

[72] *HMRC Criminal Investigation Policy*.
[73] *Supplementary written evidence*, February 10, 2016.
[74] Barron, 'Governments make tax law, Google complies', January 27, 2016.

> **Q196 Caroline Flint***:* If that is the case, why hasn't HMRC applied any penalties to Google for non-payment of tax?
>
> **Jim Harra***:* Penalties and large businesses are quite a challenge. ... In order to attach a penalty, we have to demonstrate two things: first of all, that the return was wrong – and it clearly was in this case – and secondly, that insufficient care was taken in producing the self-assessment. The challenge in transfer pricing is ... that they can take a lot of expert advice and opinion, and can take a reasonable position in relation to a complex area of law. We can challenge that and they can accept that they need to change their position, but it is very difficult to establish that they have taken insufficient care.
>
> **Q197 Caroline Flint***:* Basically their lawyers and tax people have outmanoeuvred HMRC with a story about why they should not face a penalty. You can understand why the public – whether individual taxpayers or businesses – find it hard to believe that ... in your own words, they did not return a proper tax return and have not paid the tax that they should have, but apart from the interest they have not faced a penalty. There is considerable public anger at that, because it seems that if they have enough hired guns in the form of lawyers and tax people, big companies can get away with it.
>
> **Jim Harra***:* I understand that anger. HMRC's position, and the Government's position, is that the current penalty legislation does not work in relation to large businesses in the way that it should."[75]

The focus on the participating taxpayers rather than the professional enablers means that the prevailing approach to tax avoidance (including the current penalty legislation) does not work in relation to companies and other wealthy taxpayers that can afford tax avoidance schemes because of the principle that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable to a penalty under Schedule 24."

The schemes in *Charlton* would also be described today as Base Erosion and Profit Shifting (BEPS) schemes because they were devised to erode the UK's tax base by shifting the taxable profits of UK companies to Jersey intermediaries. According to Farquharson LJ:

> "It was the case for the Crown that the accounts presented to the Revenue by the United Kingdom companies were false in that by using Charlton's scheme to transfer part of their profits to the Jersey companies they were not disclosing the full extent of the profits they had made. It was this lack of disclosure which formed the basis of the false representations alleged in the indictment. Each of the Appellants was charged in the relevant counts with cheating the Revenue by '... falsely representing that the apparent

[75] HC 788. Emphasis supplied.

> purchases (by the United Kingdom company) from (the Jersey company) were bona fide commercial transactions'."[76]

In other words, just as the returns and accounts submitted to HMRC by Google UK Ltd were not "reflecting the full value of the economic activities carried on by Google in the UK" in the words of HMRC, the returns and accounts submitted to the Inland Revenue by the United Kingdom companies in *Charlton* "were not disclosing the full extent of the profits they had made" in the UK in the words of Farquharson LJ. The Inland Revenue, however, prosecuted the professional enablers. *Charlton*, therefore, shows that the way to make the law effective in tax avoidance is to judge the schemes on the basis of whether the professional enablers cheated or defrauded the public revenue as a matter of law. As Farquharson LJ concluded:

> "It was apparent, therefore, as the learned Judge said on a number of occasions in the course of his summing-up, that there was no dispute by the end of the evidence that the schemes were being operated in fraud of the Revenue. The issue for the jury, as he correctly pointed out, was whether any, and if so which, of the Appellants took part in the devising, operation or concealment of the schemes and whether they were doing so dishonestly."[77]

VI.III. Counsel's Blessing

The participating taxpayer's obligation in respect of marketed tax avoidance schemes was considered in *Litman v HMRC*. Judge Short analysed the authorities and concluded:

> "It was accepted by HMRC that entering into a packaged avoidance scheme is not in itself a negligent act and the Tribunal accepts that the Taxpayers could not be expected to understand the legal and tax implications of the [scheme], the order in which documents needed to be signed, or the basis on which HMRC might argue that the transactions should not be respected for tax purposes. In each of these instances we accept, as reflected by the previous decisions in this area, that these are matters for which a reasonable taxpayer might properly be expected to rely on its professional advisers. The Taxpayers can rely, in this regard, on the decisions in *Bingham* and *Hanson*."[78]

[76] *Charlton*, p.506.
[77] *Charlton*, p.510. Emphasis supplied.
[78] [2014] UKFTT 089 [36].

The taxpayer's ability to rely on the decisions in *Bingham*[79] (that ignorance of technical aspects of tax legislation does not amount to negligence or fraud) and *Hanson* (that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable to a penalty under Schedule 24"[80] for negligence or fraud if the advice proves to be wrong) facilitates the use of legal opinions to sell tax avoidance schemes and to fortify the participating taxpayers' immunity from complicity in the fraud. Writing in the context of the US, where the practice originated, Rostain stated:

> "The accounting firm's opinion letter, together with a similar opinion letter from an outside law firm, could be produced down the road to show a taxpayer's good faith, thereby deflecting possible penalties if the IRS discovered and challenged the transaction. In addition, it served to reassure a client that the tax avoidance scheme was legitimate. Opinion letters are the stock in trade of tax lawyers."[81]

In the UK legal opinions (or "blessings" comparable to indulgences) are the stock-in-trade of senior members of the Revenue Bar "who retail opinions"[82] and "who prostitute themselves to these schemes."[83]

In his sanctimonious but illuminating critique, which should be seen in the context of his subsequent admission (that "[t]he vast majority of [his] work has been for taxpayers – and a majority of that work involves acting in courts and tribunals for taxpayers who have engaged in what are called (in the trade) 'marketed tax avoidance schemes'[84]), Maugham highlighted the fundamental flaw in the prevailing approach to tax avoidance unwittingly:

> "I have on my desk an Opinion - a piece of formal tax advice - from a prominent QC at the Tax Bar. In it, he expresses a view on the law that is so far removed from legal reality that I do not believe he can genuinely hold the view he says he has. At best he is incompetent. At worst, he is criminally fraudulent: he is obtaining his fee by deception. And this is not the first such Opinion I have seen; they pass across my desk all the time. ...

---

[79] [2013] UKFTT 110 (TC).
[80] Cannan J, [2012] UKFTT 314 [21].
[81] 'Travails in Tax: KPMG and the Tax-Shelter Controversy' in *Rhode et al eds. Legal Ethics: Law Stories* (2006) pp.5-6.
[82] Lord Wilberforce. Gillard, *In the Name of Charity* (London: Chatto & Windus, 1987) pp.258-259.
[83] Margaret Hodge. PAC, *Tax avoidance: tackling marketed avoidance schemes* (London: TSO, February 19, 2013), Q35.
[84] 'Tax Avoidance and Me', January 5, 2015.
https://waitingfortax.com/2015/05/01/tax-avoidance-and-me/

> Assume you are a seller of tax planning ideas: and let's call you a 'House'. You have developed a planning idea that you wish to sell to taxpayers. But your customers will typically want independent corroboration from a member of the Bar that your idea works; that is to say it delivers a beneficial tax treatment. The fees that can be generated from bringing a planning idea to market are substantial. I am aware of instances where a single planning idea has generated fees of about £100m for the House. But without barrister sign-off, you have nothing to sell. This fact creates predictable temptations for the Bar. If you are prepared to sign off a planning idea, the House will pay you handsomely; in some instances hundreds of thousands of pounds for a few days' work. ...
>
> The House will then go out and sell that idea to taxpayers. In the case of individual taxpayers, they will sell it, typically, through IFAs to whom they will pay a sales commission. That sales commission, too, can be very substantial, running in some cases into hundreds of thousands of pounds for a single client. So the IFA can be strongly incentivised to persuade their clients that the idea works, and - should the taxpayer client care about such things - that it is not aggressive tax planning.
>
> In the archetypal case the taxpayer will then make their tax return, HMRC will disallow the beneficial tax treatment, and the taxpayer will challenge that disallowance in the tax tribunal (causing years of uncertainty and substantial professional fees). Should that challenge fail, the taxpayer will lose whatever money he put into the idea, face an unexpected tax charge and, very often, be publicly pilloried into the bargain. ...
>
> Most of my colleagues at the Revenue Bar act properly and scrupulously. But it saddens me that a number, whose names are well known to us all, do not. Their behaviour makes victims of the general body of taxpayers, whose tax take is reduced. And it besmirches my profession."[85]

Every professional adviser, including every member of the Revenue Bar, involved "in the trade" of devising, marketing, implementing and otherwise facilitating the use of tax avoidance schemes, including by "acting in courts and tribunals for taxpayers who have engaged in ... 'marketed tax avoidance schemes'", cheats the public revenue or "makes victims of the general body of taxpayers, whose tax take is reduced". In the words of Viscount Simon in *Latilla v IRC*:

> "[O]ne 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."[86]

[85] 'Weak transmission mechanisms', *Taxation*, 2 October 2014, pp.8-9. Emphasis supplied.
[86] [1943] A.C. 377, 381.

In *Charlton*, Cunningham, the barrister, was convicted for "blessing" the schemes in circumstances strikingly similar to those described by Maugham. Rejecting "his case that he acted in the best traditions of the Bar"[87], Farquharson LJ stated:

> "The Crown case against Cunningham at the outset of the trial was that he had been active with Charlton in promoting the scheme from the time it was launched. ... There was evidence before the jury in the form of Mr Wheeler's interview that he had been taken by Charlton to meet Cunningham to be reassured that the scheme as sold by Charlton was tax effective. The first conference was said to have taken place at Derby on 19 March 1982 and was relied on in opening by the Crown as being part of a pattern whereby Charlton used Cunningham to reassure any doubting participants. The Crown's case against Cunningham had been that he advised Wheeler that the scheme was effective although to his knowledge it was not."[88]

VI.IV. The Twin Fundamental Flaws in the Prevailing Approach

As underlined statement by Maugham shows, the tax appeal system is designed for the relationship between the Revenue and the taxpayer. A tax avoidance appeal, therefore, obscures the fraudulent nature of tax avoidance because it is a dispute between the participating taxpayer and the Revenue to which the professional enablers are not parties.

This fundamental flaw seems to go unnoticed because, as demonstrated above, unlike the criminal courts, the civil courts do not decide the legal question whether the participating taxpayer, let alone the absent professional enablers, cheated or defrauded the public revenue as a matter of law but purport to decide whether a scheme "works" supposedly as a matter of statutory construction.

Justice O'Donnell's statement in *O'Flynn Construction v Revenue Commissioners*, which involved the GAAR in section 86 of Ireland's Finance Act 1989, demonstrates how the "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant" obscures and thus legitimises the fraudulent conduct of the professional enablers and any complicity by the participating taxpayer, even when a GAAR has been adopted:

> "The scheme in this case was devised with some ingenuity and implemented with a precision which at a technical level is undoubtedly admirable. One of the features of a tax avoidance scheme such as this is

[87] *Charlton*, p.516.
[88] *Charlton*, p.528.

> that although it is presumably explained in some detail to the participants in order to encourage them to take part, only the mechanics of the transaction are disclosed to the Revenue. When this case made its way before the Appeal Commissioners, the tax payers and their advisors did not go into evidence. Accordingly, it is not always clear what exactly was involved in some of the steps, or why each individual step was taken. However, in sum, more than 40 individual steps were taken over a period of 50 days and the end result, as intended, was that ... two companies ... reduced their profit by making capital contributions to other companies (which contributions were later written off), while the shareholders of both companies received tax relieved dividends from other entities. ...
>
> This case proceeded to some extent on the basis that since what was planned and executed here was a tax avoidance scheme, the only question was whether or not it contravened s 86 of the Finance Act 1989, and for that purpose it was said, it was not necessary to understand in any detail how the scheme worked. That course has considerable attraction, but it seems to me that in order to resolve the question of the validity of the scheme by reference to the provisions of s 86, it is necessary to seek to understand the scheme at least in broad detail. Accordingly I have sought to set out in this judgment my understanding of what is a quite intricate scheme. It follows from what has already been observed as to the limited evidence available, that it may be that I have misunderstood some aspects of the scheme. Any observations made by me in relation to the purpose of any particular step are inferences drawn by me, perhaps inaccurately, from the surrounding circumstances, and are not derived from any explanation proffered by the tax payers."[89]

The answer to the "question ... whether or not it contravened s 86 of the Finance Act 1989" tells us little or nothing about its nature and meaning in law because "in order to resolve the question of the validity of the scheme by reference to the provisions of s 86" "the taxpayers and their advisors did not go into evidence" and "it was not necessary to understand in any detail how the scheme worked." In the words of Lord Templeman's dissenting speech in *Fitzwilliam v IRC*:

> "**People should be judged by the results of their actions and not by the language of documents intended to mislead**."[90]

As the professional enablers and the participating taxpayers are *not* "judged by the results of their actions [but] by the language of documents intended to mislead" in civil litigation, the fundamental thesis that tax avoidance is cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using an individual scheme may

[89] [2011] IESC 47 [5]-[6].
[90] [1993] STC 502, 532. Emphasis supplied.

or may not be complicit is supported by obiter statements rather than actual decisions. According to Lord Templeman's dissenting statement in *Fitzwilliam*:

> "Capital transfer tax would be payable out of the estate before Lady Hastings came into her inheritance. The rate was 75%. Lady Fitzwilliam, Lady Hastings and the independent trustees hoped that their solicitors Currey & Co would find some way in which Lady Hastings could inherit the estate but avoid the payment of tax. Curreys consulted Mr Walker, now a Queen's Counsel, practising at the Chancery Bar and specialising in trusts and tax avoidance to see if he could find a way. Curreys first consulted Mr Walker on 11 October 1979 with a proposal for a tax avoidance scheme. Counsel amended the scheme from time to time and finally advised the implementation of the scheme by steps to be taken in accordance with an arranged timetable. The scheme was accepted by Curreys and was carried out between 20 December 1979 and 7 February 1980. On 18 January 1980, after step 3, Mr Herbert of counsel was asked by Curreys to advise Lady Hastings. Mr Herbert was a member of Mr Walker's chambers. Mr Herbert was ... asked ... to ... advise only on steps 4 and 5 and to discuss the matter with Mr Walker. ...
>
> **Legal advisers should not conceal their activities from their clients in the hope of deceiving the Revenue**. A client who subsequently adopts, ratifies and claims the benefit of the actions of his solicitors cannot deny the real consequences or avoid the fiscal consequences on the grounds of personal ignorance. Lord Keith does not condemn the concealment practised by Curreys with the approval of Mr Walker and does not even acknowledge that Lady Hastings was the client of Curreys and Mr Walker although the scheme was planned, concealed, implemented and completed for the benefit of Lady Hastings and nobody else.
>
> Mr Walker's scheme which trembled on the brink of a sham employed the devices which proved ineffective in *Ramsay* and *Furniss v Dawson*. ...
>
> All decisions of this House are founded on justice, principle and precedent. If an individual taxpayer employs a device to avoid tax the result is unjust because the Revenue are deprived of money intended by Parliament to be available for the common good. A decision in favour of the taxpayer, Lady Hastings in this case, would enable an individual taxpayer to drive a coach and horses through any Revenue legislation by ingenious drafting and nothing else. ...
>
> **In common with my predecessors I regard tax avoidance schemes of the kind invented and implemented in the present case as no better than attempts to cheat the Revenue**."[91]

As if to confirm the proposition that counsel's "blessing" serves to immunise the participating taxpayer from complicity in the cheating, he concluded:

[91] [1993] STC 502, 519-535. Emphasis supplied.

> "The advice of Mr Walker that such a scheme could properly be implemented for the purpose of avoiding capital transfer tax for the benefit of Lady Hastings was a complete protection for all the trustees."[92]

Lord Templeman's dissenting judgement is the only one that illuminated the nature and meaning of tax avoidance in law because of his insistence that "[p]eople should be judged by the results of their actions and not by the language of documents intended to mislead."[93] As he later re-emphasised extra-judicially:

> "**Tax should depend on facts and consequences and not on language or documents designed to enable a taxpayer to claim a tax advantage without paying the price**."[94]

Under the prevailing constructional approach whereby the professional enablers and the participating taxpayers are *not* "judged by the results of their actions [but] by the language of documents intended to mislead" and where "[t]ax [does not] depend on facts and consequences [but] on language or documents designed to enable a taxpayer to claim a tax advantage without paying the price", however, Lord Keith (with whom Lords Ackner, Browne-Wilkinson and Mustill agreed) held that the schemes "worked" despite "the concealment practised by Curreys with the approval of Mr Walker."

Lord Templeman was clear that "the concealment practised by Curreys with the approval of Mr Walker" was concealment from the client with a view to deceiving the Revenue:

> "Legal advisers should not conceal their activities from their clients in the hope of deceiving the Revenue."

It is self-evident that "the concealment practised by Curreys with the approval of Mr Walker" benefitted, rather than prejudiced, Lady Hastings, the client, because "the scheme was planned, concealed, implemented and completed for the benefit of Lady Hastings and nobody else."

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[92] Ibid, p.526.
[93] [1993] STC 502, 532.
[94] 'Tax and the taxpayer' [2001] *L.Q.R.* 575, 575. Emphasis supplied.

VI.V. The Tax Avoidance Industry

English cases like *Charlton* that support the fundamental thesis involved the minnows at the fringes of the UK tax avoidance industry. By contrast, in the US where the authorities are significantly less tolerant of white-collar crimes, the big fish in the centre ground of the tax avoidance or tax shelter industry have admitted to conspiracies to cheat and defraud the Internal Revenue Service (IRS) in recent times.

In particular, following the ground-breaking investigation by the Senate Permanent Subcommittee on Investigations from 2003 to 2005 into the devising, marketing, and implementation of tax schemes by accountants, lawyers, financial advisors and bankers[95], the IRS conducted unprecedented criminal investigations that resulted in several deferred prosecution agreements, as headlines like "Ernst & Young to Pay $123 Million to End Tax-Fraud Probe"[96] and "BDO Admits Generating $6.5 Billion in Phony Tax Shelter Losses, Pays $50 Million"[97] show.

Most notably, according to the IRS statement entitled "KMPG to Pay $456 Million for Criminal Violations"[98] dated August 29, 2005:

> "KPMG has admitted to criminal wrongdoing and agreed to pay $456 million in fines, restitution and penalties as part of an agreement to defer prosecution of the firm.
>
> In addition to the agreement, nine individuals – including six former KPMG partners and the former deputy chairman of the firm – are being criminally prosecuted in relation to the multi-billion dollar criminal tax fraud conspiracy. As alleged in a series of charging documents unsealed today, the fraud relates to the design, marketing, and implementation of fraudulent tax shelters.
>
> In the largest criminal tax case ever filed, KPMG has admitted that it engaged in a fraud that generated at least $11 billion dollars in phony tax losses which, according to court papers, cost the United States at least $2.5 billion dollars in evaded taxes. In addition to KPMG's former deputy chairman, the individuals indicted today include two former heads of KPMG's tax practice and a former tax partner in the New York, NY office of a prominent national law firm.

---

[95] *U.S Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial* Professionals, Volumes I-IV, November 18, 2003 and *The Role of Professionals Firms in the US Tax Shelter Industry*, April 13, 2005.
[96] *Bloomberg*, March 2, 2013.
[97] *Forbes*, June 13, 2012.
[98] IRS.

> The criminal information and indictment together allege that from 1996 through 2003, KPMG, the nine indicted defendants and others conspired to defraud the IRS by designing, marketing and implementing illegal tax shelters. The charging documents focus on four shelters that the conspirators called FLIP, OPIS, BLIPS and SOS. According to the charges, KPMG, the indicted individuals, and their co-conspirators concocted tax shelter transactions – together with false and fraudulent factual scenarios to support them – and targeted them to wealthy individuals who needed a minimum of $10 or $20 million in tax losses so that they would pay fees that were a percentage of the desired tax loss to KPMG, certain law firms, and others instead of paying billions of dollars in taxes owed to the government. To further the scheme, KPMG, the individual defendants, and their co-conspirators allegedly filed and caused to be filed false and fraudulent tax returns that claimed phony tax losses.
>
> KPMG also admitted that its personnel took specific deliberate steps to conceal the existence of the shelters from the IRS by, among other things, failing to register the shelters with the IRS as required by law; fraudulently concealing the shelter losses and income on tax returns; and attempting to hide the shelters using sham attorney–client privilege claims. ...
>
> To date, the IRS has collected more than $3.7 billion from taxpayers who voluntarily participated in a parallel civil global settlement initiative."[99]

In other words, as in *Charlton*, the participating taxpayers were not prosecuted. In fact, their immunity from the fraud was also fortified by the legal opinions used to sell the schemes. According to Rostain:

> "In order to make its products more attractive, KPMG emphasized that legal opinions from purportedly independent law firms were available. In the case of one product, the firm even agreed to pay a law firm a fee each time the law firm's name was mentioned during a sale, regardless of whether the firm provided an opinion."[100]

The "Statement of Facts" accompanying the "Deferred Prosecution Agreement between Ernst & Young LLP and the US Department of Justice" dated February 26, 2013, under which Ernst & Young paid $123 million in fines, restitution and penalties, underscores the pivotal role of lawyers in the tax avoidance industry:

> "Beginning in 1999 and ending in 2002, 'E&Y', in conjunction with various law firms, banks and investment advisers, developed, marketed and implemented four tax shelter products called COBRA, CDS, CDS Add-On, and PICO. Earlier and at or about the same time, other accounting firms developed similar tax shelter products and marketed them to their clients. E&Y implemented these four tax shelter products for approximately 200 high net worth clients, intending to defer, reduce or eliminate tax liabilities

[99] Ibid.
[100] Rostain, p.8.

for their clients of more than $2 billion in the aggregate. E&Y prepared tax returns reflecting tax losses claimed to have been derived from those tax shelter products and subsequently defended certain of its clients in connection with audits of those transactions by the IRS. E&Y received gross fees of approximately $123,000,000 with regard to these transactions.

A small group within E&Y known as the Strategic Individual Solutions Group ('SISG') was primarily responsible for supervising and coordinating the marketing, implementation and defense of E&Y's tax shelter products. Certain SISG tax shelter products were designed to appear to the IRS to be substantive investments that had favorable tax consequences when, in reality, the products were actually designed and marketed to clients as a series of preplanned steps that would defer, reduce or eliminate their tax liabilities, and the typical client participating in these shelters was primarily, if not exclusively, motivated to achieve a desired tax savings. In order to deceive the IRS as to the true nature of the tax strategies, and to bolster arguments that the transactions had economic substance, some SISG personnel agreed upon and directed other E&Y employees to participate in a concerted effort not to create, disseminate, or publicize documents reflecting the tax motivation behind the strategies, or the preplanned sequence of steps necessary to effect the strategies. These SISG personnel thereby sought to prevent the IRS from detecting their clients' purposes in using these strategies. For example, in certain instances, members of SISG falsely portrayed the transactions under examination as purely investment driven transactions and falsely denied a tax motivation for the transactions in response to IRS Information Document Requests and in testimony to the IRS. Further, in implementing the sale of tax shelter products, certain members of SISG also prepared documents or correspondence that falsely and inaccurately reflected events or conversations, and that were designed to improperly influence the IRS's view of the merits of the transactions in the event of an audit. These activities continued into 2003 and 2004.

The tax shelter products were implemented with opinion letters from law firms. These legal opinions were intended to provide 'penalty protection' to individual clients in the event that the IRS audited their tax returns. The opinions were premised upon certain taxpayer representations that, in some instances, E&Y employees knew were false. E&Y did not issue opinions with regard to these transactions."[101]

The innovative use of parallel civil and criminal enforcement procedures to recover avoided taxes from the participating taxpayers and punitive fines from the professional enablers in the US debunks the apologist notion that enforcement action against the tax avoidance industry in the UK will be prejudicial to the public revenue. As IRS Commissioner Everson stated while announcing the KPMG settlement:

"Today's actions demonstrate our resolve to hold accountable those who play fast and loose with the tax code. At some point such conduct passes from clever accounting and lawyering to theft from the people. We simply

[101] Exhibit B.

> can't tolerate flagrant abuse of the law and of professional obligations by tax practitioners, particularly those associated with so-called blue chip firms like KPMG that, by virtue of their prominence, set the standard of conduct for others. Accountants and attorneys should be the pillars of our system of taxation, not the architects of its circumvention."[102]

The essence of the fundamental thesis, which is a fundamental departure from the existing body of knowledge, is that the "point such conduct passes from clever accounting and lawyering to theft from the people" as a matter of law can only be determined by judging the conduct of the professional enablers.

Gammie's historical overview, which shows that the loss schemes that resulted in the criminal proceedings in the US have always been the stock-in-trade of the UK's tax avoidance industry, underscores how the prevailing focus on the symptoms of tax avoidance (the participating taxpayers) rather than the causes (the professional enablers) constitutes a licence to cheat for the tax avoidance industry:

> "I have an enduring memory of attending a meeting as a newly-qualified solicitor nearly forty years ago at the office of a firm that specialized in devising and implementing tax schemes. On that occasion it was the office of Emson & Dudley rather than that of Rossminster or Bradman organizations. ...
>
> On the occasion in question I was representing a client who wished to reduce his liability to capital gains tax. The liability had arisen on a recent disposal but that was no obstacle to the proposed relief: the scheme ensured that an offsetting loss would appear as if by magic. All that had to be factored in was the size of the loss, which would form the basis of the figures to be inserted in the transaction document and the fee that would be paid.
>
> Most clients took the matter no further but in this case my client bought the scheme. His reasoning was simple: I could not say absolutely that the scheme did not work. ... He was happy to bet Emson & Dudley's fees to see if tax could be avoided. The details of those arrangements escape me but the manner of their execution does not. At the outset the point was made that each step was intended to create the particular legal rights and obligations documented. Furthermore, any party (including the offshore entities involved) after any step could decide not to enter into the next step in the sequence. Pre-prepared scheme documents were then circulated at the meeting and solemnly signed in the correct order. I recall pointing out at one stage that if the merry-go-round were in fact to stop my client could have some difficulty extricating himself from the financial commitments he appeared to have assumed. Needless to say, the documents continued to circulate and he encountered no such difficulty. He entered the building with a large tax liability and he exited expecting to have none. As solicitors we did not ordinarily deal with the submission of clients' annual tax returns

[102] Ibid. Emphases supplied.

> or with the subsequent negotiation of their tax liabilities. As I heard nothing further, I assume that tax was successfully avoided, unless the matter remained open long enough to be caught by the decision in *Ramsay*.
>
> By 2005 methods of implementation had apparently become more streamlined for taxpayers. The representative of NT [No Tax] Advisers [in *Barnes v HMRC*[103]] visited Mr Barnes' office for him to sign in escrow the suite of scheme documentation and to provide a letter of authority enabling them to enter dates, amounts, and 'any other issues' into the documents, to change the dates, and in their absolute and sole discretion to release the documents from escrow. My part in Mr Barnes' case was to explain to the Tribunal as Counsel for HMRC why such arrangements did not achieve their objective of exonerating Mr Barnes from tax on his annual income.
>
> My early experience of such schemes gave birth to ... the belief that tax liabilities ... ought not to be capable of being negated by the simple expedient of passing papers round a table; it made no sense to impose a tax if tax could be so easily avoided."[104]

The tax appeal system and the constructional approach to tax avoidance by the Revenue and the courts make "tax liabilities ... capable of being negated by the simple expedient of passing papers round a table" because they are fundamentally flawed as demonstrated above.

VI.VI. Revenue Discretion

The dogma that "tax avoidance is legal" is fundamentally flawed because tax avoidance (or cheating the public revenue by the professional advisers that devise, market, implement, and otherwise facilitate the use of tax schemes in which the taxpayer using an individual scheme may or may not be complicit) can amount to a criminal offence or a civil fraud or an administrative fraud depending on whether "the tax authorities … take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-fraud penalties or simply establishing tax liability without fines or penalties, applying doctrines such as substance over form."[105]

VI.VII. Criminal Offence

In the highly exceptional case of *Charlton* where the Revenue took "the procedural course of bringing a criminal tax-fraud case", it invoked the common law offence of

[103] [2011] UKFTT 95.
[104] 'Tracing the Boundaries of Sham and Ramsay' in Simpson and Stewart (ed), *Sham Transactions* (Oxford: OUP, 2013) pp.211-212.
[105] Wisselink, p.203.

cheating the public revenue which "acts upon the offender, and inflicts a penalty"[106] in criminal proceedings. As Cunningham stated in an article:

> "From February 1994 until August 1994, the writer had the inglorious distinction of being a participant in the longest ever prosecution by the Inland Revenue ... as a defendant! He was convicted on two counts of cheating the Inland Revenue by concealing the existence of two fraudulent schemes in the course of an Enquiry Branch investigation. He was sent to prison for fifteen months. On appeal, the conviction was upheld but the sentence was reduced to nine months. ...
>
> The counts on the indictment related to twelve different schemes. The writer was found guilty of concealing two of them. ... There was an assessment under appeal in relation to the United Kingdom company when Enquiry Branch raided the premises of the accountants and the company and others (not the writer's chambers). The result was that the pending appeal hearing was replaced by a criminal trial."[107]

The conviction and incarceration of the professional advisers prove that tax avoidance is a crime or "an act that is capable of being followed by criminal proceedings"[108] or an "act prohibited with penal consequences."[109] In the words of Farquharson LJ's sentencing remarks that embody the overriding legal and moral duty of honesty imposed by the pre-existing common law of cheating:

> "It is a feature, no doubt, of the tax or Revenue law of any country that it must, to a large extent, in its tax-gathering activities, rely on the truthfulness of the taxpayer in indicating the extent of his income or whatever other matter is relevant to the particular statute being considered. It follows also that the Revenue not only have to rely on the taxpayer's good faith, but more especially on the professional advisors they appoint to act for them and, accordingly, when professional advisors are found to have acted dishonestly towards the Revenue, it is almost inevitable, as I think each counsel before us has recognised, that sentences of imprisonment must follow and we adhere to that position."[110]

VI.VIII. Civil Fraud

In the landmark case of *Ramsay v CIR*, where the Revenue decided to "take the procedural course of ... establishing tax liability without fines or penalties, applying doctrines such as substance over form"[111] by pleading fraud in the House of Lords, it

[106] Blackstone.
[107] Cunningham, pp.329-333. Emphasis supplied.
[108] Glanville Williams.
[109] Lord Atkin.
[110] *Charlton*, p.531.
[111] Wisselink, p.203.

invoked the pre-existing common law of cheating which "acts upon the offence, by setting aside the fraudulent transaction" in civil proceedings. According to Lord Wilberforce:

> "The first of these appeals is an appeal by W. T. Ramsay Ltd., a farming company. In its accounting period ending 31 May 1973 it made a 'chargeable gain' for purposes of corporation tax by a sale-leaseback transaction. This gain it desired to counteract, so as to avoid the tax, by establishing an allowable loss. The method chosen was to purchase from a company specialising in such matters a ready-made scheme. The general nature of this was to create out of a neutral situation two assets one of which would decrease in value for the benefit of the other. The decreasing asset would be sold, so as to create the desired loss; the increasing asset would be sold, yielding a gain which it was hoped would be exempt from tax. In the courts below, attention was concentrated upon the question whether the gain just referred to was in truth exempt from tax or not. The Court of Appeal, reversing the decision of Goulding J., decided that it was not.
>
> In this House, the Crown, while supporting this decision of the Court of Appeal, mounted a fundamental attack upon the whole of the scheme acquired and used by the appellant. It contended that it should simply be disregarded as artificial and fiscally ineffective."[112]

The *Ramsay* principle is, therefore, a clear application of the pre-existing common law of cheating. In the words of Simpson:

> "This judge-made move towards regulating the conduct of citizens certainly goes beyond anything expressly demanded by the legislation. To that extent, it clearly involves the recognition that there is, after all, some common law (in the widest sense of that term) of taxation."[113]

Judge Learned Hand's seminal statement of the sham transaction doctrine in *Gilbert v Gregory*, which Lord Wilberforce cited with approval in *Ramsay*, also shows that "it clearly involves the recognition that there is, after all, some common law (in the widest sense of that term) of taxation":

> "It is a corollary of the universally accepted canon of interpretation that the literal meaning of the words of a statute is seldom, if ever, the conclusive measure of its scope. Except in rare instances statutes are written in general terms and do not undertake to specify all the occasions they are meant to cover; and their interpretation demands the projection of their expressed purpose upon occasions not present in the minds of those who enacted them. The Income Tax Act imposes liabilities upon taxpayers based upon their financial transactions, and it is of course true that the payment of the tax itself is a financial transaction. If, however, the taxpayer

[112] 54 TC 101, 183. Emphasis supplied.
[113] Simpson (2001) p.190.

> enters into a transaction that does not appreciably affect his beneficial interest except to reduce his tax, the law will disregard it; for we cannot suppose that it was part of the purpose of the Act to provide an escape from the liabilities it sought to impose."[114]

As a matter of law, "a transaction that does not appreciably affect his beneficial interest except to reduce his tax" cheats the public revenue, and in the absence of anti-avoidance legislation "the law [that] will disregard it" is the pre-existing common law of cheating which "acts upon the offence, by setting aside the fraudulent transaction" in civil proceedings.

VI.IX. Administrative Fraud

Long before the ongoing Profit Diversion Compliance Facility, HMRC's 'sweetheart' tax deals with companies like Google that used tax avoidance schemes to divert profit taxable in the UK to offshore jurisdictions highlighted the fact that it usually deals with tax fraud by "imposing only civil tax-fraud penalties".[115]

VI.X. The Tax Dogma

Charlton disproved the dogma that "tax evasion is illegal but tax avoidance is legal" and proved the maxim that "the Revenue's discretion is nine-tenths of tax law". According to Rhodes et al:

> "It is a commonly held belief among professional advisers that tax avoidance is legal and tax evasion is illegal. Tax avoidance schemes may fail but the taxpayers and their advisers have, until now, been secure in the knowledge that the worst that can happen is the receipt of a large bill for tax and interest. ...
>
> Amongst professional tax advisers, alarm and concern have been expressed at the approach of the Revenue and the conduct of the case. It has been argued that there is a general move to 'blur' the 'very clear' distinction between legal tax avoidance and illegal evasion. However, it might well be suggested that the distinction is not and has never been as clear as many professional advisers (and their clients) would like to believe. Where avoidance arrangements are wholly artificial and have no substance then clearly it is and always has been open to the Revenue and the courts to consider whether they are in fact 'devices to cheat the public revenue'.
>
> What perhaps has confused the issue is the Revenue's highly selective policy on prosecutions. Although the Revenue are a law enforcement

[114] 248 Fed. 2nd 299, 411 (1957).
[115] Wisselink.

> agency, their principal purpose is to collect taxes. Accordingly, historically, they have only been interested in invoking the criminal law where they consider that they will be successful and the case will generate publicity which will serve as a warning to other taxpayers or professional advisers. Should this attitude change, and should the Revenue seek to act as a law enforcement agency on the lines adopted so successfully many years ago by the US Internal Revenue Service, then many more taxpayers and their professional advisers may find that they are at risk.
>
> Moreover, the terms 'tax avoidance' and 'tax evasion' have been created by the legal and accountancy professions as convenient generic terms to distinguish what is legal from what is illegal, and the fact that they have also been adopted by the courts should not blind us to what they actually are."[116]

In other words, the supposed doctrine that "tax avoidance is legal", which is universally accepted as gospel truth in domestic and international taxation, rests for its support upon a fundamental misunderstanding of the fact that in all jurisdictions "it is entirely within the discretion of the tax authorities whether they take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-fraud penalties or simply establishing tax liability without fines or penalties, applying doctrines such as substance over form"[117], the *Ramsay* principle in English law, the sham transaction doctrine in American law and the abuse doctrine in European Union law. In the words of Lord Tomlin in *Duke of Westminster v CIR* that is often used ironically to justify it:

> "The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting 'the incertain and crooked cord of discretion' for 'the golden and streight metwand of the law.'"[118]

VII. THE MEANING OF TAX MITIGATION IN LAW

Tax mitigation is making a true and honest return by a taxpayer without using a tax scheme.

Tax mitigation is distinguished from tax avoidance by the absence of a tax scheme and thus dishonesty. In the words of Lord Templeman in *Matrix-Securities*:

> "Every tax avoidance scheme involves a trick and a pretence."[119]

[116] Rhodes, pp.203-206. Emphases supplied.
[117] Wisselink, p.203.
[118] [1936] A.C. 1, 19.
[119] [1994] STC 272, 281.

In *CIR v Challenge*, where Lord Templeman invented the concept of 'tax mitigation' while delivering the advice of the majority, he distinguished it from tax avoidance on the basis that it does not involve a scheme or arrangement or dishonesty:

> "The material distinction in the present case is between tax mitigation and tax avoidance. A taxpayer has always been free to mitigate his liability to tax. In the oft quoted words of Lord Tomlin in *IRC v Duke of Westminster* 'Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be'[120]. In that case however the distinction between tax mitigation and tax avoidance was neither considered nor implied.
>
> **Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability**. [In] tax mitigation ... the taxpayer's tax advantage is not derived from an 'arrangement' but from the reduction of income which he accepts or the expenditure which he incurs.
>
> Thus when a taxpayer executes a covenant and makes a payment under the covenant he reduces his income. If the covenant exceeds six years and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the payment under the covenant.
>
> When a taxpayer makes a settlement, he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income.
>
> Where a taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitled the taxpayer to reduction of tax liability. The tax advantage results from the expenditure on the premium.
>
> A taxpayer may incur expense on export business or incur capital or other expenditure which by statute entitles the taxpayer to a reduction of his tax liability. The tax advantages result from the expenditure for which Parliament grants specific tax relief. ...
>
> 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**."[121]

Applying the test of "how an honest person would behave" advanced by Lord Nicholls in *Brunei*, an honest person involved in tax mitigation "**reduces his income or incurs**

[120] [1936] AC 1, 19.
[121] [1986] STC 548, 554-555.

expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability" but a dishonest person involved 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**." In the words of Lord Templeman in *CIR v Challenge*:

> "In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax."[122]

The red herrings that are usually introduced into the debate, such as ISAs, premium bonds and pension contributions, are cases of tax mitigation distinguishable by the fact that there is no scheme or trick or pretence because "the taxpayer seeks to obtain a tax advantage [after] suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax." In the words of Lord Templeman in *Ensign Tankers*:

> "There is nothing magical about tax mitigation whereby a taxpayer suffers a loss or incurs expenditure in fact as well as in appearance."[123]

The absence of case of law on ISAs and premium bonds is testament to the fact that the Revenue will not object to a tax advantage based on "tax mitigation whereby a taxpayer suffers a loss or incurs expenditure in fact as well as in appearance."

VIII. THE PREVAILING DEFINITIONS OF TAX EVASION, TAX AVOIDANCE AND TAX MITIGATION

VIII.I The Tax Dogma

As the analysis of the existing literature above shows, the pre-existing definitions are based on the dogma that 'tax avoidance is legal' because of the failure to recognise that the prevailing constructional approach to tax avoidance does not judge the conduct of the professional enablers and the participating taxpayers as a matter of law.

[122] Ibid, p.555.
[123] [1992] STC 226, 240.

VIII.II Lord Templeman's Definitions

The last definitive contribution by Lord Templeman, who invented the evasion-avoidance-mitigation trichotomy, was in his 2001 article for the *Law Quarterly Review* entitled 'Tax and the Taxpayer'[124]. As the title shows, Lord Templeman restated the tax dogma by focusing on the taxpayer and failing to judge the conduct of the professional enablers of tax avoidance.

Subject to that flaw, his definitions of the "three methods by which an individual taxpayer may seek to reduce his burden of tax"[125] support the definitions proposed in this thesis.

Tax evasion is cheating the public revenue by a taxpayer who deliberately fails to make a return of the relevant tax liability or who deliberately makes a false return of the relevant tax liability without using a tax scheme. According to Lord Templeman:

> "The first method is tax evasion and is a criminal offence. **The taxpayer conceals or fraudulently misrepresents to the Revenue the incidence and ambit of his tax affairs**."[126]

The taxpayer who "conceals … the incidence and ambit of his tax affairs" cheats by deliberately failing to make a return of the relevant tax liability as in *Mavji* while the taxpayer who "fraudulently misrepresents to the Revenue the incidence and ambit of his tax affairs" cheats by deliberately making a false return of the relevant tax liability without using a tax scheme as in *Hudson*.

Tax avoidance is cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using a specific scheme may or may not be complicit. According to Lord Templeman:

> "The second method is tax avoidance, which does not involve unlawful conduct. **The taxpayer's advisers invent a scheme whereby he can hope to enjoy the benefit of a taxable event without becoming liable**

[124] 'Tax and the Taxpayer' [2001] *L.Q.R.* 575.
[125] Ibid.
[126] ibid. Emphasis supplied.

> **to pay the tax**. A tax avoidance scheme includes one or more interlinked steps which have no commercial purpose except for the avoidance of tax otherwise payable, and can conveniently be described as artificial steps."[127]

The scheme (and thus the involvement of the professional enablers) distinguish the conducts of the taxpayer involved in tax evasion and the taxpayer involved in tax avoidance. By merging Lord Templeman's definitions of tax avoidance and tax evasion, in tax avoidance:

> "The taxpayer's advisers invent a scheme whereby he can hope to enjoy the benefit of a taxable event without becoming liable to pay the tax."
>
> "The taxpayer conceals or ... misrepresents to the Revenue the incidence and ambit of his tax affairs."

In tax avoidance, whether "[t]he taxpayer conceals or ... misrepresents to the Revenue the incidence and ambit of his tax affairs" fraudulently or negligently or honestly depends on his knowledge, abilities and circumstances. The effect of the principle that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable" for fraud or negligence only because the advice proves to be wrong is that the conduct of the taxpayer is likely to be honest rather than negligent or fraudulent.

Lord Templeman based the tax dogma ("tax evasion ... is a criminal offence" and "tax avoidance ... does not involve unlawful conduct") upon a misconception of the procedural difference between criminal and civil law:

> "The tax evader commits a criminal offence punishable with prison, penalties and fines. The tax avoider commits no offence and only risks failure to avoid the tax."[128]

"The tax evader commits a criminal offence punishable with prison, penalties and fines" because in criminal proceedings, which the Revenue usually brings in cases that are not resolved by contract settlement, the criminal law "acts upon the offender, and inflicts a penalty." "The tax avoider commits no offence and only risks failure to avoid the tax" because in civil proceedings, which the Revenue usually brings in cases that are not resolved by contract settlement, the civil law "acts upon the offence, by setting aside the fraudulent transaction." The unprecedented prosecution and incarceration of the

[127] Ibid. Emphases supplied.
[128] Ibid. 587.

professional enablers in *Charlton* prove that tax avoidance "is a criminal offence" which is simply "an act that is capable of being followed by criminal proceedings"[129] or an "act prohibited with penal consequences."[130]

Lord Templeman's proposition that "tax avoidance ... does not involve unlawful conduct" because "[t]he tax avoider commits no offence and only risks failure to avoid the tax" in civil proceedings is a *non sequitur*. Tax avoidance is still unlawful in civil law which "acts upon the offence, by setting aside the fraudulent transaction". As he, himself, stated:

> "No one has ever advanced a convincing reason for allowing tax avoidance schemes based on artificial steps to distort the operation of taxing statutes and frustrate the intentions of Parliament."[131]

The true question, therefore, is whether the Revenue and the courts should continue to turn a blind eye to the conduct of the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes or artificial steps included in otherwise clearly taxable transactions. In the words of Lord Templeman:

> "On the one hand a taxpayer is free to organise his affairs so as to pay the least tax. On the other hand tax avoidance schemes which involves artificial steps are unfair to the public purse and may involve millions of pounds of lost revenue; specific legislation passed to outlaw a type of avoidance scheme is not retrospective and complicates a law which is already complicated. ... Tax avoidance schemes are also unfair to wage and salary earners and the generality of taxpayers because such schemes require the inventive genius of expensive lawyers and accountants studying the fine print of tax legislation to find loopholes and juggling with subsidiary companies and captive shareholdings. Tax should depend on facts and consequences and not on language or documents designed to enable a taxpayer to claim a tax advantage without paying the price."[132]

The fact that "such schemes require the inventive genius of expensive lawyers and accountants" makes the question of a well-informed taxpayer devising his own scheme without professional advice academic. A taxpayer well-informed enough to devise a tax avoidance scheme without "the inventive genius of expensive lawyers and accountants" and other professional enablers is more appropriately described as a self-advising professional than a taxpayer, not least

[129] Glanville Williams.
[130] Lord Atkin.
[131] Ibid, p.587.
[132] Templeman, p.575.

because he clearly has the ability to devise schemes for other people. The absence of case of law on a well-informed taxpayer devising his own scheme without professional advice shows that the issue is indeed academic.

Tax mitigation is making a true and honest return by a taxpayer without using a tax scheme. According to Lord Templeman:

> "**The** third method is tax mitigation whereby a **taxpayer** incurs expenditure which **reduces his taxable income or his taxable assets or** whereby a taxpayer **incurs expenditure which Parliament wishes to encourage or reward by a tax allowance or deduction**. Tax mitigation may take a variety of forms but is distinguishable from tax avoidance; tax mitigation does not include any artificial step though the motive which inspires a taxpayer may be mainly or wholly the desire to reduce tax. A taxpayer may consider that premium bonds are a bad investment or that an ISA has a poor chance of increasing in value or that his children do not deserve his bounty. Nevertheless if he makes an investment or divests himself of property and otherwise fulfils the requirement of the legislation, then even though he may do so to reduce his tax, his motive is irrelevant."[133]

A scheme is not required in tax mitigation where "a taxpayer incurs expenditure which reduces his taxable income or his taxable assets or ... incurs expenditure which Parliament wishes to encourage or reward by a tax allowance or deduction" because in the words of Lord Templeman:

> "The object of a tax avoidance scheme is to enable the taxpayer to enjoy a taxable event without paying the tax."[134]

VIII.III. UK Government's Definitions

On March 19, 2015 the Chancellor of the Exchequer and the Chief Secretary to the Treasury presented to Parliament a joint HMRC and HM Treasury strategy entitled "*Tackling Tax Evasion and Avoidance*", which "sets out the government's plans to find and punish more evaders, deter more avoiders and reassure the vast majority of taxpayers who already pay what they owe."[135] It provides these underlying definitions:

> "**Clarifying tax terminology**
>
> **Tax evasion** is always illegal. It is when people or businesses deliberately do not declare and account for the taxes that they owe. It includes the

[133] Ibid, pp.575-576. Emphasis supplied.
[134] Ibid, p.576.
[135] Cm 9047, p.5.

> hidden economy, where people conceal their presence or taxable sources of income.
>
> **Tax avoidance** involves bending the rules of the tax system to gain a tax advantage that Parliament never intended. It often involves contrived, artificial transactions that serve little or no purpose other than to produce this advantage. It involves operating within the letter – but not the spirit – of the law. Most tax avoidance schemes simply do not work, and those who engage in it can find they pay more than the tax they attempted to save once HMRC has successfully challenged them.
>
> **Tax planning** involves using tax reliefs for the purpose for which they were intended, for example, claiming tax relief on capital investment, or saving via ISAs or for retirement by making contributions to a pension scheme."[136]

Tax evasion is cheating the public revenue when *taxpayers* or "people or businesses deliberately do not declare and account for the taxes that they owe" by deliberately failing to make a return or by deliberately making a false return without using a tax scheme.

Tax avoidance is cheating the public revenue by *professional enablers* "bending the rules of the tax system to gain a tax advantage that Parliament never intended" by devising, marketing, implementing and otherwise facilitating the use of a tax avoidance scheme or "contrived, artificial transactions that serve little or no purpose other than to produce this advantage" in which the taxpayer using the scheme to gain this advantage may or may not be complicit. Under the constructional approach some "tax avoidance schemes simply do not work, and those who engage in it can find they pay more than the tax they attempted to save once HMRC has successfully challenged them."

Tax planning or *tax mitigation* is making a true and honest return by a *taxpayer* without using a tax scheme and "involves using tax reliefs for the purpose for which they were intended."

By failing to judge the conduct of the enablers of tax avoidance, therefore, "the government's plans to ... deter more avoiders and reassure the vast majority of taxpayers who already pay what they owe" effectively preserve the licence to cheat enjoyed by the tax avoidance industry.

[136] Ibid.

VIII.IV. HMRC's Definitions

Every loss to the public revenue must fall within the fraud-negligence-honesty trichotomy, depending on the knowledge, abilities and circumstances of the taxpayer and any professional adviser involved.

Because of the fallacy that "tax avoidance is legal" and the failure to consider cheating by the professional enablers of tax avoidance, the focus is invariably on tax evasion or cheating by a taxpayer who deliberately fails to make a return or deliberately makes a false return without using a tax scheme. The 1920 Royal Commission on Income Tax considered the matter and concluded:

> "The amount that the Revenue loses by these means cannot be definitely known ... but the evidence as a whole fully convinced us that there is a serious loss of revenue caused by **fraud**, **negligence**, and **ignorance**, and that there is a considerable minority of taxpayers who ... deliberately seek to cheat their fellows by understating their liability to assessment."[137]

The Committee on the Enforcement Powers of the Revenue Departments (the Keith Committee) similarly stated:

> "While the majority of taxpayers meet their obligations with fairly good grace, some do not. Enforcement powers are therefore necessary not only to coerce the **dishonest** and the **neglectful**, but to encourage the **honest** and conscientious."[138]

By contrast, in order to boost its performance in *Tackling Tax Evasion and Avoidance* (which as explained above is "the government's plans to find and punish more evaders, deter more avoiders and reassure the vast majority of taxpayers who already pay what they owe"[139]) HMRC attributes the *Tax Gap* (which it defines as "the difference between the amount of tax that should, in theory, be paid to HMRC, and what is actually paid"[140]) to eight "taxpayer behaviours"[141] by dividing tax evasion and tax avoidance into new legal nonsenses thus:

> "The tax gap can be described as the tax that is lost through a range of behaviours – **non-payment**, use of **avoidance** schemes, **legal interpretation** of the tax effects of complex transactions, **error**, **failure to**

[137] *Report of the Royal Commission on The Income Tax*, p.135. Emphases supplied.
[138] *Final Report*, p.3. Emphases supplied.
[139] HMT, *Tackling Tax Evasion and Avoidance*, March 19, 2015, p.5.
[140] HMRC, *Measuring Tax Gaps 2018 edition*, p.5.
[141] Ibid, p.11.

> **take reasonable care**, **evasion**, the **hidden economy** and **criminal attacks** on the tax system."[142]

Error and *failure to take reasonable care* correspond to honest mistake and negligence respectively. *Non-payment* can be honest or negligent or fraudulent.

Like *evasion* and *avoidance*, however, *legal interpretation*, *hidden economy* and *criminal attacks* are legal nonsenses substituted for cheating the public revenue or tax fraud. In particular, *legal interpretation* is a new term for what is traditionally understood as tax avoidance.

HMRC's "Descriptions"[143] and "estimate of taxpayer behaviours attributed to the tax gap for 2016-17"[144] support the above propositions:

> "**Criminal attacks** [**£5.4bn** or **16%**]
>
> Organised criminal gangs undertake co-ordinated and systematic attacks on the tax system. This includes smuggling goods such as alcohol or tobacco, VAT repayment fraud and VAT Missing Trader Intra-Community (MTIC) fraud.
>
> **Evasion** [**£5.3bn** or **16%**]
>
> Tax evasion is an illegal activity, where registered individuals or businesses deliberately omit, conceal or misrepresent information in order to reduce their tax liabilities.
>
> **Hidden economy** [**£3.2bn** or **10%**]
>
> Undeclared economic activity that involves what we call 'ghosts' — whose entire income is unknown to HMRC, and 'moonlighters' — who are known to us in relation to part of their income, but have other sources of income that HMRC does not know about.
>
> There is a difference between the hidden economy and tax evasion:
> • Hidden economy — where an entire source of income is not declared.
> • Tax evasion — where a declared source of income is deliberately understated.
>
> **Avoidance** [**£1.7bn** or **5%**]
>
> Avoidance is exploiting the tax rules to gain a tax advantage that Parliament never intended. It often involves contrived, artificial transactions that serve little or no commercial purpose other than to produce a tax advantage. It involves operating within the letter but not the spirit of the law. ...

[142] Ibid. Emphasis supplied.
[143] Ibid, p.20.
[144] Ibid.

> Tax avoidance is not the same as tax planning. Tax planning involves using tax reliefs for the purpose for which they were intended. For example, claiming tax relief on capital investment, saving in a tax-exempt ISA or saving for retirement by making contributions to a pension scheme are all forms of tax planning.
>
> **Legal interpretation** [**£5.3bn** or **16%**]
>
> Legal interpretation losses arise where the customer's and HMRC's interpretation of the law and how it applies to the facts in a particular case, result in a different tax outcome. Examples include the correct categorisation of an asset for allowances, the allocation of profits within a group of companies, or VAT liability of a particular supply.
>
> **Non-payment** [**£3.4bn** or **10%**]
>
> For direct taxes, non-payment refers to tax debts that are written off by HMRC and result in a permanent loss of tax — mainly as a result of insolvency. It does not include debts that are eventually paid.
>
> VAT non-payment differs as it is based on the difference between new debts arising and debt payments.
>
> **Failure to take reasonable care** [**£5.9bn** or **18%**]
>
> Failure to take reasonable care results from a customer's carelessness and/or negligence in adequately recording their transactions and/or in preparing their tax returns. Judgements of 'reasonable care' should consider and reflect a customer's knowledge, abilities and circumstances.
>
> **Error** [**£3.2bn** or **10%**]
>
> Errors result from mistakes made in preparing tax calculations, completing returns or in supplying other relevant information, despite the customer taking reasonable care."[145]

"**Tax planning** involves using tax reliefs for the purpose for which they were intended" and thus corresponds to tax mitigation or making a true and honest return by a taxpayer without using a tax scheme.

"**Hidden economy** — where an entire source of income is not declared" is cheating by a taxpayer who deliberately fails to make a return of the relevant tax liability, as in *Mavji*. "**Tax evasion** — where a declared source of income is deliberately understated" is cheating by a taxpayer who deliberately makes a false return of the relevant tax liability without using a tax scheme, as in *Hudson*. Both **hidden economy** and **tax evasion**, therefore, fall with the definition of tax evasion as cheating by a taxpayer who

[145] HMRC, p.20.

deliberately fails to make a return or who makes a deliberately false return without using a scheme.

Charlton shows that tax avoidance or cheating by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using a specific scheme may or may not be complicit encompasses **avoidance** ("exploiting the tax rules to gain a tax advantage that Parliament never intended") and and **legal interpretation** ("where the customer's and HMRC's interpretation of the law and how it applies to the facts in a particular case, result in a different tax outcome"). Every tax avoidance dispute is a case "where the customer's and HMRC's interpretation of the law and how it applies to the facts in a particular case, result in a different tax outcome."

As expounded in chapters one and six, marketed tax avoidance masterminded by the tax avoidance industry and offshore tax evasion masterminded by the private banking industry constitute **criminal attacks** or "co-ordinated and systematic attacks on the tax system".

An analysis of the "estimate of taxpayer behaviours attributed to the tax gap for 2016-17" shows how the introduction of new legal nonsenses enables HMRC to deflect the criticism that "HMRC is too passive in its approach to closing the tax gap"[146] by masking its poor performance in *Tackling Tax Evasion and Avoidance*, particularly tax avoidance for which it comes under the greatest criticism.

The division of tax evasion into *evasion* (£5.3bn) and *hidden economy* (£3.2bn) reduces the loss from tax evasion by £3.2bn.

Criminal attacks (£5.4bn) reduces the losses from tax evasion and tax avoidance by £5.4bn.

The division of tax avoidance into *avoidance* (£1.7bn) and *legal interpretation* (£5.3bn) reduces the loss from tax avoidance by £5.3bn. **In other words, it is not the tax gap caused by *legal interpretation* that is a legal nonsense, but the term *legal interpretation*. The tax gap caused by *legal interpretation* (£5.3bn) is part of the**

[146] PAC (2012) 5.

tax gap caused by tax avoidance, but by substituting 'legal interpretation' HMRC reduces the recorded tax gap for tax avoidance by £5.3bn.

Most significantly, HMRC underestimates the loss from tax avoidance and thus the tax gap by the billions of pounds diverted from the public revenue by multinational corporations and avoids the criticism that "HMRC has not been sufficiently challenging of multinationals' manifestly artificial tax structures"[147] by claiming that:

> "Avoidance ... does not include international tax arrangements like base erosion and profit shifting (BEPS), which will be tackled multilaterally through the Organisation for Economic Co-operation and Development (OECD). The OECD defines BEPS as 'tax planning strategies that exploit gaps and mismatches in tax rules to make profits disappear for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid'.[148]"[149]

In fact, the opening paragraph of the Inland Revenue's Statement of Evidence in *Charlton* corresponds to the OECD's definition of BEPS cited by HMRC:

> "The prosecution case is that each of the defendants participated in one or more of a series of similar schemes to cheat the public revenue. The purpose and effect of each scheme was the same. The apparent taxable profits of a United Kingdom business would be reduced below their true level. An untaxed fund would accumulate in an offshore company for the use of the directors/proprietors of the United Kingdom business."[150]

The enormity of the amount of loss from corporate tax avoidance excluded and the absurdity of the £1.7bn figure for tax avoidance are underscored by the statement by HMRC's then Permanent Secretary for Tax in 2011 that:

> "In 2006 HMRC adopted a new approach to reaching tax settlements with large business. ... Settlements of above £1bn are now not uncommon, and £4.5bn has come from just four settlements with bespoke governance."[151]

In administering the tax credits system, HMRC does not make any distinction between fraud and *criminal attacks*, *evasion*, *avoidance* and *legal interpretation*.

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[147] PAC (2013) 5.
[148] OECD*, BEPS - Frequently Asked Questions* (117).
[149] HMRC, p.20.
[150] Masters, pp 388-389.
[151] Syal, 'Revealed: 'Sweetheart' tax deals each worth over £1bn', *The Guardian*, April 29, 2013.

Similarly, cheating the public revenue includes cheating the Department of Works and Pensions, as demonstrated above, but benefits cheats are not divided into evaders and avoiders, and neither the authorities nor the public make room for *legal interpretation*. After all, a typical dispute between a customer and the DWP arises "where the customer's and [the DWP's] interpretation of the law and how it applies to the facts in a particular case, result in a different tax outcome."

IX. THE ANTIDOTE TO TAX AVOIDANCE

IX.I The Cheating or Fraud Approach to Tax Avoidance

The fundamental contribution of this thesis is that judging tax avoidance schemes on the basis of the legal question whether the professional enablers and the participating taxpayers cheated or defrauded the public revenue as a matter of law (hereafter referred to as "the cheating or fraud approach") is the antidote to tax avoidance, tax complexity and tax uncertainty and the recipe for tax justice and tax simplicity in all jurisdictions.

According to Farquharson LJ's seminal statement of the overriding legal and moral duty of honesty imposed by the pre-existing common law of cheating in *Charlton*:

> "It is a feature, no doubt, of the tax or Revenue law of any country that it must, to a large extent, in its tax-gathering activities, rely on the truthfulness of the taxpayer in indicating the extent of his income or whatever other matter is relevant to the particular statute being considered. It follows also that the Revenue not only have to rely on the taxpayer's good faith, but more especially on the professional advisors they appoint to act for them".[152]

The determination of tax avoidance litigation on the basis of the same legal question whether the participating taxpayer, but more especially the professional enablers, cheated or defrauded the public revenue as a matter of law is, therefore, a requirement of "the existing constitutional principle of the rule of law"[153] and tax justice. In the words of "Watchful":

> "This is not quite the paradox it seems if we remember that the Tax Acts are but a part of the general law of the land. Just as, on the one hand, nobody can be taxed otherwise than in accordance with the law, so it can

[152] *Charlton*, p.324.
[153] Section 1 of the Constitutional Reform Act 2005.

and should be insisted that the whole of that law is relevant in any question concerning taxation."[154]

IX.II The Recipe for Tax Avoidance, Tax Complexity, and Tax Uncertainty

The full version of Lord Diplock's theory of retrospective judicial legislation shows clearly that the constructional approach is the recipe for the judge-induced vicious cycle of tax avoidance, tax complexity and tax uncertainty:

> "Whenever the Court decides that kind of dispute it legislates about taxation. It makes a law taxing all gains of the same kind or all documents of the same kind. Do not let us deceive ourselves with the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant. Anyone who has decided tax appeals knows that most of them concern transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all. Some of the transactions are of a kind which had never taken place before the Act was passed: they were devised as a result of it. ...
>
> This should be borne in mind when one complains of the complexity of taxing statutes. They should be drafted so as to leave no room for dispute as to the application to particular transactions. The history of tax legislation is thus the history of an attempt to deal specifically with the liability to tax of every kind of financial transaction which people enter into. And it is a history of failure. ... [I]n the face of human ingenuity in devising new variants of transactions, this aim is impossible of achievement. It is worse. It is self-defeating."[155]

Tax complexity (or "**the history of an attempt to deal specifically with the liability to tax of every kind of financial transaction which people enter into**") results from the fact that anti-avoidance legislation that is not retrospective does not affect **existing tax avoidance schemes** ("**transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all**") but creates loopholes for **new schemes** ("**transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it**"). In the words of the NAO:

> "Introducing narrowly targeted changes to legislation that stop particular schemes is not always effective and has disadvantages, such as increasing the length and complexity of tax law. They can also open new opportunities for avoidance." [156]

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[154] 'Common Law Prosecutions for Revenue Fraud' [1956] *BTR* 119, p.119.
[155] Diplock, pp.6-8. Emphases supplied.
[156] NAO, pp.20-23.

In *Plummer*[157], Viscount Dilhorne described Rossminster's Capital Income Plan masterminded by Roy Tucker as "an ingenious, complicated and well thought out scheme ... to avoid the payment of tax by those who participated and to raid the Treasury using the technicalities of revenue law as the necessary weapon."[158] According to an associate:

> "Roy could take a piece of legislation and come up with a tax-avoidance idea in ten minutes".[159]

The House of Lords held that the scheme "worked" by a majority (Viscount Dilhorne and Lord Diplock dissenting). Lord Wilberforce concluded:

> "One final point: the familiar argument was used that Parliament can never have intended to exempt from the taxing provisions an arrangement solely designed to obtain fiscal advantages. But this is not the question, nor is a canon of interpretation of this kind admissible - or indeed a workable canon. The question is whether a certain series of transactions in a certain legal form do or do not fall within the taxing words. If they do not, and if Parliament dislikes the consequence, it can change the law - as in fact it has done since the scheme in question was operated. The subject is entitled to be judged under the law as it stood at the relevant time."[160]

"The subject is entitled to be judged under the law as it stood at the relevant time" but *the law* includes both the tax Act which the tax avoidance scheme was devised to cheat and the pre-existing common law that prohibits the cheating.

In an interview published by the *Financial Times* on 9 October 1979 (following the hearing of *Plummer* by the House of Lords in June but before the delivery of the judgment in November 1979) Tucker demonstrated how the notion that "if Parliament dislikes the consequence, it can change the law" sends Parliament and the Revenue on a fool's errand in the context of "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it":

> "After working out the avoidance objective the Revenue was trying to ban, you start thinking of other ways of reaching the same result."[161]

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[157] [1979] STC 793.
[158] 54 TC 1, 44.
[159] Gillard, p.59, citing Richard Gardner.
[160] *Plummer*, pp.38-44.
[161] *Financial Times*, 9 October 1979.

Writing in 2012, Roy Lyness (who masterminded the 'K2' scheme used by the comedian Jimmy Carr and others) provided this up-to-date analogy:

> "It's a game of cat and mouse. The Revenue closes one scheme, we find another way round it. It's like a sat-nav. I'm driving to Manchester, get a message saying there's a smash at Stoke, press this button to re-route. That's all we do with tax avoidance. The Revenue puts a block in, we just go round the block."[162]

Tax uncertainty or **retrospective judicial legislation** ("[**w**]**henever the Court decides that kind of dispute it legislates about taxation**") results from the application of "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant" to "transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all" and "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it." According to Lord Diplock:

> "In 1891 Parliament passed the Stamp Act providing for the imposition of ad valorem stamp duty upon various classes of documents. Written agreements for the sale of simple contract debts owed by debtors outside the United Kingdom made between 1901 and 1931 were liable to ad valorem stamp duty. That was because in a case decided in 1901 the Court of Appeal interpreted the relevant words of the Stamp Act 1891 in one way. Its judgment stood until 1931 when it was overruled by the House of Lords, who interpreted the same words in the opposite sense. The effect was the same as if a section had been inserted in the Finance Act 1901 imposing ad valorem stamp duty on this kind of document, and a section inserted in the Finance Act 1931 repealing it. ...
>
> I do not suggest that the Courts provide a suitable source of legislation in this field. Not only for the conventional reason that taxation is the responsibility of an elected legislature but also for the reason that a taxing statute in particular should not be retrospective. People should be able to arrange their affairs with knowledge of what their resulting liability to tax will be. But because the Courts in legal theory are merely expounding the meaning of words used by Parliament when the tax Act was passed, even though the exposition as in the example I have given comes forty years later, the only law the court can make is retrospective law."[163]

The constructional approach has resulted in landmark volte-face by the highest court in the land. In *FA & AB Ltd v Lupton*[164] the House of Lords effectively overruled its

[162] Mostrous (2012).
[163] Diplock, p.8.
[164] [1972] AC 634.

decision on similar facts ten years earlier in *Griffiths v J P Harrison*.[165] According to Monroe's graphic account:

> "In February and March 1962 the case of *Harrison* v *Griffiths* came before the House of Lords. The taxpayer company purchased shares pregnant with dividend. It extracted or 'stripped' the dividend. It sold the shares at a loss. It claimed relief for this 'trading' loss against the tax notionally deducted from the dividend. If the purchase of the shares, the stripping of the dividend and the sale of the shares constituted either a transaction carried out in the course of a share dealing trade or of itself was an adventure in the nature of trade, the claim for loss relief must succeed. It was the task of the Special Commissioners before whom the appeal came to decide the facts. They did. They found that the taxpayer company's transaction in the shares (the purchase and sale and the intermediate stripping of the dividend) was not entered into as part of any trade of dealing in shares and was not an adventure in the nature of trade. ... A minority of the judges before whom the subsequent three appeals came took that view; but a majority, including the critical majority of three to two in the House of Lords, took the view that the true and only reasonable conclusion contradicted the determination of the Special Commissioners. The shares were purchased to be sold. That was a trade. That was that.
>
> Nine years later the case of *FA & AB* came to the House of Lords. In the intervening years Parliament had been busy blocking loopholes as new and ever more dazzling tricks were displayed on the high wire of dividend stripping. The statutory provisions, however, made no difference to the *FA & AB* case. On somewhat similar facts to the *Harrison* case the House of Lords decided the case the other way. Two of the five Law Lords distinguished the facts from the facts in the earlier case; two thought the earlier decision wrong; one reassessed the earlier decision. All five considered the relevant transaction not to be share-dealing within the trade of dealing in shares. ... The Special Commissioners were, of course, wrong once again. They had followed in the second case the decision of the House of Lords in the first case."[166]

In 1980 in *Vestey v IRC*[167] the House of Lords suspended its pretension to infallibility and explicitly overruled its 1948 decision in *Congreve v IRC*[168], which had in the meantime been followed by the Court of Appeal in *R v Bambridge*[169] and expressly approved by the 1955 Royal Commission on the Taxation of Profits and Income.

To invent the *Ramsay* principle, Lords Wilberforce, Fraser, Russell, Roskill and Bridge effectively overruled the decision by Lords Wilberforce, Fraser, Keith and Dilhorne (Lord Diplock dissenting) in *Plummer* fifteen months earlier. As Lord Oliver put it:

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[165] [1962] 1 All ER 909.
[166] Monroe, pp.74-75.
[167] [1977] STC 414.
[168] [1948] 1 All E.R. 948.
[169] 36 TC 313.

> "What is interesting about this case is how the House continued nevertheless to pay lip-service to the *Westminster* decision (described as embodying a 'cardinal principle') and slid quietly over the inconveniently inconsistent case of *Plummer* by distinguishing it on the somewhat specious ground that in that case the taxpayer had actually paid out some money (although he got it back immediately)."[170]

In the more recent decision of the Supreme Court in *Tower MCashback v HMRC* Lord Walker sought to pre-empt justified criticisms of uncertainty thus:

> "If a majority of the court agrees with my conclusion, it is to be expected that commentators will complain that this court has abandoned the clarity of *BMBF* and returned to the uncertainty of *Ensign*. I would disagree. Both are decisions of the House of Lords and both are good law. The composite transactions in this case, like that in *Ensign* (and unlike that in *BMBF*) did not, on a realistic appraisal of the facts, meet the test laid down by the CAA, which requires real expenditure for the real purpose of acquiring plant for use in a trade. Any uncertainty that there may be will arise from the unremitting ingenuity of tax consultants and investment bankers determined to test the limits of the capital allowances legislation."[171]

IX.III The Antidote to Tax Avoidance, Tax Complexity, and Tax Uncertainty

The pre-existing common law of cheating the public revenue, which corresponds to tax fraud in all jurisdictions, is the antidote to tax avoidance ("transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it"), tax complexity ("the history of an attempt to deal specifically with the liability to tax of every kind of financial transaction which people enter into") and tax uncertainty ("[w]henever the Court decides that kind of dispute it legislates about taxation").

As demonstrated above, the development of the *Ramsay* principle under the defective tax appeal system was an inchoate judicial recognition of cheating as the antidote to tax avoidance. As Avery Jones put it in his exposition of "the judge induced disease of 'tax avoidance'"[172]:

> "[T]he turning-point in tax cases was caused by the realisation by the judges that the narrow semantic approach led inevitably to tax avoidance. The courts were faced with lots of cases about tax avoidance schemes, which they alone had caused. ... The only way out of hearing an eternal

[170] Lord Oliver, p.179.
[171] [2011] UKSC 19 [80].
[172] Avey Jones.

> diet of artificial tax avoidance cases was for the judiciary to invent a principle, a principle so strong that it could overrule a previous House of Lords decision on the same facts. *Ramsay* and then *Furniss v Dawson*, by applying an extraneous principle to the interpretation of tax legislation, came as something of a shock."[173]

As if to disguise the fraudulent nature of tax avoidance and protect the tax avoidance industry, however, their lordships denied that they were "applying an extraneous principle to the interpretation of tax legislation." As Lord Hoffmann admitted after the decision in *MacNiven v Westmoreland*:

> "In choosing the constructional approach rather than the *Furniss v Dawson* formula, the House had to rewrite history in a way which struck some people as a little disingenuous. We said that the formula was not a freestanding principle but rather the effect of construing a taxing provision in a particular way."[174]

The development of the *Ramsay* principle was indeed a recognition of the pre-existing common law of cheating, which "acts upon the offence, by setting aside the fraudulent transaction"[175] in civil proceedings, as what Lord Hoffmann described severally in *MacNiven* as "an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision"[176], "some paramount provision subject to which everything else must be read"[177] and thus "a broad spectrum antibiotic which killed off all tax avoidance schemes, whatever the tax and whatever the relevant statutory provisions."[178]

Contrary to his claim that "the courts have no constitutional authority to impose such an overlay upon the tax legislation and ... have not attempted to do so"[179], that was precisely what the Barons of the Exchequer did in 1584 in ***Heydon's Case***[180] when they developed the mischief rule, which "marks the first and indeed only attempt by the judges fully to rationalise that important part of their function which concerns statutory

[173] Ibid, citing *Moodie* [1993] STC 188 as it affects *Plummer* [1979] STC 793.
[174] 'Tax avoidance' [2005] *B.T.R.* 197, 202.
[175] Blackstone, p.89.
[176] [2001] UKHL 6 at [29].
[177] Ibid.
[178] Ibid [49].
[179] [2001] UKHL 6 at [29].
[180] (1584) 3 Coke 7a.

interpretation"[181] and which "embodies the necessary legal policy of any democratic state."[182] According to Simpson's rebuttal of "that apologist denial"[183]:

> "The first indication that it is wrong comes from Lord Hoffmann's parallel insistence that the *Ramsay* principle is a principle of construction. Principles of construction *are* judicial overlays onto the legislation, operating across the board rather than in the circumstances of particular statutory words; and they tend accordingly to have constitutional significance. ... It is only because the need for them often arises in the context of statutory interpretation that they have so readily been disguised as involving no more than the identification of the (implied) intention of Parliament. ...
>
> But the real question to be addressed here is whether the development of the *Ramsay* principle could be better understood precisely as a fundamental, judge-made 'overlay' upon the statutory rules, and whether it can be found to be acceptable as such. If it can, then it will be a seminal indication of the pre-existing, constitutional common law of taxation, and may hold the key for the improvement of our anti-avoidance techniques in general, and perhaps even for a better understanding of the constitutional niceties of our tax system as a whole."[184]

This thesis develops the inchoate *Ramsay* principle to remedy the defect in the tax appeal system by extending the pre-existing common law of cheating, which is "the pre-existing, constitutional common law of taxation" and which Lord Mansfield described in his seminal exposition in *R v Bembridge* as "so essential to the existence of the country and the constitution, that ... the constitution would not exist without it"[185], to the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in order to unite the criminal and civil law and to give effect to the rule of law and tax justice.

If by devising or marketing or implementing or otherwise facilitating the use of a tax avoidance scheme the professional enablers cheated the public revenue as a matter of law, the participating taxpayer cannot recover any tax advantage from it in law, and any appeal against the Revenue's decision disallowing the tax advantage should be defeated by "the principle that the courts would not lend their assistance to the achievement of an unlawful purpose."[186]

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[181] Bennion, p.918.
[182] Ibid, p.1009.
[183] 'The Ramsay principle: a curious incident of judicial reticence?' [2004] *B.T.R.* 358, 359.
[184] Ibid.
[185] (1783) 22 State Tr. 1, 155.
[186] Lord Hoffmann, *Norglen v Reeds* [1999] 2 AC 1, 13.

Where the participating taxpayer is complicit in the cheating, as well as advancing this defence, the Revenue should also plead that in consequence he cannot recover any tax advantage in law because of "the principle that nobody may benefit from his own civil *or* criminal wrong."[187]

Furthermore, the corollary of the cardinal principle that "fraud unravels all" (or, if one likes, "cheating changes everything") is that a tax avoidance scheme, which amounts to cheating the public revenue or tax fraud under the pre-existing general law, is unravelled *in toto* and thus outside the scope of the terms of the tax Act it was devised to cheat or defraud *ab initio*. This means that no question of statutory construction should arise in any case of tax avoidance scheme.

The constructional approach is the recipe for tax avoidance, tax complexity and tax uncertainty as demonstrated above because it subverts these principles.

In his famous statement in *Latilla*, which involved the schemes devised to transfer assets abroad, Viscount Simon acknowledged that tax avoidance cheats the public revenue but maintained the fallacy that tax cheats "are within their legal rights" by relying on the constructional approach:

> "[O]f recent years much ingenuity has been expended in certain quarters in attempting to devise methods of disposition of income by which those who were prepared to adopt them might enjoy the benefits of residence in this country while receiving the equivalent of such income without sharing in the appropriate burden of British taxation. Judicial dicta may be cited which point out that, however elaborate and artificial such methods may be, those who adopt them are 'entitled' to do so. There is, of course, no doubt that they are within their legal rights, but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship. On the contrary, one 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. Another consequence is that the legislature has made amendments to our income tax code which aim at nullifying the effectiveness of such schemes. The question in the present appeal is whether s.18 of the Finance Act, 1936, has the result of checkmating the design of avoiding income tax and sur-tax which was the main purpose of certain highly artificial dispositions made in 1933."[188]

[187] Lord Steyn, *R v Hinks* [2001] 2 A.C. 241, 252.
[188] *Latilla*, p.382.

"Judicial dicta ... cited which point out that, however elaborate and artificial such methods may be, those who adopt them are 'entitled' to do so", invariably focus on the participating taxpayers. If the professional enablers that "devise methods ... by which those who were prepared to adopt them might enjoy the benefits of residence in this country ... without sharing in the appropriate burden of British taxation" cheat the public revenue in law and "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" in fact, however, "the principle that the courts would not lend their assistance to the achievement of an unlawful purpose" means that "those who adopt them are [not] 'entitled' to do so" and "are [not] within their legal rights". Where "those who adopt them" are complicit in the cheating "the principle that nobody may benefit from his own civil *or* criminal wrong" will apply in addition.

There is, therefore, no need for the *complexity* resulting from "amendments to our income tax code which aim at nullifying the effectiveness of such schemes" and the *uncertainty* resulting from "[t]he question ... whether s. 18 of the Finance Act, 1936, has the result of checkmating the design of avoiding income tax and sur-tax", which the House of Lords answered in the affirmative in 1943 in *Latilla* and in 1948 in *Congreve v IRC*[189], but in the negative in 1980 in *Vestey v IRC*[190] when they overruled *Congreve* which had been followed by the Court of Appeal in *Bambridge v IRC*[191] and approved by the 1955 Royal Commission on the Taxation of Profits and Income.

Despite its correct diagnosis, the 1955 Royal Commission followed the prevailing approach in its prognosis and thus fell into the same error:

> "Avoidance of tax is a problem that faces every tax system and is likely to continue to do so when rates are high and the burden of tax is seen to have a major influence upon the affairs of business and upon every aspect of social and personal life. Not all systems attempt to solve the problem in the same way, nor is there necessarily any large measure of agreement as to what is involved in the idea of tax avoidance. But until some certainty is reached upon this question of definition, the question as to what sort of steps should be taken to prevent or correct it remains an aimless one. We propose therefore to begin by discussing the meaning of tax avoidance in so far as the phrase is used to denote something which a tax system should be concerned to control.
>
> It is usual to draw a distinction between tax avoidance and tax evasion. The latter denotes all those activities which are responsible for a person not

[189] [1948] 1 All E.R. 948.
[190] [1977] STC 414.
[191] 36 TC 313.

> paying the tax that the existing law charges upon his income. *Ex hypothesi* he is in the wrong, though his wrong-doing may range from the making of a deliberately fraudulent return to a mere failure to make his return or to pay his tax at the proper time. By tax avoidance, on the other hand, is understood some act by which a person so arranges his affairs that he is liable to pay less tax than he would have paid but for the arrangement. Thus the situation which he brings about is one in which he is legally in the right, except so far as some special rule may be introduced that puts him in the wrong.
>
> The treatment of tax avoidance in the United Kingdom would present much less difficulty if it were possible to assert as a matter of general principle that a man owes a duty not to alter the disposition of his affairs so as to reduce his existing liability to tax or, alternatively, for the purpose or for the main purpose or partly for the purpose of bringing this result about. But there is no such principle, and we are satisfied that it neither could nor ought to be introduced."[192]

Tax evasion, which "denotes all those activities which are responsible for a person not paying the tax that the existing law charges upon his income ... from the making of a deliberately fraudulent return to a mere failure to make his return or to pay his tax at the proper time", **is cheating by a taxpayer who deliberately fails to make a return of the relevant tax liability or deliberately makes a false return of the relevant tax liability without using a tax scheme**.

Tax avoidance, which "denotes all those activities which are responsible for a person not paying the tax that the existing law charges upon his income" on the ground that a scheme devised, marketed, implemented and otherwise facilitated by the professional enablers has extinguished it, **is cheating by the professional enablers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using a particular scheme may or may not be complicit**. *Ex hypothesi* the professional enablers are in the wrong, and "the principle that the courts would not lend their assistance to the achievement of an unlawful purpose" means that the participating taxpayer cannot claim any advantage from the scheme. Where the participating taxpayer is complicit "the principle that nobody may benefit from his own civil *or* criminal wrong" applies in addition. There is, therefore, no need for the tax complexity and tax uncertainty resulting from the question whether "some special rule may be introduced that puts him in the wrong."

[192] Royal Commission, p.304.

"The treatment of tax avoidance in the United Kingdom [and in all jurisdictions] would present much less difficulty", therefore, if tax avoidance schemes were judged by the civil courts and the Revenue authorities on the basis of the legal question whether the professional enablers and the participating taxpayers cheated or defrauded the public revenue as a matter of law. In the words of Walton J in *Vestey*:

> "I conceive it to be in the national interest, in the interest not only of all individual taxpayers, which includes most of the nation, but also in the interests of the Revenue authorities themselves, that the tax system should be fair. ... One should be taxed by law, and not be untaxed by concession. ... A tax system which enshrines obvious injustices is brought into disrepute with all taxpayers accordingly, whereas one in which injustices, when discovered, are put right (and with retrospective effect when necessary) will command respect and support."[193]

IX.IV. The Recipe for Tax Justice

Tax justice is referred frequently in cases but without definition. In *Arsenal Football Club v Ende* Lord Wilberforce stated that:

> "To produce a sense of justice is an important objective of taxation policy".[194]

Tax justice can be defined as the intersection or coincidence of law and morality in the overriding legal and moral duty of honesty imposed by the pre-existing common law of cheating.

In his article 'Positivism and the Separation of Law and Morals', Hart stated that leading Positivists, whose insistence on a clear distinction between law as it is and law as it ought to be is usually described as "the separation of law and morals", recognised this concept:

> "They certainly accepted many of the things that might be called 'the intersection of law and morals.' First, they never denied that, as a matter of historical fact, the development of legal systems had been powerfully influenced by moral opinion, and, conversely, that moral standards had been profoundly influenced by law, so that the content of many legal rules mirrored moral rules or principles. ... Secondly, neither Bentham nor his followers denied that by explicit legal provisions moral principles might at different points be brought into a legal system and form part of its rules, or

[193] [1977] STC 414, 439.
[194] [1977] 2 All ER 267, 272.

> that courts might be legally bound to decide in accordance with what they thought just or best."[195]

Farquharson LJ's statement in *Charlton* shows that the enactment of a Tax Act by Parliament means that "by explicit legal provisions moral principles ["the truthfulness of the taxpayer ... but more especially ... the professional advisers they appoint to act for them"] are brought into a legal system and form part of its rules". The rule of law and Parliamentary sovereignty, therefore, mean that the "courts are ... legally bound to decide in accordance with" the overriding duty of honesty imposed by the pre-existing common law of cheating.

The false law-and-morality dichotomy and the false rule of law argument used to justify tax avoidance rest upon the failure to "remember that the Tax Acts are but a part of the general law of the land."[196] According to Freedman:

> "The attitude of the judges to the correct development of the case law does not, of course, address the question of whether there is a morality against which taxpayers and their advisers should not offend, regardless of what the legislation or case law states. Recent comments from the tax collection agencies in the UK and elsewhere, from politicians and the media all suggest that there is some kind of overriding moral duty to pay the 'right' or 'fair' amount of tax and to exercise self-restraint which goes beyond complying with the law. ...
>
> A rather more sensible response to the morality card, however, is that taxpayers have a guiding principle that they need only pay what has been determined by Parliament through legislation and that, under the *Duke of Westminster's* case, they may arrange their affairs in such a way as to pay the lowest amount of tax possible, provided they are within the law. By definition, the law does not extend to a moral code not embodied in legislation or case law. This attitude is deeply embedded in our history and politics, and in our law. According to this account, calls on morality, where the law proves inadequate to achieve what government intends, are unreasonable, unfair and incomprehensible since taxpayers are entitled to be able to rely on the law as it is written."[197]

As *Charlton* demonstrates, "taxpayers are entitled to be able to rely on the law as it is written" but the law includes the pre-existing common law of cheating, which is "a moral code ... embodied in legislation [and] case law", and which provides "a morality against which taxpayers and their advisers should not offend". The "overriding moral duty to pay the 'right' or 'fair' amount of tax" does not, therefore, require taxpayers and

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[195] 'Positivism and the Separation of Law and Morals' (1958) 71 *Harv LR* 593, 598.
[196] 'Watchful'.
[197] Freedman [2004] 336-338.

professional advisers "to exercise self-restraint which goes beyond complying with the law."

Indeed, Honoré, who Freedman relied on, used the legal and moral obligation to pay tax to illustrate his theory of 'The Dependence of Morality on Law':

> "According to most people's moral outlook members of a community should make a contribution to the expense of meeting collective needs. A morality which denied this would hardly count as co-operative. In a monetary economy the contribution has to be mainly in money, and takes the form of paying taxes. So members of a community have in principle a moral obligation to pay taxes. But this obligation is incomplete or, if one prefers, inchoate, apart from law. It has no real content until the amount or rate of tax is fixed by an institutional decision, by law."[198]

The "amount or rate of tax" fixed by an Act of Parliament is safeguarded by the pre-existing common law of cheating the public revenue, which imposes the overriding legal and moral duty of honesty on taxpayers and professional advisers. The proposed cheating or fraud approach unites the legal and moral duties to contribute to the public revenue honestly. In the words of the Law Commission:

> "Dishonesty necessitates a moral as well as a factual enquiry."[199]

IX.V. The Recipe for Tax Simplicity

The overriding legal and moral duty of honesty also unites the law with common sense and fairness. In *Bradbury and Edlin*, where the taxpayer challenged his conviction for cheating, Bray J stated:

> "It is said that that is not an offence known to the law, that it is not within the common law of England. It certainly struck me, when the argument was made, that if it was not an offence it was quite time it was made an offence. But the common law of England is based on common sense, and it seems to me to be eminently in accord with common sense that when a person commits an offence of this kind, and makes a false statement with a view to prejudicing His Majesty's revenue, it ought to be punishable."[200]

[198] (1993) 13 *OJLS* 1, 5.
[199] (2002) 39.
[200] [1956] 2 Q.B. 262, 263.

By contrast, under the constructional approach to tax avoidance litigation in *Mayes v HMRC*, Proudman J, with whom the Court of Appeal agreed, upheld the "SHIPS 2" scheme, stating:

> "I sympathise with the instinctive reaction that such an obvious scheme ought not to succeed. However I cannot extract from the legislation any underlying or overriding purpose enabling me to conclude that parts of the scheme may be ignored. To do so would ... revert to an acceptance of the type of submission that was roundly rejected in *MacNiven.* I am bound by the ratio of the decision in *MacNiven* and in my judgment it points only one way on the facts of this case."[201]

The layman's "instinctive reaction that such an obvious scheme ought not to succeed" is superior in law and fact to "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant" because it corresponds to the overriding common law duty of honesty imposed by cheating. In the words of the Criminal Law Revision Committee (CLRC):

> "Dishonesty is something which laymen can easily recognise when they see it".[202]

X. CHAPTERS OUTLINE

The rest of this thesis, which is divided into three parts, comprises eleven chapters and a conclusion. Each is a polemic against the tax dogma.

The first part deals with tax avoidance and tax evasion and expounds the overarching thesis.

Chapter one proves that tax avoidance and tax evasion constitute the common law offence of cheating the public revenue, which corresponds to tax fraud in both the criminal and civil law in all jurisdictions. It also underscores the fundamental principle, which is critical to understanding the fraudulent nature of a tax avoidance scheme, that cheating and fraud under the common law and fraud under the Fraud Act are 'conduct' offences committed by prejudicing another person's proprietary interest rather than 'result' offences that require proof of actual loss, because they all boil down to dishonesty.

[201] [2010] STC 1 [45].
[202] The Criminal Law Revision Committee, eighth report, para 39.

Chapter two demonstrates the inherently fraudulent nature of a tax avoidance scheme in criminal and civil law. It shows that the corollary of the fundamental principle that cheating and fraud under the common law and fraud under the Fraud Act are 'conduct' offences committed by "deliberate dishonesty to the prejudice of another person's proprietary right"[203] is that any professional adviser involved in *devising* a tax avoidance scheme cheats the public revenue or "prejudice[s], or take[s] the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so" in the words of Hardy J's classic definition. A tax avoidance scheme is, therefore, a fraud and a cheat by design as a matter of law regardless of whether it "works" as a matter of statutory construction under "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant."

Chapter three uses the roles of lawyers in blessing tax schemes, concealing tax schemes, subverting anti-avoidance doctrines and defending tax schemes in litigation to underscore the inherently fraudulent nature of a tax avoidance scheme and the inherently fraudulent nature of the conduct of the lawyers involved in devising, marketing, implementing and otherwise facilitating its use. It concludes that the fraudulent nature of a tax avoidance scheme invokes the principle that where confidential communication between a lawyer and client is for the purpose of obtaining legal advice as to how to commit a fraud or an illegality or an iniquity it is not privileged, which means that a taxpayer involved in a tax scheme is not entitled to legal professional privilege.

Chapter four unravels the reliance of the dogma "tax evasion is illegal but tax avoidance is legal" on the equation of 'tax evasion' to tax fraud and the equation of both to cheating the public revenue by fraudulent concealment. It shows that the corollary of the proposition that a tax avoidance scheme is a cheat and a fraud by design established in chapter two is that the fraudulent nature of tax avoidance does not depend on any subsequent concealment by the enabling professional advisers or by the participating taxpayer.

Chapter five uses a historical analysis of the Revenue's "highly selective" prosecution policy to demonstrate that the dogma "tax avoidance is legal and tax evasion is illegal" rests for its support upon a fundamental misunderstanding of the fact in all cases of tax

[203] James J, *R v Sinclair* [1968] 1 W.L.R. 1246, 1250.

fraud "it is entirely within the discretion of the tax authorities whether they take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-fraud penalties or simply establishing tax liability without fines or penalties".[204]

Chapter six similarly uses HMRC's recent sweetheart tax deals, including the offshore tax evasion settlement with HSBC and the offshore tax avoidance settlements with Vodafone and Google, to demonstrate that the dogma "tax avoidance is legal and tax evasion is illegal" involves a misconception of the fact that in all cases of tax fraud "it is entirely within the discretion of the tax authorities whether they take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-fraud penalties or simply establishing tax liability without fines or penalties".

The third part concentrates on tax avoidance and expounds the fundamental contribution.

Chapter seven demonstrates that the proposed cheating or fraud approach to tax avoidance will give effect to the principle of the equality of taxation expounded by Adam Smith and shows that the prevailing constructional approach enforces what he described as the inequality of taxation by explaining the latter's manifestations in the perverse 'certainty' argument, the objections to retrospective anti-avoidance legislation and the fallacy of profit maximisation.

Chapter eight proposes and expounds the concept of 'the primacy of the public revenue law'. It demonstrates that it corresponds to cheating the public revenue and thus underpins the proposed cheating or fraud approach to tax avoidance. By contrast, it critiques 'the primacy of the private law' that underlies the prevailing constructional approach using the English *Snook* sham doctrine, the *Duke of Westminster* principle, the *Ramsay* principle, and the American private law sham doctrine and tax sham transaction doctrine.

Chapter nine demonstrates that the mischief rule provides original authoritative judicial support for the proposed cheating or fraud approach to tax avoidance. It shows that its development by the Barons of the Exchequer in *Heydon's Case*[205] is a seminal recognition of the pre-existing common law of cheating or fraud, which "acts upon the

[204] Wisselink, p.203.
[205] (1584) 3 Coke 7a.

offence, by setting aside the fraudulent transaction"[206] in civil proceedings, as what Lord Hoffmann described variously in *MacNiven* as "an overlay upon the tax legislation"[207], "an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision"[208], "some paramount provision subject to which everything else must be read"[209] and thus "a broad spectrum antibiotic which killed off all tax avoidance schemes, whatever the tax and whatever the relevant statutory provisions."[210]

Chapter ten similarly demonstrates that the *Ramsay* principle provides a modern authoritative judicial support for the proposed cheating or fraud approach to tax avoidance. It shows that its development by the House of Lords is a seminal reaffirmation of the pre-existing common law of cheating or fraud as "an overlay upon the tax legislation", "an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision", "some paramount provision subject to which everything else must be read" and thus "a broad spectrum antibiotic which killed off all tax avoidance schemes, whatever the tax and whatever the relevant statutory provisions."

Chapter eleven expounds the origins and developments of the concepts of tax evasion, tax avoidance and tax mitigation and uses the landmark cases analysed in chapters nine and ten to demonstrate that "the elusive concept of 'tax avoidance'"[211] was invented by the legal and tax professions to disguise the fraudulent nature of "the judge induced disease of 'tax avoidance'"[212] and thus serves to legitimise the resultant fraudulent multi-billion pound tax avoidance industry.

The **Conclusion** highlights the fact that the existing body of knowledge in both domestic and international law continues to rest upon the dogma that "tax avoidance is legal and tax evasion is illegal"; reaffirms the overarching thesis that both tax avoidance and tax evasion amount to cheating the public revenue in law; and explains the main corollaries of the fraudulent and criminal nature of tax avoidance, namely: the

[206] Blackstone, p.89.
[207] [2001] UKHL 6 at [29].
[208] Ibid.
[209] Ibid.
[210] Ibid [49].
[211] Nolan, *Willoughby*, p.1003.
[212] Avery Jones.

proposed new approach to tax avoidance, defamation and malicious falsehood, confidentiality and whistleblowing, and money laundering.

The thesis also includes five appendices. Appendix 1 is the Information in the KPMG tax avoidance case of *USA v KPMG LLP*, which fortifies the proposed definition of tax avoidance. Appendix 2 is the Information in the HSBC tax evasion case of *USA v Sanjay Sethi*, which fortifies the proposed definition of tax evasion. Appendix 3 is the marketing letter in *Ramsay*, which illuminates the fraudulent nature of a tax avoidance scheme. Appendix 4 is the concealment letter in *KPMG*, which also elucidates the fraudulent nature of tax avoidance. Appendix 5 is HMRC's Written Evidence to the PAC concerning the Google settlement, which also elucidates the fraudulent nature of tax avoidance. Appendix 6 is the letter by Chancellor George Osborne to Chairman Ben Bernanke on behalf of HSBC.

XI. TIME LIMIT

The contents of the thesis are based on materials available up to 1 March, 2019.

PART TWO

THE MEANING OF TAX AVOIDANCE AND TAX EVASION IN LAW

CHAPTER ONE

THE NATURE AND MEANING OF TAX AVOIDANCE AND TAX EVASION IN CRMINAL AND CIVIL LAW

> **The next direction I have to give you is what in law is cheating the Public Revenue. To cheat, members of the jury, is defined by the concise Oxford Dictionary as: 'To deceive, or trick, a person into or out of a thing.' The common law offence of cheating the Public Revenue does not necessarily require a false representation either by words or conduct. Cheating can include any form of fraudulent conduct which results in diverting money from the Revenue and in depriving the Revenue of the money to which it is entitled. It has, of course, to be fraudulent conduct. That is to say, deliberate, dishonest conduct by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so.**
>
> Mr Justice Hardy, *R v Stephen Less, The Times,* March 30, 1993.

1.1. INTRODUCTION

This chapter develops the overarching thesis that tax avoidance and tax evasion amount to the common law offence of cheating the public revenue, which corresponds to tax fraud in both the criminal and civil law in all jurisdictions.

Justice Hardy's classic definition in his summing up approved by the Court of Appeal in *Less* shows that the ambit of the common law offence is wider than the civil law and dictionary meanings of cheating and fraud and thus covers every case of tax avoidance and tax evasion.

As a 'conduct' (as opposed to 'result') crime, "diverting money from the Revenue" or "depriving the Revenue of the money to which it is entitled" is not a requirement as Hardy J implied. In *R v Hunt*, where the Court of Appeal rejected the appellant's contention "that the offence of cheating at common law is a 'result' crime and ... not indictable unless the resultant loss is alleged and proved"[213], Stuart-Smith LJ noted that:

> "The last sentence makes it plain that the actual result of the loss does not need to be proved."[214]

The rest of this chapter expounds the common law offences of cheating the public revenue, conspiracy to defraud and fraud, the Fraud Act 2006, and statutes against tax frauds including the GAAR; and explains the procedural distinction between the

[213] [1994] STC 819, 826.
[214] Ibid, p.827.

criminal and civil law. It then uses cheating to expound tax avoidance and tax evasion; and uses conspiracy to defraud to expound marketed tax avoidance and offshore tax evasion.

1.2. CHEATING THE PUBLIC REVENUE

1.2.1. Common Cheat

The right of the Revenue, like any other party, to bring a civil action for cheating has never been disturbed by the courts or by Parliament. All the judicial and legislative developments regarding cheating the public revenue have been concerned with when it would amount, in addition, to a criminal offence.

According to the classic definition of the original common law offence of cheating or "common cheat" by Hawkins:

> "Cheats punishable by public prosecution ... at common law, may in general be described to be deceitful practices, in defrauding or endeavouring to defraud another of his known right by means of *some artful device*, contrary to the plain rules of common honesty. ...
>
> The deceitful receiving of money from one man to another's use, upon a false pretence of having a message and order to that purpose, is not punishable by a criminal prosecution, because it is accompanied with no manner of artful contrivance, but wholly depends on *a bare naked lie;* and it is said to be needless to provide severe laws for such mischiefs, against which the common prudence and caution may be a sufficient security."[215]

Lord Templeman's classic statements in *Challenge* show that actionable cheating "accompanied with no manner of artful contrivance, but wholly depends on *a bare naked lie"* corresponds to tax evasion while indictable cheating "by means of *some artful device*, contrary to the plain rules of common honesty" corresponds to tax avoidance:

> "Evasion occurs when the commissioner is not informed of all the facts relevant to an assessment of tax. ...
>
> In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure

[215] *Pleas of the Crown*, (London: Sweet & Maxwell, 1824) p.318.

> which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax."[216]

East similarly wrote that cheating "by means of *some artful device*" such as by using false weights or measures was indictable because by such 'false tokens' "the public in general may be imposed upon without any imputation of folly or negligence."[217]

In *R* v *Jones*, therefore, A was indicted for obtaining £20 from B by falsely pretending that he had been sent by C to get £20 for his use. Holt C.J. acquitted him, stating:

> "It is no crime unless he came with false tokens. Shall we indict one man for making a fool of another? Let him bring his action."[218]

1.2.2. Cheating the Crown and the Public

Hawkins wrote that "all frauds affecting the crown and public at large are indictable as cheats at common law."[219] East also stated that:

> "All frauds affecting the crown and public at large are indictable, though arising out of a particular transaction or contract with the party."[220]

Lord Mansfield's seminal exposition in *R v Bembridge*[221] specifically reaffirmed the Revenue's right to bring a civil action. *Bembridge* involved what would be described today as a 'sweetheart tax deal'. As Goddard CJ explained in *Hudson*:

> "The matter came before the Court of King's Bench in *Rex v Bembridge* in 1783, when a public officer, one Charles Bembridge, was indicted for a fraud on the Crown because he had knowingly and wrongly certified the amount due from the late Paymaster-General, Lord Holland, to the Crown. It does not appear that he had gained anything from it, but he did it and did it fraudulently, as the jury found."[222]

The basis of Bembridge's appeal was that the Crown's remedy was limited to a civil action. As Lord Mansfield put it, "the objection then is, that at most this amounts to a breach of trust, a concealment, a fraud of a pecuniary nature, which is a civil injury, and

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[216] *Challenge*, pp.554-555.
[217] *Pleas of the Crown* (London: J. Butterworth, 1803) p.820.
[218] (1703) 92 ER 174.
[219] Hawkins.
[220] *Treatise of the Pleas of the Crown* (London: J. Butterworth, 1803) Vol. II, p.820.
[221] (1783) 22 State Tr. 1.
[222] [1956] 2 Q.B. 252, 259-260.

therefore not indictable; that he is accountable, - an agent, a trustee that embezzles money, or by neglect suffers it to be lost, is accountable, - for a civil injury, and not for a public offence".[223]

Lord Mansfield rejected the appeal, and affirmed the conviction on the grounds of misconduct in a public office and cheating the public revenue respectively:

> "Now, there are two principles which seem to me clearly applicable to this prosecution; the first I will venture to lay down is, that if a man accepts an office of trust and confidence, concerning the public, especially when it is attended with profit, he is answerable to the king for his execution of that office; and he can only answer to the king in a criminal prosecution, for the king cannot otherwise punish his behaviour, in acting contrary to the duty of his office, and that this holds equally by whomsoever or howsoever he is appointed to the office, by whomsoever the office is given. ...
>
> There is another principle too, which I think applicable to this prosecution, and that is this; where there is a breach of trust, a fraud, or an imposition in a subject concerning the public, which, as between subject and subject, would only be actionable by a civil action, yet as that concerns the King and the public (I use them as synonimous terms), it is indictable; that is another principle of which you will make the application to the present case, without losing time in doing it. And there are some authorities; though I should think the principle so essential to the existence of the country and the constitution, that, without any authority, I may fairly say the constitution would not exist without it, - but I think there are authorities that support that principle. So long ago as the reign of Edward the 3d, it was taken to be clear that an indictment would lie for an omission or concealment of a pecuniary nature, to the prejudice of the king; and therefore, that in 27 Assize, Placito 17, it was presented that such and such had levied a hundred marks of the county for the array of certain archers, which money had never come to the profit of the king; had this been between subject and subject, it would have been an action for money had and received; that would have been no crime, but barely keeping the money in his own hands which belonged to another; but concerning the public, - concerning the king, - so long ago as the reign of Edward the 3rd, it was held to be indictable."[224]

In *Hudson*, Lord Goddard cited Lord Mansfield's statement with approval, and concluded:

> "That is the clearest possible statement by a great master of the common law that a fraud on the public by an individual is indictable, although the particular fraud might not have been indictable if it had been a fraud by one subject upon another. The simple question is, therefore, has that law ever been altered? We can find no case in which it ever has been altered. The

[223] *Bembridge*, p.155.
[224] Ibid, pp.155-156.

> doctrine laid down by Hawkins, and by East, was affirmed by Lord Mansfield in *R v Bembridge* in the clearest possible manner."[225]

1.2.3 The Constitutional Common Law of Taxation

In *Pattni*, Judge Mercer reaffirmed the constitutional significance of cheating by rejecting the frequent argument that it is too uncertain to satisfy the requirements of article 7 of the ECHR:

> "[P]rior, at any rate, to the passing of the Human Rights Act 1998 the common law offence of cheating the Revenue was alive and well and in appropriate cases provided a relevant charge. ... In my view the common law of cheating the Revenue as interpreted by recent judicial decisions, and if properly understood and adequately particularised, is clear and ascertainable as well as readily understood by a jury."[226]

Parliament expressly affirmed the constitutional importance of cheating the public revenue in section 32(1)(a) of the Theft Act 1968, which abolished cheats which are punishable at common law "except as regards offences relating to the public revenue". The Act, therefore, preserved the right of the Revenue to bring a civil action for cheating or to plead cheating as a defence in a civil action against it.

Parliament effectively reaffirmed the constitutional importance of cheating in the Fraud Act. In the debate on the Bill Lord Kingsland tabled an amendment for the "abolition of offence of cheating the public revenue" supposedly because it is "ill-defined". Citing *Pattni*, the Attorney-General, Lord Goldsmith, resisted the amendment. Using 'tax evasion' to describe tax fraud, he stated:

> "This was an issue that the Law Commission quite specifically excluded from its review. It says at the beginning of its report that there are certain specialist branches of fraud that ... required separate consideration. Among those it included ... the common law offence of cheating the Revenue. ... It may be that if the Bill is enacted the use of the offence of cheating the public revenue will decline. As it stands, the offence is regularly used by prosecutors ... to deal with cases of tax evasion. I am sure that we all want to ensure that HMRC continues to have all the tools necessary to prevent others not meeting their fiscal obligations."[227]

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[225] *Hudson*, p.260.
[226] [2001] Crim. L.R. 570.
[227] Hansard, HL, Vol 673, cols 1457-1458 (July 19, 2005).

Cheating the public revenue, therefore, remains the only form of cheating contrary to the common law which is indictable in criminal proceedings and actionable in civil proceedings.

1.2.4. The Supreme Court's Decision in *Ivey*

The Supreme Court's decision in *Ivey* has changed the law on the question of "deliberate, dishonest conduct by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question **knowing that he has no right to do so**" in the words of Hardy J's classic definition in *Less*. In *Less*, he applied the now defunct *Ghosh* test:

> "I direct you that you must approach the question of dishonesty in two stages. You must first of all decide whether according to the ordinary standards of reasonable and decent people as determined by yourselves what was done in respect of the non-payment of tax was dishonest. If it was not dishonest by those standards that is the end of the matter and the prosecution fails. If it was dishonest by those standards then you must consider a further question. That is to say, whether the defendant himself must have realized what he was doing was [by] those standard of reasonable and decent people dishonest. If your answer to that second question, if you come to it, is, 'Yes, we are sure', then convict. If your answer is, 'No', or, 'We are not sure', then acquit."[228]

The acceptance of the mantra that "tax avoidance is legal" as gospel truth in the existing body of knowledge effectively made the *Ghosh* test a "defence" in tax avoidance because the accused could argue that he did not realise that it was dishonest because the profession and the wider society consider it to be "legal". According to Ormerod:

> "[T]he accused might say that he believed that ordinary people would consider the activity to be lawful. This falls squarely within the *Ghosh* test as a matter for the discretion of the jury."[229]

The effect of *Ivey* is that the accused would no longer be able to say that he believed that ordinary people would consider the activity to be lawful. In the words of Lord Nicholls in *Royal Brunei* which the Supreme Court affirmed in *Ivey* as "[t]he test of dishonesty"[230] in both civil and criminal proceedings:

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[228] *Less.*
[229] Cheating the public revenue (1998) *Crim. L.R.* 627, p.638.
[230] Lord Hughes [74].

> "In most situations there is little difficulty in identifying how an honest person would behave."[231]

Tax avoidance, which is a subject where the views of the tax profession of what is right and wrong diverges from those of the general body of taxpayers, is the paradigm of cases where "there is little difficulty in identifying how an honest person would behave." According to Porcheddu:

> "The decision in *Ivey* ... could encourage fact-finding tribunals and juries to find that, according to the contemporary standards of reasonable and honest people, particularly aggressive and artificial tax structures that do not appear to be supported by any genuine commercial drivers display a dishonest intent on the part of the management that approved them. In these circumstances, those in management might no longer be able to defend themselves by relying on their subjective belief that what they were doing was not dishonest."[232]

1.3. CONSPIRACY TO DEFRAUD

In *Scott v Metropolitan Police Commissioner*, where the House of Lords held that the related common law offence of conspiracy to defraud is also a conduct offence, Lord Diplock stated:

> "Although at common law no clear distinction was originally drawn between conspiracies to 'cheat' and conspiracies to 'defraud,' these terms being frequently used in combination, by the early years of the nineteenth century 'conspiracy to defraud' had become a distinct species of criminal agreement independent of the old common law substantive offence of 'cheating.' The abolition of this substantive common law offence by section 32 (1) (a) of the Theft Act 1968, except as regards offences relating to the public revenue, thus leaves surviving and intact the common law offence of conspiracy to defraud."[233]

Viscount Dilhorne stated that there is "no support for the view that in order to defraud a person that person must be deceived"[234], and concluded:

> "One must not confuse the object of a conspiracy with the means by which it is intended to be carried out."[235]

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[231] *Brunei*, p.389.
[232] 'A practical approach to the corporate criminal offence', *Tax Journal*, December 8, 2017, p.15.
[233] Ibid, p.840.
[234] [1975] A.C. 819, 838.
[235] Ibid, p.839.

1.4. FRAUD

"The classic statement of the nature of fraud"[236] by Stephen corresponds for tax purposes to Justice Hardy's classic statement of "what in law is cheating the Public Revenue" in *Less*:

> "Fraud. There has always been a great reluctance amongst lawyers to attempt to define fraud, and this is not unnatural when we consider the number of different kinds of conduct to which the word is applied in connection with different branches of law, and especially in connection with the equitable branch of it. I shall not attempt to construct a definition which will meet every case which might be suggested, but there is little danger in saying that whenever the words 'fraud' or 'intent to defraud' or 'fraudulently' occur in the definition of a crime two elements at least are essential to the commission of the crime: namely, first, deceit or an intention to deceive or in some cases mere secrecy; and, secondly, either actual injury or possible injury or an intent to expose some person either to actual injury or to a risk of possible injury by means of that deceit or secrecy."[237]

In other words, fraud or cheating may be perpetrated by misrepresentation (or deceit or deception) without concealment (or secrecy or non-disclosure) and an intent to defraud or cheat need not necessarily involve an intent to conceal; and vice versa.

Fraudulent misrepresentation is the paradigm of fraudulent conduct. According to the Law Commission:

> "The concept of fraudulent misrepresentation is well established in both the civil and criminal law. It may be defined as an assertion of a proposition which is untrue or misleading, either in the knowledge that it is untrue or misleading or being aware of the possibility that it might be. The assertion may be express, implicit in written or spoken words, or implicit in non-verbal conduct. The proposition asserted may be one of fact or of law. It may be as to the current intentions, or other state of mind, of the defendant or any other person."[238]

As a representation may be express or implicit, fraudulent misrepresentation encompasses fraudulent concealment. As the Law Commission put it:

> "Secrecy can be regarded as a kind of deception by omission. One person may deceive another by taking positive steps to create a false impression

[236] The Law Commission, *Fraud*, July 2002, p.57. It was cited with approval by Viscount Dilhorne in *Scott,* p.836.
[237] *History of the Criminal Law of England*, p.121.
[238] *Fraud*, p.60-61.

> in the other's mind, or may simply refrain from taking any steps to dispel such an impression."[239]

Fraudulent misrepresentation and fraudulent concealment are, therefore, not mutually exclusive, and both tax evasion and tax avoidance can be described as either fraudulent misrepresentation (or express misrepresentation) or fraudulent concealment (or implied misrepresentation by concealment).

The term "possible injury" in Stephen's definition confirms that fraud is also a 'conduct' crime. In the words of James J in *R v Sinclair*:

> "To cheat and defraud is to act with deliberate dishonesty to the prejudice of another person's proprietary right."[240]

1.5. FRAUD ACT 2006

1.5.1. Background

The immediate history of the Act started with the Law Commission's 1996 Consultation Paper *Legislating the Criminal Code: Fraud and Deception*[241], which was followed by its 2002 report *Fraud*.[242] The Government responded in the Home Office 2004 Consultation Paper *Fraud Law Reform*.

1.5.2. Conduct Offence

The Government accepted the Law Commission's proposal to enact a conduct offence that corresponds to cheating and conspiracy to defraud:

> "We re-considered the argument, made by a few respondents, that the concept of fraud should include the requirement that the victim's financial interests be imperilled. However there was very wide support for the Law Commission's proposal that the crime should be complete if the offender has the intention to make a gain or cause loss. The argument is that the focus should be on the offender's behaviour and that the gravity of the offence depends on his intention, not the result."[243]

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[239] Ibid, p.63.
[240] [1968] 1 W.L.R. 1246, 1250.
[241] No 155.
[242] No 276, Cm 5560, July 2002.
[243] *Fraud Law Reform: Government Response to Consultations*, para.11.

The principal offence is, therefore, a general fraud or dishonesty offence created by section 1 in these terms:

> "(1) A person is guilty of fraud if he is in breach of any of the sections listed in subsection (2) (which provide for different ways of committing the offence).
> (2) The sections are — (a) section 2 (fraud by false representation), (b) section 3 (fraud by failing to disclose information), and (c) section 4 (fraud by abuse of position)."

The Explanatory Notes confirm that the three offences are conduct offences because while "the intention of making a gain or causing loss or risk of loss to another"[244] is a requirement, "[t]he gain or loss does not actually have to take place."[245]

Dishonesty is, therefore, the *mens rea* for each form of the offence. The Law Commission[246] and the Government[247] intended that the *Ghosh* definition should apply. This was emphasised repeatedly in the parliamentary debates, including by the Attorney General and the Solicitor General.[248] The substitution of the objective civil law test by the Supreme Court in *Ivey*, therefore, redefined the Act the way it redefined cheating the public revenue and conspiracy to defraud.

1.5.3. Fraud by False Representation

The Law Commission "concluded that this form of the new offence should be defined in terms of misrepresentation rather than deception", but that "the distinction is immaterial."[249]

Section 2, which corresponds to fraudulent misrepresentation under the common law, provides that:

> "(1) A person is in breach of this section if he—
> (a) dishonestly makes a false representation, and
> (b) intends, by making the representation—(i) to make a gain for himself or another, or (ii) to cause loss to another or to expose another to a risk of loss.

[244] Ibid, para 11.
[245] Ibid.
[246] *Legislating the Criminal Code: Fraud and Deception* (1996) and *Fraud* (2002).
[247] *Fraud Law Reform* (2004).
[248] Hansard, HL Debates, 19 July 2005, col 1424 (A-G); House of Commons Research Paper 31/06, at 14; Standing Committee B, 20 June 2006, col 8 (Solicitor General).
[249] *Fraud*, p.61.

(2) A representation is false if—
(a) it is untrue or misleading, and
(b) the person making it knows that it is, or might be, untrue or misleading.

(3) 'Representation' means any representation as to fact or law, including a representation as to the state of mind of—
(a) the person making the representation, or
(b) any other person.

(4) A representation may be express or implied."

Subsection (4) confirms that fraudulent misrepresentation encompasses express misrepresentation and implied misrepresentation by concealment.

1.5.4. Fraud by Failing to Disclose Information

The Government accepted "that failure to disclose could in some cases amount to a false representation" but decided "that it might be helpful, particularly for juries, to have the point made clear on the face of the law."[250]

Section 3, which corresponds to fraudulent concealment under the common law, provides that:

"A person is in breach of this section if he—
(a) dishonestly fails to disclose to another person information which he is under a legal duty to disclose, and
(b) intends, by failing to disclose the information—
(i) to make a gain for himself or another, or
(ii) to cause loss to another or to expose another to a risk of loss."

Virtually all cases of failing to disclose information under section 3 would, therefore, amount to false representation under section 2.

In its explanation of the concept of "legal duty", which was adopted in the Explanatory Notes[251], the Law Commission stated:

"Such a duty may derive from statute (such as the provisions governing company prospectuses), from the fact that the transaction in question is one of the utmost good faith (such as a contract of insurance), from the express or implied terms of a contract, from the custom of a particular trade or

[250] *Fraud Law Reform*, para.21.
[251] Paragraph 18.

market, or from the existence of a fiduciary relationship between the parties (such as that of agent and principal)."[252]

Farquharson LJ's statement in *Charlton* of the pre-existing common law duty of honesty imposed by cheating on professional advisers and taxpayers shows that it derives "from the fact that the transaction in question is one of the utmost good faith":

> "It is a feature, no doubt, of the tax or revenue law of any country that it must, to a large extent, in its tax gathering activities, rely on the truthfulness of the taxpayer in indicating the extent of his income or whatever other matter is relevant to the particular statute being considered. It follows also that the Revenue not only have to rely on the taxpayer's good faith, but more especially on the professional advisers they appoint to act for them and, accordingly, when professional advisers are found to have acted dishonestly towards the Revenue, it is almost inevitable, as I think each counsel before us has recognised, that sentences of imprisonment must follow and we adhere to that position."[253]

Waterhouse LJ's original statement in the earlier case of *R v Phelps and Stockitt* demonstrates that the duty on professional advisers also derives "from the custom of a particular trade":

> "In cases in which professional men abuse the privilege of their profession, albeit to assist clients but with the object of defrauding the Public Revenue, it is inevitable that sentences of immediate imprisonment will be imposed and that those sentences will be of substantial duration. They must be deterrent sentences because the operations of the Inland Revenue depend to a very great extent upon the integrity of members of the accountants' profession in this country."[254]

1.5.5. Fraud by Abuse of Position

The protection of the public interest in tax settlements by the common law was fortified by the offence of fraud by abuse of position under section 4 of the Fraud Act, which encompasses cheating the public revenue by abuse of office and misconduct in a public office:

> "(1) A person is in breach of this section if he–
> (a) occupies a position in which he is expected to safeguard, or not to act against, the financial interests of another person,
> (b) dishonestly abuses that position, and
> (c) intends, by means of the abuse of that position–

[252] *Fraud*, paragraph 7.28.
[253] Ibid 531.
[254] (1993) 14 Cr. App. R. 141, 145.

(i) to make a gain for himself or another, or
(ii) to cause loss to another or to expose another to a risk of loss.

(2) A person may be regarded as having abused his position even though his conduct consisted of an omission rather than an act."

Goddard CJ's summary of *Bembridge* cited above shows that the defendant did not intend "to make a gain for himself" in terms of section 4(1)(c)(i) but intended "to cause loss to another or to expose another to a risk of loss" in terms of section 4(1)(c)(ii).

Indeed, the example in the Explanatory Notes, which is analogous to a sweetheart tax deal, shows that fraud by abuse of position is wider than bribery:

> "The term 'abuse' is not limited by a definition, because it is intended to cover a wide range of conduct. Moreover subsection (2) makes clear that the offence can be committed by omission as well as by positive action. For example, an employee who fails to take up the chance of a crucial contract in order that an associate or rival company can take it up instead at the expense of the employer, commits an offence under this section."[255]

1.5.6. Codification of Cheating

The Fraud Act, which corresponds to the common law offences of cheating the public revenue, conspiracy to defraud and fraud, meets Baker's objections:

> "For those countries - like the UK - where we still have the offence of defrauding the Revenue as a common law offence based upon court decisions, this is no longer acceptable. Taxpayers are entitled to a clear, statutory definition of what is regarded as criminal conduct."[256]

The Act provides taxpayers, professional advisers and Revenue officials with "a clear, statutory definition of what is regarded as criminal conduct."

1.6. STATUTES AGAINST FRAUD

1.6.1. Statutes Against Tax Fraud

Statutes against frauds are the precursors of today's anti-avoidance legislation, enacted to complement the pre-existing common law of fraud. According to Bennion:

[255] Paragraph 21.
[256] Baker, pp.8-9.

> "Sometimes Parliament inserts special provisions in an Act for the purpose of countering evasion of its requirements. … The presence or absence of such provisions does not affect the general duty of the courts to counter evasion."[257]

In *Twyne's Case* the Star Chamber held "that all statutes made against fraud should be liberally and beneficially expounded to suppress the fraud."[258]

Statutes against tax fraud are, therefore, statutes against fraud that codify specific forms of cheating the public revenue already prohibited by the pre-existing common law. According to Bennion:

> "An early example was a statute of Edward I against mortmain. An earlier provision of the Magna Carta to the like effect having been subject to evasion, this statute said mortmain was not to be effected *quacunque arte vel ingenio* (by whatever art or ingenuity).
>
> A modern instance is the Customs and Excise Management Act 1979 s 170(2), which provides that a person who does certain acts in relation to goods with intent to evade any prohibition or restriction on the goods, or to evade duty, is guilty of an offence and may be detained."[259]

Mortmain, which means "the dead hand", refers to the perpetual, inalienable ownership of real estate by a corporation or legal institution such as the Church. The Statutes of Mortmain were, therefore, enacted by Edward I in 1279 and 1290 to counter cheating the public revenue by passing land into the possession of the Church.

1.6.2. Civil Fraud[260] Penalties Legislation

Section 6 of statute 12 Hen. 7 (c. 13) 1496 entitled "An Act for a Subsidie to be graunted to the Kinge, and for dischardg of some psons from payment thereof" imposed "the doble some of the same Money so upon hym assessed not paied" for any non-payment.

Section 25 of statute 5 Eliz. 1 (c.31) 1562, entitled "penalty on evasion under such pretext, double rate", penalised, amongst other things, "covyn", "crafte" and "deceipte".

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[257] *Bennion*, p.1014.
[258] (1601) 3 Coke 80, 82a.
[259] *Bennion*, p.1014.
[260] According to White, '"Civil penalties": oxymoron, chimera and stealth sanction' (2010) *L.Q.R.* 593, 593: "'Civil penalties' seems an oxymoron: if something is 'civil', how can 'penalties' arise, for do not 'penalties' actually define the criminal law?"

Section 53 of "An Act for granting an Aid to Her Majesty to be raised by a Land Tax in Great Britain for the Service of the Year One thousand seven hundred and fourteen" (1713, Statute 13 Anne, c. 1) penalised any "fraud or covin".

Section 14 of 3 Jac. 1 (C. 26) 1605-6 entitled "Penalty on Evasion under such Pretext, &c. Double Rate" provided that "everie such person that, by such meanes or otherwise, willingly by Covine or without just cause, shall happen to escape from the said Taxacions ... shalbe charged ... the double value of so much as he should might or ought to have beene set and taxed at by vertue of this Act".

Section 53 of statute 13 Anne (c. 1) 1713 (An Act for granting an Aid to Her Majesty to be raised by a Land Tax in Great Britain for the Service of the Year One thousand seven hundred and fourteen) entitled "Persons avoiding the Tax, charged Treble", penalised "any other Fraud or Covin".

Section 92 of the first Income Tax Act of 1799 effectively covered every form of cheating the public revenue in relation to income tax:

> "That if any Person who ought to be charged by virtue of this Act, shall ... by <u>any Falsehood, Fraud, Covin, Art, or Contrivance whatsoever, already used or practised, or to be used or practised</u> shall not be charged and assessed according to the true Intent and Meaning of this Act, every such Person shall, on Proof thereof, before any two Commissioners, be charged and assessed, for the Purposes of this Act, Double the Amount of the Charge which ought to have been made on such Person."[261]

The underlined expression corresponds to Hardy J's classic definition of cheating as "any form of fraudulent [or] dishonest conduct by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so."

Section 178 of the Income Tax Act 1842 substituted "any Falsehood, willful Neglect, Fraud, Covin, Art, or Contrivance whatsoever" and increased the penalty to "Treble the Amount of the Difference between the Sum with which such Person shall have been charged and the Sum with which he ought to have been charged."

[261] Emphasis supplied.

Section 30 of the Income Tax Act 1918 similarly codified the pre-existing common law of cheating and fraud:

> "**Penalty for fraudulent claims.**
>
> (1) A person who in making a claim for or obtaining any exemption, abatement, or relief hereinbefore described, or in obtaining any certificate as aforesaid—
> (a) is guilty of any fraud or contrivance; or
> (b) fraudulently conceals or untruly declares any income or any sum which he has charged against or deducted from, or was entitled to charge against or to deduct from another person; or
> (c) fraudulently makes a second claim for the same cause,
> shall forfeit the sum of twenty pounds and treble the tax chargeable in respect of all the sources of his income and as if such claim had not been allowed.
>
> (2) A person who knowingly and willfully aids or abets any person in committing an offence under this section shall forfeit the sum of fifty pounds."

Under section 30(1)(b), a taxpayer who "fraudulently conceals" cheats by fraudulent concealment under the common law and defrauds by failing to disclose information under section 3 of the Fraud Act 2006 while a taxpayer who "untruly declares" cheats by fraudulent misrepresentation under the common law and defrauds by false representation under section 2 of the Fraud Act. In both cases the taxpayer is "guilty of any fraud or contrivance" under section 30(1), as is any professional adviser "who knowingly and willfully aids or abets" the taxpayer under section 30(2).

Section 48 of the Income Tax Act 1952 penalised "any falsehood, willful neglect, fraud, covin, art or contrivance whatsoever" with "treble the amount of the charge which ought to have been made".

1.6.3. The 1970 Changes

The legislative changes of 1970 changed the formulation and created a parallel system of civil fraud penalty and anti-avoidance legislation.

Part X of TMA 1970 entitled "Penalties" enacted the penalty regime in sections 93 – 107, based on whether the person acted "fraudulently or negligently".

1.6.4. Anti-Avoidance Legislation

In a shift from the previous use of 'fraud', 'evasion' and 'avoidance' as synonyms, which reflected developments in case law, Part 7 of ICTA 1970 that enacted the 'Cancellation of Tax Advantages from Certain Transactions in Securities' and the 'Transfer of Assets Abroad' provisions in Chapter 1 and 3 respectively was entitled 'Tax Avoidance'.

Part XVII of ICTA 1988, also entitled 'Tax Avoidance', enacted the Controlled Foreign Companies (CFC) provisions in Chapter 4 (sections 747-756) and the transfer pricing provisions in Chapter 6 (sections 770-773).

The decision of the ECJ in *Cadbury Schweppes v IRC*[262] that the CFC provisions did not constitute a restriction on freedom of establishment under articles 43 and 48 of the European Charter shows that anti-avoidance legislation falls within the ambit of the pre-existing common law of cheating. Affirming the decision of Advocate General Léger, the Grand Chamber held that:

> "Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a member state of profits made by a controlled foreign company in another member state, where those profits are subject in that state to a lower level of taxation than that applicable in the first state, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable. Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that controlled company is actually established in the host member state and carries on genuine economic activities there."[263]

A "wholly artificial arrangement" that does not involve "genuine economic activities" is a fraud. According to the Grand Chamber:

> "As suggested by the United Kingdom government and the Commission at the hearing, that finding must be based on objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment. If checking those factors leads to the finding that the CFC is a fictitious establishment not carrying out any genuine economic activity in the territory of the host member state, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a 'letterbox' or 'front' subsidiary."[264]

[262] [2006] STC 1908.
[263] Ibid, p.1941. Emphases supplied.
[264] Ibid, p.1940.

1.7. THE GENERAL ANTI-ABUSE RULE (GAAR)

The substantive provisions of the General Anti-Abuse Rule (GAAR) enacted in Part 5 of Finance Act 2013 show that "abuse" falls within the ambit of the pre-existing common law of cheating the public revenue and fraud:

> "**207 Meaning of "tax arrangements" and "abusive"**
>
> (1) Arrangements are *"tax arrangements"* if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements.
>
> (2) Tax arrangements are *"abusive"* if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including—
> (a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,
> (b) whether the means of achieving those results involves one or more contrived or abnormal steps, and
> (c) whether the arrangements are intended to exploit any shortcomings in those provisions.
>
> (3) Where the tax arrangements form part of any other arrangements regard must also be had to those other arrangements.
>
> (4) Each of the following is an example of something which might indicate that tax arrangements are abusive—
> (a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,
> (b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and
> (c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid,
> but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.
>
> (5) The fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive.
>
> (6) The examples given in subsections (4) and (5) are not exhaustive."[265]

[265] Emphasis supplied.

"Each ... example of something which might indicate that tax arrangements are abusive" in section 207(4) is a prima facie case of fraud by false representation under section 2 of the Fraud Act and cheating by fraudulent misrepresentation under the common law. The legal question raised in each case, therefore, is whether "the person making it knows that it is, or might be, untrue or misleading" in the words of section 2(2) of the Fraud Act or "knowing that he has no right to do so" in the words of Hardy J in *Less*.

Honest people do not submit tax returns on the basis of arrangements that result in "an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes", or "deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes", or "a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid".

To consider "if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted" as directed by section 207(4) is, therefore, to substitute the legal fiction of statutory construction for this legal question.

"The fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice" under section 207(5) does not change their nature in law. In the words of Lord Wilberforce in *Vestey*:

> "A proposition that whether a subject is to be taxed or not, or that, if he is, the amount of his liability is to be decided (even though within a limit) by an administrative body, represents a radical departure from constitutional principle."[266]

1.8. THE PROCEDURAL DISTINCTION BETWEEN CRIMINAL AND CIVIL LAW

Blackstone's statement of the distinction between penal statutes and statutes against frauds defines the different procedural consequences of findings of fraud or cheating in criminal and civil proceedings:

> "Penal statutes must be construed strictly. ... Statutes against frauds are to be liberally and beneficially expounded. This may seem a contradiction to

[266] [1980] STC 10, 18-19.

> the last rule; most statutes against frauds being in their consequences penal. But this difference is here to be taken: where the statute acts upon the offender, and inflicts a penalty, as the pillory or a fine, it is then to be taken strictly; but when the statute acts upon the offence, by setting aside the fraudulent transaction, here it is to be construed liberally."[267]

Section 1(3) of the Fraud Act 2006 shows that it is a penal statute that "acts upon the offender, and inflicts a penalty":

> "A person who is guilty of fraud is liable—
> (a) on summary conviction, to imprisonment for a term not exceeding 12 months or to a fine not exceeding the statutory maximum (or to both);
> (b) on conviction on indictment, to imprisonment for a term not exceeding 10 years or to a fine (or to both)."

By contrast, section 209(1) of Finance Act 2013 shows that the GAAR in Part 5, which "has effect for the purpose of counteracting tax advantages arising from tax arrangements that are abusive"[268], is a statute against fraud that "acts upon the offence, by setting aside the fraudulent transaction":

> "If there are tax arrangements that are abusive, the tax advantages that would (ignoring this Part) arise from the arrangements are to be counteracted by the making of adjustments."

Anti-avoidance legislation decriminalises cheating or fraud, which is why it "should be liberally and beneficially expounded." The judicial legitimisation of tax avoidance under the prevailing constructional approach, however, supposes that anti-avoidance legislation, and indeed all tax legislation, "must be construed strictly" like penal statutes. The underlined "double reasonableness test" in section 207(2) of the GAAR resulted from this recommendation by Aaronson:

> "I have concluded that a GAAR which is appropriate for the UK must be driven by an overarching principle. This is that it should target those highly abusive contrived and artificial schemes which are widely regarded as intolerable, but that it should not affect the large centre ground of responsible tax planning. Critically, I consider that this overarching principle must be supported by the simple proposition that where there can be reasonable doubt as to which side of the line any particular arrangement falls on, then that doubt is to be resolved in favour of the taxpayer so that the arrangement is treated as coming within the unaffected centre ground."[269]

[267] Blackstone, pp.88-89.
[268] Section 206(1).
[269] Aaronson, p.28.

This "overarching principle" is akin to the benefit of a doubt enjoyed by an accused in criminal proceedings where fraud must be proved beyond reasonable doubt and where the criminal law such as the common law offence of cheating the public revenue or a penal statute like the Fraud Act "acts upon the offender, and inflicts a penalty" and "is ... to be taken strictly."

In civil proceedings, where fraud is proved on a balance of probability, a statute against fraud like the GAAR "acts upon the offence, by setting aside the fraudulent transaction, here it is to be construed liberally." In the words of Lord Hardwicke in *Kinaston v Clark* that should govern the construction of the GAAR:

> "The known rule upon statutes made to prevent frauds is, that they ought to have the most liberal construction, as in *Twyne's* case."[270]

1.9. TAX AVOIDANCE

The hallmark of tax avoidance is that each of **the professional advisers** involved in devising or marketing or implementing or otherwise facilitating the use of a tax scheme cheats the public revenue or "prejudice[s], or take[s] the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so." According to Farquharson LJ in *Charlton*:

> "The case for the prosecution was that Charlton had devised a dishonest, tax-avoidance scheme for the benefit of some of the firm's clients and that the Appellants were involved with the implementation of the schemes or the concealment from the Revenue of the existence of the fraud."[271]

Using the tax avoidance scheme by **the participating taxpayer** is a distinct and separate *actus reus* or "prejudice, or ... risk of prejudicing, the Revenue's right to the tax in question". The corollary of the principle that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable"[272] for negligence, let alone fraud, if the advice proves to be wrong is that the participating taxpayer using a tax avoidance scheme "to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question" is *not* likely to do so "knowing that he has no right to do so." In *Charlton*, Farquharson LJ applied the principle that

[270] (1741) 2 Atk. 204, 205.
[271] 67 TC 500, 504-505. Emphases supplied.
[272] [2012] UKFTT 314 at [21]. Emphasis supplied.

cheating is a conduct crime which means "that the actual result of the loss does not need to be proved"[273] thus:

> "Furthermore, it was urged upon us that, unusually perhaps in a fraud of this scale, there was no loss to the public purse, in the sense that apart from one company the tax that was due, as a result of this defrauding of the Revenue, has now all been repaid as well as penalties and interest."[274]

In the earlier case of *R v Phelps and Stockitt*, where the professional enablers who devised, marketed, implemented and otherwise facilitated the use of similar tax avoidance schemes were convicted on an indictment containing counts of cheating the public revenue and conspiracy in the Crown Court at Middlesex Guildhall, Waterhouse LJ similarly stated:

> "The prosecution accepted that, in the event, there was no net loss overall to the Revenue. Although some of the clients were in liquidation, penalties and interest charges were imposed on other clients so that the Inland Revenue did not sustain a net loss."[275]

The conviction and incarceration of the professional advisers in *Charlton* and *Phelps* prove that devising or marketing or implementing or concealing or otherwise facilitating the use of a tax avoidance scheme by **the professional enablers** is a crime or an "act prohibited with penal consequences" or "an act that is capable of being followed by criminal proceedings". According to Waterhouse LJ:

> "In cases in which professional men abuse the privilege of their profession, albeit to assist clients but with the object of defrauding the Public Revenue, it is inevitable that sentences of immediate imprisonment will be imposed and that those sentences will be of substantial duration. They must be deterrent sentences because the operations of the Inland Revenue depend to a very great extent upon the integrity of members of the accountants' profession in this country."[276]

In *R v Dimsey*[277] and *R v Allen*[278] the Court of Appeal and the House of Lords upheld the conviction and imprisonment of **the professional enablers and the participating taxpayers** involved in similar schemes on indictments containing counts of conspiracy

[273] Stuart-Smith LJ, *Hunt*, p.827.
[274] *Charlton*, p.532.
[275] (1993) 14 Cr. App. R. 141, 142.
[276] Ibid, p.145.
[277] [2001] 1520.
[278] [2001] 1537.

to cheat the public revenue by the Guildford and Knightsbridge Crown Courts respectively.

In *Dimsey*, the conviction of the participating taxpayer (Chipping) on nine separate counts the professional enablers (Dimsey – the deviser of the scheme and Da Costa – the taxpayer's solicitor) were not charged with proves that, subject to the requisite *mens rea*, using a tax avoidance by **the participating taxpayer** is also a crime or an "act prohibited with penal consequences" or "an act that is capable of being followed by criminal proceedings". According to Lord Scott:

> "In due course the Revenue commenced criminal proceedings against Mr Chipping, Mr Da Costa and the appellant. There were eleven counts. All bar one, count ten, were counts under which Mr Chipping alone was accused of cheating the revenue."[279]

1.10. MARKETED TAX AVOIDANCE

The Information in *USA v KPMG* (in Appendix 1) shows that avoidance, particularly marketed tax avoidance, is a **conspiracy to cheat or defraud** or "prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so" by each of the professional enablers involved in devising, marketing, implementing and otherwise facilitating the use of a tax avoidance scheme in which the participating using an individual scheme may or may not be complicit. According to paragraphs 8 and 9:

> "During the period from at least in or about 1996 through at least in or about 2003, the defendant KPMG, and others known and unknown (hereinafter the 'co-conspirators'), participated in a scheme to defraud the IRS by devising, marketing, and implementing fraudulent tax shelters, by preparing and causing to be prepared, and filing and causing to be filed with the IRS false and fraudulent U.S. individual income tax returns containing the fraudulent tax shelter losses, and by fraudulently concealing from the IRS those shelters. This illegal course of conduct was deliberately approved and perpetrated at the highest levels of KPMG's tax management, and involved dozens of KPMG partners and other personnel.
>
> KPMG and its co-conspirators designed and marketed these shelters as a means for wealthy individuals with taxable income or gains generally in excess of $10 million in 1997 and of £20 million in 1998-2000 fraudulently to eliminate or reduce the tax paid to the IRS on that income or gain. As marketed and implemented, instead of the wealthy clients paying U.S.

[279] [2001] STC 1520, 1526.

> individual income taxes generally exceeding 20% of the income or gain, the client could choose the amount of tax loss desired and pay certain of the conspirators and others an all-in cost generally equal to approximately 5 to 7% of the desired tax loss. This "all-in" cost included the fees of KPMG, the SF Entities, the various law firms that supplied opinion letters, including a prominent national law firm with offices in New York, New York (the 'Law Firm'), the bank participants, and others, as well as a small portion that would be used to execute purported 'investments' that were designed to make it appear that the shelters were legitimate 'investments' rather than tax shelters. The size of the purported 'investments,' the timing of the transactions, and the amount of the fees to certain conspirators and participants were all determined based on the tax loss to be generated."

In *Drummond v HMRC* the Special Commissioner summarised the contemporaneous KPMG loss scheme in strikingly similar terms:

> "Mr Simon McKie, director and controlling shareholder of MCL, formulated the strategy to enable individual customers with otherwise unrelieved capital gains to generate offsetable capital losses without suffering a corresponding economic loss. ... The strategy was to be marketed by MCL which would approach third party advisers (primarily tax professionals) and inform those advisers of the strategy in confidence. In late 2000 Simon McKie drafted a detailed strategy description which gave numerical examples of how it might be implemented with an analysis of its tax effects. ... Simon McKie had three meetings with KPMG (accountants). KPMG, Mr McKie said in evidence, adopted it as a preferred strategy for their clients (subject to technical approval) and signed a confidentiality agreement on 15 February 2001.
>
> Mr Jason Drummond is a man of means. He had realised a gain of £4.8 million earlier in the financial year on sale of shares in a company in which he still had a large holding and that holding was, he said, 'just one of my assets'. He had, he explained, asked KPMG to be more proactive in his tax affairs and had been having conversations with them about different schemes or strategies that could be used to offset his tax. ... Mr Drummond agreed with KPMG to engage KPMG to give advice on the strategy 'involving the acquisition and subsequent encashment of second-hand endowment bonds' and to be introduced to MCL. KPMG also agreed to assist Mr Drummond with the reporting of the transaction to the Inland Revenue. KPMG's fee was to be '1% of the value of the bonds you purchase'."[280]

As a matter of law, "to enable individual customers with otherwise unrelieved capital gains to generate offsetable capital losses without suffering a corresponding economic loss" is to cheat the public revenue or "to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question". According to the Special Commissioner:

[280] 79 TC 793, 801-803.

> "EFG Private Bank and its employees who 'advised' Ms. Sedgley and Mr. Drummond were, in my view, acting out a charade for which EFG Private Bank were paid a single fee of £5,000 by London & Oxford. Ms. Sedgley had been introduced to EFG Private Bank by Simon McKie and Mr. Newton."[281]

Under the constructional approach to tax avoidance, however, the Revenue and the courts failed to judge their conduct. As Rimer LJ put it:

> "The issue relates to the calculation of Mr. Drummond's liability to capital gains tax ('CGT') for the tax year ended 5 April 2001. During that year Mr. Drummond made a capital gain of some £4.875 million upon the sale of shares. It exposed him to a large CGT liability. He claims to have been entitled to set against that gain an allowable loss of £1,962,233 ('£1.962 million'), so reducing the CGT liability by some £588,000. HMRC challenge his claim to do so. Their reason is that whilst the £4.875 million gain was a real economic gain, the claimed loss was not a real economic loss. Mr. Drummond's claim is based on a tax avoidance scheme into which he bought at a cost of some £210,000 (part of the £1.962 million). The scheme depends upon a claimed application to the facts of s 37(1) of the Taxation of Chargeable Gains Act 1992 ('TCGA'). HMRC accept that s 37(1) applies, but their position is that it does not enable Mr. Drummond to create the magic he claims to conjure from it."[282]

To "accept that s 37(1) applies" after contending "that whilst the £4.875 million gain was a real economic gain, the claimed loss was not a real economic loss" is to divert attention from the conduct of the professional enablers and the participating taxpayer, and indeed the nature of the scheme, to the statutory provisions the scheme was devised to cheat and defraud.

In *Astall & Edward v HMRC*, which involved another contemporaneous KPMG loss scheme, the Special Commissioner stated:

> "The scheme is entirely artificial and the Appellants had no commercial purposes in entering into it other than generating an artificial loss to set against taxable income.
>
> The terms of the Security were, in the words of the KPMG memorandum given to clients interested in the scheme, 'structured so that it falls within the definition of a relevant discounted security for tax purposes.'"[283]

[281] Ibid, p 810.
[282] Ibid, p.825.
[283] 80 TC 22, para.21.

1.11. TAX EVASION

The hallmark of tax evasion is that the **taxpayer** cheats the public revenue or "prejudice[s], or take[s] the risk of prejudicing, the Revenue's right to the tax in question *knowing that he has no right to do so*" by deliberately failing to make a return of the relevant tax liability or by making a deliberately false return of the relevant tax liability without using a tax scheme.

In *R v Mavji*, the taxpayer cheated the public revenue by deliberately failing to make returns of VAT liability. According to Davies J:

> "This appellant was in circumstances in which he had a statutory duty to make value added tax returns and to pay over to the Crown the value added tax due. He dishonestly failed to do either. Accordingly, he was guilty of cheating HM The Queen and the public revenue."[284]

In *R v Hudson* the taxpayer cheated the public revenue by deliberately making a false return of income tax liability without using a tax scheme. Goddard CJ stated:

> "We think that the offence here consisted of sending in documents to the inspector of taxes which were false and fraudulent to the appellant's knowledge ... for the purpose of avoiding the payment of tax. That is defrauding the Crown and defrauding the public."[285]

In *Hunt*, Stuart-Smith LJ cited *Hudson* for "the view that the offence is a conduct crime", stating:

> "In *R v Hudson* this court held that the offence of making a false statement tending to prejudice the Queen and the public revenue with intent to defraud the Queen is, and always has been, a common law misdemeanour and includes the offence of causing to be delivered to an inspector of taxes accounts relating to the profit of a business which falsely and fraudulently state the profits to be less than they actually were."[286]

1.12. OFFSHORE TAX EVASION

The Information in the HSBC case of *USA v Sethi* (in Appendix 2) shows that offshore tax evasion is a conspiracy to cheat or defraud the public revenue or "to prejudice, or

[284] *Mavji*, pp.1391-1392.
[285] [1956] 2 QB 252, 261-262.
[286] Ibid, p.827.

take the risk of prejudicing, the Revenue's right to the tax in question" between a **taxpayer** who fails to make a return of the relevant tax liability or who makes a deliberately false return of the relevant tax liability without using a tax avoidance scheme "knowing that he has no right to do so" **and** his **professional enablers** usually in the private banking or wealth management industry. According to paragraphs 15 to 21 which refer to HSBC as "the International Bank":

> "Defendant SANJAY SETHI was born in India, become a lawful resident of the United States on or about March 10, 1989, and became a naturalized United States citizen on or about June 1, 2004. From at least 2004 to the present, SETHI lived in Watchung, New Jersey.
>
> From in or about 2001 until in or about 2009, defendant SANJAY SETHI had a financial interest in undeclared bank accounts located in Switzerland and India. The accounts located in Switzerland and India were maintained at the International Bank.
>
> U.S. Banker A, a co-conspirator who is not charged as a defendant herein, was a senior vice president of a cross-border banking group with the private bank division of the International Bank that focused on developing and servicing clients in the United States with ties to India and elsewhere in South Asia. U.S. Banker A was based in the International Bank's New York, New York office.
>
> U.K. Banker A, a co-conspirator who is not charged as a defendant herein, was a high-ranking executive of the International Bank and the head of a cross-border banking group within its private bank division that focused on developing and servicing clients worldwide with ties to countries in south Asia. U.K. Banker A was based in the International Bank's London, England office.
>
> Swiss Banker A, a co-conspirator who is not charged as a defendant herein, was a financial advisor for the International Bank and was based in Geneva, Switzerland.
>
> From in or about 2001 through on or about April 21, 2010, in the District of New Jersey and elsewhere, the defendant, SANJAY SETHI, did knowingly and intentionally combine, conspire, confederate and agree with others to defraud the United States and an agency thereof, that is, the Internal Revenue Services of the United Sates Department of the Treasury, in the ascertainment, computation, assessment and collection of federal income taxes.
>
> The object of the conspiracy was for defendant SANJAY SETHI and his co-conspirators to conceal from the IRS the existence, ownership, and income derived from SETHI's undeclared bank accounts in Switzerland and India."

The involvement of professional advisers makes it a conspiracy like tax avoidance, but like classic tax evasion it does not require a tax scheme that is disclosed to the Revenue. The principle that "if a taxpayer reasonably relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable" for negligence or fraud if the advice proves to be wrong will, therefore, not avail the taxpayer. The purpose of professional advice is not to enable him to prove that he acted not "knowing that he has no right to do so" but to reassure him that he will be protected from discovery by the tax authorities.

The "Swiss Leaks" – the disclosure by the International Consortium of Investigative Journalists (ICIJ) of some 30,000 secret bank accounts holding almost £78 billion of assets in HSBC Private Bank (Suisse) – revealed how the private banking or wealth management industry perpetrate offshore tax evasion. In contrast to the prosecution of one of the 3,600 potential UK tax evaders on the "Falciani list" and the amnesty granted to HSBC and their staff under the UK-Swiss tax treaty, there has been "more than 100 prosecutions of evaders and 50 of their banking facilitators"[287] in the US, including *Sethi*. According to the ICIJ:

> "The bank repeatedly reassured clients that it would not disclose details of accounts to national authorities, even if evidence suggested that the accounts were undeclared to tax authorities in the client's home country. Bank employees also discussed with clients a range of measures that would ultimately allow clients to avoid paying taxes in their home countries. This included holding accounts in the name of offshore companies to avoid the European Savings Directive, a 2005 Europe-wide rule aimed at tackling tax evasion through the exchange of bank information."[288]

The new corporate offences of failure to prevent the criminal facilitation of tax evasion under Part 3 of the Criminal Finances Act 2017 do not change the meaning of offshore tax evasion in law. According to HMRC:

> "The new offences will be committed where a relevant body fails to prevent an associated person *criminally* facilitating the evasion of a tax, and this will be the case whether the tax evaded is owed in the UK or in a foreign country.
>
> Previously, attributing criminal liability to a relevant body required prosecutors to show that the senior members of the relevant body were involved in and aware of the illegal activity, typically those at the Board of Directors level. ...

[287] *Private Eye*, 2 October 2015, p.37.
[288] ICIJ.

> The new offence, however, does not radically alter what is criminal, it simply focuses on who is held to account for acts contrary to the current criminal law. It does this by focussing on the failure to prevent the crimes of those who act for or on behalf of a corporation, rather than trying to attribute criminal acts to that corporation."[289]

1.13. CONCLUSION

This chapter proved the overarching thesis that tax avoidance and tax evasion constitute the common law offence of cheating the public revenue, which corresponds to tax fraud in both the criminal and civil law in all jurisdictions.

It also underscored the fundamental principle, which is critical to understanding the fraudulent nature of a tax avoidance scheme, that cheating and fraud under the common law and fraud under the Fraud Act are 'conduct' offences committed by prejudicing another person's proprietary interest rather than 'result' offences that require proof of actual loss because they all boil down to dishonesty. In the words of James J in *R v Sinclair*:

> "To cheat and defraud is to act with deliberate dishonesty to the prejudice of another person's proprietary right."[290]

[289] HMRC, *Tackling tax evasion*, September 1, 2017, pp.3-4.
[290] [1968] 1 W.L.R. 1246, 1250.

CHAPTER TWO

THE FRAUDULENT NATURE OF A TAX AVOIDANCE SCHEME IN CRIMINAL AND CIVIL LAW

> **Whenever the Court decides that kind of dispute it legislates about taxation. It makes a law taxing all gains of the same kind or all documents of the same kind. Do not let us deceive ourselves with the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant. Anyone who has decided tax appeals knows that most of them concern transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all. Some of the transactions are of a kind which had never taken place before the Act was passed: they were devised as a result of it. The Court may describe what it is doing in tax appeals as interpretation. So did the priestess of the Delphic oracle.**
> Lord Diplock, *The Courts As Legislators* (University of Birmingham, 1965) page 6.

2.1. INTRODUCTION

This chapter establishes the inherently fraudulent nature of a tax avoidance scheme in both the criminal and civil law based on the fundamental principle that cheating and fraud are 'conduct' crimes committed by prejudicing the Revenue's right to the tax in question rather than 'result' crimes that require proof of actual loss to the Revenue.

Using Lord Diplock's theory of retrospective legislation, which underscores the fundamental flaw in the prevailing constructional approach to tax avoidance, a tax avoidance scheme is by definition *two or more interrelated "transactions … of a kind which had never taken place before the [tax] Act [it was devised to cheat or defraud] was passed … devised as a result of it."* It can, therefore, amount to *two or more interrelated "transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all."*

The two minimum interrelated transactions required to constitute a scheme comprise one 'normal' or 'real' transaction (such as the deed of covenant in *Westminster*) and one 'abnormal' or 'artificial' transaction (such as the letter of explanation in *Westminster*) hence Lord Templeman's statement that:

> "A tax avoidance scheme includes one or more interlinked steps which have no commercial purpose except for the avoidance of tax otherwise payable, and can conveniently be described as artificial steps."[291]

[291] 'Tax and the Taxpayer' [2001] *L.Q.R.* 575, 575.

A tax avoidance scheme or *two or more interrelated transactions of a kind which had never taken place before the tax Act it was devised to cheat or defraud was passed, devised as a result of it* is the paradigm of a fraud upon an Act in civil law. In the words of Lord Rodger in *R v J*:

> "The notion of a fraud upon an Act, acting in *fraudem legis*, is ancient. Although the outer limits of the doctrine remain notoriously difficult to define, this case at least falls squarely within its scope."[292]

A tax avoidance scheme or *two or more interrelated transactions of a kind which had never taken place before the* tax *Act it was devised to cheat or defraud was passed, devised as a result of it* falls within Hardy J's classic definition of "what in law is cheating the Public Revenue" in criminal law:

> "To cheat ... is defined by the concise Oxford Dictionary as: 'To deceive, or trick, a person into or out of a thing.' The common law offence of cheating the Public Revenue does not necessarily require a false representation either by words or conduct. Cheating can include any form of fraudulent [or] dishonest conduct by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so."[293]

The narrower dictionary definition of cheating corresponds to Lord Templeman's statement in *Matrix-Securities*: "Every tax avoidance scheme involves a trick and a pretence."[294] *A fortiori*, every tax avoidance scheme falls within the wider definition of "what in law is cheating the Public Revenue."

A fraud upon a tax Act in civil law is cheating the public revenue in criminal law because as "Watchful" stated in relation to the common law offence of cheating: "All taxation is the creature of statute. ... The gist of the crime is fraud upon the Crown."[295] Every fraud upon a Tax Act in civil law is, therefore, a fraud upon the Crown or cheating the public revenue or tax fraud in criminal law.

The rest of this chapter develops this fundamental proposition by using the common law offences of cheating the public revenue and conspiracy to defraud and the common

[292] [2004] UKHL 42 [64].
[293] *Less*. Emphases supplied.
[294] [1994] STC 272, 281.
[295] "Watchful", pp.119-124.

law concepts of fraud upon an Act and fraud to establish the fraudulent nature of a tax avoidance scheme in criminal and civil law.

2.2. CHEATING THE PUBLIC REVENUE

2.2.1. Common Cheat

Hawkins' classic definition of common cheat (abolished by section 32(1)(a) of the Theft Act 1968 "except as regards offences relating to the public revenue") corresponds broadly to the dictionary definition of cheating and Lord Templeman's statement and embodies the two ingredients of a tax scheme:

> "Cheats which are punishable at Common Law, may, in general be described to be deceitful practices, in defrauding or endeavouring to defraud another of his known right by means of some artful device, contrary to the plain rules of common honesty."[296]

By merging the two classic definitions, tax avoidance schemes can be defined in criminal law as ***deceitful practices*** *to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question by means of some* ***artful device****, contrary to the plain rules of common honesty*.

2.2.2. The Device: A Cheat by Design

The corollary of the principle that cheating is a conduct crime committed by "prejudice, or ... the risk of prejudicing, the Revenue's right to the tax in question" (rather than "a 'result' crime ... not indictable unless the resultant loss is alleged and proved"[297]) is that a tax avoidance scheme is a cheat by design (rather than by poor implementation).

This means that each of the professional advisers involved in *devising* it cheats the public revenue or "prejudice[s], or take[s] the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so." As Farquharson LJ stated in *Charlton*:

> "The case for the prosecution was that Charlton had devised a dishonest, tax-avoidance scheme for the benefit of some of the firm's clients and that

[296] Hawkins (1716), p.187. Emphases supplied.
[297] Stuart-Smith, LJ, *Hunt*, p.826.

> the Appellants were involved with the implementation of the schemes or the concealment from the Revenue of the existence of the fraud."[298]

This shows that *marketing* or *implementing* or *concealing* or *otherwise facilitating the use* of the scheme is a distinct and separate *actus reus* or "prejudice, or ... risk of prejudicing, the Revenue's right to the tax in question" from *devising* the scheme, which consummates the offence.

In terms of the DOTAS legislation, a tax avoidance scheme amounts to cheating the public revenue or "prejudice, or ... risk of prejudicing, the Revenue's right to the tax in question" when "*it is capable of implementation in practice*" under HMRC's definition of "when it is made available for implementation by others", namely:

> "A person makes a scheme available for implementation if and when:
> • the scheme is fully designed
> • it is capable of implementation in practice
> • he/she communicates information about the scheme to potential clients suggesting that they consider entering into transactions forming part of the scheme."[299]

In other words, the fact that "the scheme is fully designed" may not suffice. According to HMRC:

> "The design of a scheme will typically consist of a number of elements (e.g. a partnership, a loan, partner's contributions, the purchase of assets, etc) structured to deliver the expected tax advantage. The scheme will be capable of implementation in practice only when the elements of the design have been put into place 'on the ground'. So, for example, if the design includes a loan, it will be capable of implementation only if and when an actual loan provider is in place and funds made available."[300]

The scheme is, therefore, already a cheat or fraud in law at the third stage where "he/she communicates information about the scheme to potential clients suggesting that they consider entering into transactions forming part of the scheme." According to HMRC:

> "A scheme can be made available by more than one person such as by the scheme designer or those who provide the scheme under a licensing agreement with the designer."[301]

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[298] *Charlton*, p.505.
[299] HMRC, *DOTAS Guidance*, para.3.5. Emphasis supplied.
[300] Ibid.
[301] Ibid.

The prevailing view that a tax avoidance scheme can only amount to cheating or fraud by poor implementation, which underpins the tax avoidance industry, was effectively rejected in *Charlton*. As Masters, who was called as an expert witness for Charlton, put it in his article:

> "I was asked about the types of tax saving schemes that were current at the time the *Charlton* transactions were implemented. This was relevant because the impression being given by the Inland Revenue was that the schemes themselves were illegal. This clearly was not the case. Whether the way they were implemented was illegal was another matter altogether (and one for the jury to decide). The Inland Revenue was, to say the least, not strenuous in its efforts to make this distinction clear. … The opening paragraph of the Crown's Statement of Evidence is interesting:
>
> > 'The prosecution case is that each of the defendants participated in one or more of a series of similar schemes to cheat the public revenue. The purpose and effect of each scheme was the same. The apparent taxable profits of a United Kingdom business would be reduced below their true level. An untaxed fund would accumulate in an offshore company for the use of the directors/proprietors of the United Kingdom business.'
>
> This is not focusing on the true issue. The schemes might well have had the purpose and effect attributed to them, that certainly does not make them illegal. Any improper and dishonest implementation of such schemes or inaccurate reporting to the Inland Revenue might make them illegal but that is another matter."[302]

Benson J, with whom the jury and the Court of Appeal agreed, rejected these submissions, stating:

> "I do not accept the proposition, perhaps the jury will, that sales and purchases do not cease to be real if the objective is to seek the dishonest reduction of tax liability."[303]

As the object or purpose of a tax avoidance scheme is "to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question" ("The object of a tax avoidance scheme is to enable the taxpayer to enjoy a taxable event without paying the tax."[304]) the question of illegality is completed by devising the scheme and does not turn on "the way they were implemented", let alone on "inaccurate reporting to the Revenue". To adopt the words of Gammie:

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[302] Masters, pp 388-389.
[303] *Charlton*, pp.507-508.
[304] Templeman, 'Tax and the Taxpayer', p.576.

> "Tax liabilities ... ought not to be capable of being negated by the simple expedient of passing papers round a table; it made no sense to impose a tax if tax could be so easily avoided."[305]

As if to confirm the principle that cheating is a conduct crime which means "that the actual result of the loss does not need to be proved"[306], which underscores the irrelevance of "the way they were implemented", Farquharson LJ stated that "there was no loss to the public purse".[307]

2.2.3. The Deceit: A Mismatch between the Tax and True Positions

A tax avoidance scheme is a cheat and a fraud by design because of an in-built deceit or misrepresentation. The object – "to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question" or "to enable the taxpayer to enjoy a taxable event without paying the tax"[308] – requires the creation of a mismatch between the true or economic position that exists in the real world for other purposes and the false or fiscal position that is presented to the Revenue for tax purposes.

Under the GAAR, each of the "examples of something which might indicate that tax arrangements are abusive"[309] involves such a mismatch or false representation:

> "(a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,
> (b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and
> (c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid".[310]

Bergin's apt analogy of Starbucks' scheme illustrates how "the arrangements result in an amount of ... profits ... for tax purposes that is significantly less than the amount for economic purposes":

> "Starbucks' coffee menu famously baffles some people. In Britain, it's their accounts that are confusing. Starbucks has been telling investors the business was profitable, even as it consistently reported losses. This

[305] Simpson and Stewart (ed).
[306] Stuart-Smith LJ, *Hunt*, p.827.
[307] *Charlton*, p.532.
[308] Templeman.
[309] S.207(4) FA 2013.
[310] Ibid.

> apparent contradiction arises from tax avoidance, and sheds light on ... tactics used by multinationals the world over. Starbucks has told investors one thing and the taxman another. ...
>
> Accounts filed by its UK subsidiary show that since it opened in the UK in 1998 the company has racked up over 3 billion pounds in coffee sales, and opened 735 outlets but paid only 8.6 million pounds in income taxes, largely due because the taxman disallowed some deductions. Over the past three years, Starbucks has reported no profit, and paid no income tax, on sales of 1.2 billion pounds in the UK. ... Yet transcripts of investor and analyst calls over 12 years show Starbucks officials regularly talked about the UK business as 'profitable', said they were very pleased with it, or even cited it as an example to follow for operations back home in the United States. ...
>
> You could think of Starbucks' differing versions of its experience in the UK as two different coffees. To its investors, it sells an espresso - strong and vibrant. The UK taxman gets a watered-down Americano."[311]

To tell investors one thing and the taxman another to avoid tax is to cheat the public revenue.

Lord Templeman's summary in *Ensign* illustrates how "the arrangements result in a claim for the repayment ... that has not been, and is unlikely to be, paid":

> "The scheme in the present case had the apparently magic result of creating for tax purposes an expenditure of $14,000,000 while incurring a real expenditure of only $3,250,000."[312]

The judicial review in *Matrix-Securities v IRC*[313] turned similarly on what Lord Templeman described as "the contradiction between the letter dated 15 July 1993 to the inspector which refers to a price of £95m for the relevant interest and the letter dated 19 August 1993 to the receiver which refers to a price of £8m"[314], which underpinned the scheme. As he put it:

> "The South Quay trust is a tax avoidance scheme because it aims to produce fiscal expenditure of £95m and a real expenditure of only £8m. The courts have long since insisted that fiscal consequences correspond to real consequences.
>
> Every tax avoidance scheme involves a trick and a pretence. It is the task of the Revenue to unravel the trick and the duty of the court to ignore the pretence."[315]

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311 'Starbucks slips the UK tax hook', *Reuters*, October 15, 2012. Emphases supplied.
312 *Ensign*, p.238.
313 [1994] STC 272.
314 *Matrix*, p.280.
315 Ibid, p.281.

It is the duty of the court to unravel every tax scheme which invariably involves a trick and a pretence.

2.2.4. "Honest" Tax Avoidance Scheme

The corollary of the proposition that a tax avoidance scheme is a cheat by design is that the apologist notion of "honest" tax avoidance scheme is a contradiction in terms.

In *Burmah Oil*, Lord Fraser claimed that "the fact that the purpose of the scheme was tax avoidance does not carry any implication that it was in any way reprehensible or other than perfectly honest and respectable."[316]

In *Furniss*, Lord Brightman stated that the scheme is "a simple and honest scheme which merely seeks to defer payment of tax until the taxpayer has received into his hands the gain which he has made."[317] To "defer payment of tax" is to "to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question".

2.2.5. "Dishonest" Tax Avoidance Scheme

The converse corollary of the proposition that a tax avoidance scheme is a cheat by design is that Lord Farquharson's description of the scheme in *Charlton* as "a dishonest, tax-avoidance scheme"[318] is tautology.

2.3. CONSPIRACY TO DEFRAUD

Paragraph 8 of the Information in *USA v KPMG* underscores the proposition that a tax avoidance scheme is a conspiracy to a cheat and defraud by design:

> "During the period from at least in or about 1996 through at least in or about 2003, the defendant KPMG, and others known and unknown (hereinafter the 'co-conspirators'), participated in a scheme to defraud the IRS by devising, marketing, and implementing fraudulent tax shelters, by preparing and causing to be prepared, and filing and causing to be filed with the IRS false and fraudulent U.S. individual income tax returns containing the fraudulent tax shelter losses, and by fraudulently concealing from the IRS

[316] [1982] STC 30, 37.
[317] [1984] STC 153, 159-160.
[318] *Charlton*, p.505.

> those shelters. This illegal course of conduct was deliberately approved and perpetrated at the highest levels of KPMG's tax management, and involved dozens of KPMG partners and other personnel."

The underlined words show that what Commissioner Everson referred to as the "point such conduct passes from clever accounting and lawyering to theft from the people"[319] was when the scheme was devised.

The two reasons given by the Government for rejecting the Law Commission's recommendation to abolish conspiracy to defraud are particularly relevant to tax avoidance:

> "It was argued that conspiracy to defraud was well defined and is not tied to economic gain or loss, but only requires that the conduct prejudices another person's rights. That makes it particularly useful in intellectual property cases and in cases where no economic loss has been suffered. ...
>
> It is also useful in dealing with cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions.
>
> Some respondents referred to limitations on statutory conspiracy (under the Criminal Law Act 1977) - in particular that the parties to it must intend that the substantive offence will be perpetrated by one or more of the conspirators. This is not required for conspiracy to defraud. In *Hollinshead*[320] for example the defendants conspired to market devices for use by third parties to avoid paying for electricity used. The Court of Appeal held that this did not amount to a conspiracy to commit offences under section 2 of the 1977 Act, as the defendants themselves were not practising the fraud on the electricity companies, but it did constitute conspiracy to defraud. One respondent said that this situation often arose in cases involving intellectual property: for example a group of people conspire to manufacture counterfeit goods but do not themselves commit any deception in selling them on to another person, who makes the actual public sale. ... Bearing in mind in particular the *Hollinshead* type of case, we decided to accept the view of the majority and retain common law conspiracy to defraud for the present."[321]

Tax avoidance schemes, which are cheats and frauds by design, are a "*Hollinshead* type of case" because the professional enablers that devise them "do not themselves commit any deception in selling them on to" the participating taxpayers who make the false representation in the tax returns submitted to the Revenue. This is why a conduct offence like cheating or conspiracy to defraud which "is not tied to economic gain or

[319] KMPG.
[320] [1985] 1 All ER 850.
[321] *Fraud Law Reform*, paras 41, 42 and 45. Emphases supplied.

loss, but only requires that the conduct prejudices [the Revenue's] rights" is "particularly useful in [tax avoidance] cases where no economic loss has been suffered" just by devising and marketing the schemes.

A tax avoidance scheme is also the paradigm of "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions." The growth of the tax avoidance industry is attributable to the failure of judges to recognise this fact. As Lord Templeman put it in *Fitzwilliam*:

> "The earliest case in which a tax avoidance scheme appears to have been considered as a whole and held to be ineffective for the purpose of the tax sought to be avoided was *Lupton v FA & AB*. That was a dividend stripping device.
>
> Since the dividend stripping cases there have been several cases in which a tax avoidance scheme has been considered as a whole and in which the device of self cancelling or circulating payments has been held to be ineffective for the purpose of the tax sought to be avoided. These cases are *Black Nominees v Nicol*, *Ramsay, Eilbeck v Rawling, Burmah* and *Moodie v IRC*. The scheme in the present case with regard to the contingent moiety provides another example.
>
> There have been several cases in which a tax avoidance scheme has been considered as a whole and in which the device of dividing one transaction into two or more has been held to be ineffective for the purpose of the tax sought to be avoided. These cases are *Floor v Davis*, *Chinn v Collins*, *Furniss v Dawson* and *Ensign Tankers v Stokes*. The scheme in the present case with regard to the vested moiety provides another example....
>
> All decisions of this House are founded on justice, principle and precedent. If an individual taxpayer employs a device to avoid tax the result is unjust because the Revenue are deprived of money intended by Parliament to be available for the common good. ...
>
> **On principle, transactions such as tax avoidance schemes which are intended to operate as a whole must be judged by the results of those transactions considered as a whole, not by the language of each transaction considered separately**. ...
>
> In common with my predecessors I regard tax avoidance schemes of the kind invented and implemented in the present case as no better than attempts to cheat the Revenue."[322]

The highlighted principle is why it is important to recognise that a tax avoidance scheme requires more than one transaction and why it is defined in this thesis as ***two or more***

[322] [1993] STC 502, 534-535. Emphasis supplied.

interrelated *transactions of a kind which had never taken place before the tax Act it was devised to cheat or defraud was passed devised as a result of it*.

2.4. FRAUD UPON AN ACT OR FRAUD ON THE LAW OR ABUSE OF LAW

2.4.1. Fraud or Cheating

The concept of fraud upon an Act or fraud on the law or abuse of law or evasion or avoidance of an Act originated from Roman law. According to Van der Stok:

> "*In fraudem legis agere* concerns, according to the Roman lawyer Paulus, the act of someone *qui salvis verbis legis sententiam ejus circumvenit* (who without infringing the words of the law, deceives the purport thereof)."[323]

It is simply fraud which "acts upon the offence, by setting aside the fraudulent transaction" in the construction of statutes in civil proceedings. According to Bennion:

> "The courts have frequently held that a construction is to be preferred that prevents evasion of the intention evinced by Parliament to provide an effective remedy for the mischief against which the enactment is directed. When deliberately embarked on, such evasion is judicially described as a fraud on the Act."[324]

In *Bills v Smith*, Cockburn CJ explained that "the courts, from the time of Lord Mansfield, held that if a trader, in contemplation of bankruptcy, with a view to evade the bankruptcy law, preferred a particular creditor to the detriment of the rest, such a preference was a fraud upon the law."[325]

In the 1824 case of *Fox v Bishop of Chester*, Abbott CJ referred to "the well-known principle of law, that the provisions of an Act of Parliament shall not be evaded by shift or contrivance."[326]

2.4.2. Fraud Upon a Tax Act or Fraud on Tax Law or Abuse of Tax Law

Phillimore translated the concept of fraud on the law as "*contra legem facit qui id facit quod lex prohibet – in fraudem vero legis qui salvis verbis legis, sententiam ejus*

[323] 'General anti-avoidance provisions: a Dutch treat', (1998) B.T.R. 150, 151.
[324] Ibid, p.1010.
[325] (1865) 6 B&S 314, 319.
[326] (1824) 2 B&C 635, 655.

circumvenit" (or "**he violated the law who transgressed its meaning, though he kept within its letter**.)"[327]

A tax avoidance scheme or *two or more interrelated transactions of a kind which had never taken place before the* tax *Act it was devised to cheat or defraud was passed, devised as a result of it* is a fraud upon a Tax Act or a fraud on tax law or an abuse of tax law, hence the familiar expression embedded in HMRC's and UK Government's definition:

> "Tax avoidance involves bending the rules of the tax system to gain a tax advantage that Parliament never intended. It often involves contrived, artificial transactions that serve little or no purpose other than to produce this advantage. **It involves operating within the letter – but not the spirit – of the law**."[328]

As explained in chapter one, "bending the rules of the tax system to gain a tax advantage that Parliament never intended" constitutes "fraudulent conduct ... to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question"; and "contrived, artificial transactions that serve little or no purpose other than to produce this advantage" amount to "deceitful practices, in defrauding or endeavouring to defraud [the Revenue] by means of some artful device, contrary to the plain rules of common honesty."

The false dichotomy between "the letter" and "the spirit" of the law involves the failure to "remember that the Tax Acts are but a part of the general law of the land."[329] To adopt the words of Lord Hoffmann in *Norglen*:

> "It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes. There is no need for such spooky jurisprudence."[330]

The subversion of the rule of law by tax avoidance schemes is better understood by considering the notion of "legal" avoidance of tax law as a contradiction in terms that illustrates the Orwellian doublethink:

> "**If you kept the small rules, you could break the big ones."**[331]

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[327] *Principles and Maxims of Jurisprudence* (London: Parker and Son, 1856), p.314.
[328] HMT, *Tackling Tax Evasion and Avoidance*, p.5; HMRC, *Measuring Tax Gaps*, p.5.
[329] "Watchful", p.119.
[330] [1999] 2 AC 1, 14.
[331] Orwell, *Nineteen Eighty-Four*.

A tax avoidance scheme involves the use of the **small rules** (or particular provision(s) of the relevant tax Act) **to break the big ones** (or general principles like the pre-existing common law of cheating the public revenue and tax fraud). According to Monroe:

> "It may be difficult to identify comprehensively and with precision the factors which characterise such schemes for the schemes are many and varied. The categories of fiscal ingenuity are not closed. A common starting point is to find a statutory relief or other provision in the tax code normally invoked to obtain a reduction in a taxpayer's liability in the context of some commercial transaction. A transaction bearing a marked resemblance to such a commercial transaction is then engineered and the relief or deduction is claimed."[332]

In *Willoughby*, Lord Nolan described a tax avoidance scheme as "a course of action designed to conflict with or defeat the evident intention of Parliament."[333] In *Lupton*, Lord Donovan described it as "the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons."[334]

In *Plummer*[335], Viscount Dilhorne described Rossminster's Capital Income Plan masterminded by Roy Tucker as "an ingenious, complicated and well thought out scheme ... to avoid the payment of tax by those who participated and to raid the Treasury using the technicalities of revenue law as the necessary weapon."[336] According to an associate:

> "Roy could take a piece of legislation and come up with a tax-avoidance idea in ten minutes".[337]

The House of Lords held that the scheme "worked" by a majority (Viscount Dilhorne and Lord Diplock dissenting). Lord Wilberforce concluded:

> "One final point: the familiar argument was used that Parliament can never have intended to exempt from the taxing provisions an arrangement solely designed to obtain fiscal advantages. But this is not the question, nor is a canon of interpretation of this kind admissible - or indeed a workable canon. The question is whether a certain series of transactions in a certain legal form do or do not fall within the taxing words. If they do not, and if Parliament dislikes the consequence, it can change the law - as in fact it

[332] (1981) 74.
[333] [1997] 1003.
[334] [1972] 657.
[335] [1979] STC 793.
[336] 54 TC 1, 44.
[337] Gillard, p.59, citing Richard Gardner.

> has done since the scheme in question was operated. The subject is entitled to be judged under the law as it stood at the relevant time."[338]

"The subject is entitled to be judged under the law as it stood at the relevant time" but *the law* includes both the tax Act which the tax avoidance scheme was devised to cheat and the pre-existing common law that prohibits the cheating.

In an interview published by the *Financial Times* on 9 October 1979 (following the hearing of *Plummer* by the House of Lords in June but before the delivery of the judgment in November 1979) Tucker demonstrated how the notion that "if Parliament dislikes the consequence, it can change the law" sends Parliament and the Revenue on a fool's errand in the context of "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it":

> "After working out the avoidance objective the Revenue was trying to ban, you start thinking of other ways of reaching the same result."

Writing in 2012, Roy Lyness (who masterminded the 'K2' scheme used by comedian Jimmy Carr and others) provided this up-to-date analogy:

> "It's a game of cat and mouse. The Revenue closes one scheme, we find another way round it. It's like a sat-nav. I'm driving to Manchester, get a message saying there's a smash at Stoke, press this button to re-route. That's all we do with tax avoidance. The Revenue puts a block in, we just go round the block."[339]

These brazen statements illustrate what Lord Eldon described in 1829 in *Fox v Bishop of Chester* as "a fraud on the law, or ... an insult to an Act of Parliament".[340]

2.4.3. Abuse of Right

The common misconception that abuse of law or fraud upon an Act (which equates to *fraude à la loi* or *fraus legis* in civil law jurisdictions) has no place in the common law results from the failure to distinguish it from the different concept of abuse of right (or *abus de droit* in civil law jurisdictions).

[338] *Plummer*, pp.38-44.
[339] Mostrous (2012).
[340] (1829) I D&C 416, 429-430.

Abuse of right also originated in Roman jurisprudence and was translated by Maule, J in *Acton v Blundell* thus: "if a man digs a well in his own field, and thereby drains his neighbour's, he may do so, unless he does it maliciously."[341] In other words, while abuse of law is concerned with "purpose", abuse of right considers "motive".

In *Mayor of Bradford v Pickles*, Smith, L.J. explained that the law on abuse of right was "definitively settled"[342] by the House of Lords in *Chasemore v Richards* where Lord *Wensleydale* held that:

> "The civil law deems an act, otherwise lawful in itself, illegal if done with a malicious intent of injuring a neighbour, *animo vicino nocendi* … but this principle has not found a place in our law."[343]

Following *Bradford*, the House of Lords emphasised through Lord Herschell in *Allen v Flood* that:

> "It is certainly a general rule of our law that an act prima facie lawful is not unlawful and actionable on account of the motive which dictated it."[344]

2.4.4. The Supposed Rejection of Abuse of Law in English Law

In *Bayliss v Gregory*, which is one of the co-joined appeals in *Craven v White* that started the retreat from the *Ramsay* principle, Vinelott J rejected the Revenue's argument for the extension of the inchoate fiscal nullity version that reached its high-water mark in *Furniss v Dawson* into a full-fledged fraud principle by invoking *abuse of right*:

> "It is immaterial for this purpose that Mr Gregory, the majority shareholder in Holdings, had de facto control of Holdings and that the exchange was made with a view to the avoidance or the indefinite postponement of a liability to capital gains tax and for no other purpose. The doctrine of abuse of right by a taxpayer which obtains in some continental countries has no place in our jurisprudence."[345]

[341] 12 M. & W. 324, 336.
[342] [1895] 1 Ch 145,162.
[343] 7 H. L. C. 349, 388.
[344] [1898] AC 1, 123-124.
[345] [1986] S.T.C. 22, 43-44. Emphasis supplied.

Commenting on the application by the ECJ of the concept of 'abusive practice' it developed in non-tax cases to the Sixth VAT Directive in *Halifax v Customs and Excise Commissioners*[346], Freedman cited Vinelott J's statement and referred to *abuse of law*:

> "The concept of abuse of law has been rejected in UK tax law in the past but may now be entering into UK jurisprudence through this and other decisions of the ECJ. It is possible that the development of this jurisprudence in a European context could even have an influence on the development of the UK direct tax case law, although it is more likely that it will be confined to indirect tax. It could be that legislation will be needed to clarify the full effect of the *Halifax* case."[347]

Dixon and Cannon also argued that Vinelott J stated his rejection in *Bayliss* "far too emphatically so for us to suddenly embrace"[348] the abuse doctrine.

As abuse of law or fraud upon an Act is a bona fide common law principle that corresponds to the concept of fraud, there is no legal objection to the application of the abuse doctrine in tax avoidance cases in the UK.

2.4.5. The Rejection of the Business Purpose Test in Canada

The Supreme Court of Canada also rejected the business purpose test in *Stubart Investments v The Queen*[349] by equating abuse of law to abuse of rights. Justice Estey stated:

> "What then is the law in Canada as regards the right of a taxpayer to order his affairs so as to reduce his tax liability without breaching any express term in the statute? Historically, the judicial response is found in *Bradford v Pickles*, where it was stated:
>
> > 'If it was a lawful act, however ill the motive might be, he had a right to do it. If it was an unlawful act, however good his motive might be, he would have no right to do it.'[350]
> >
> > 'No use of property, which would be legal if due to a proper motive, can become illegal because it is prompted by a motive which is improper or even malicious.'[351]"[352]

[346] [2006] E.C.R. I-1609.
[347] Freedman (2007) *L.Q.R.* 53, 83. Emphasis supplied.
[348] 'Halifax and Ramsay', *Tax Journal*, March 12, 2007.
[349] [1984] 1 S.C.R. 536, 552.
[350] Lord Halsbury, p.594.
[351] Lord Watson, p.598.
[352] [1984] 1 S.C.R. 536, 552.

As explained above, *Bradford* was concerned with *abuse of right*, and did not involve taxation. In fact, the misconception in *Stubart* originated from the judges' reliance on an article by Ward and Cullity entitled "Abuse of Rights and the Business Purpose Test as Applied to Taxing Statutes''[353], which Justice Estey described as "the high water mark in the opposition to the introduction of a business purpose test."[354] When it was presented in *The Cambridge Lectures*[355] in 1981 the French scholar André Tunc noted that it "depart[ed] from the proper field of abuse of right" into the territory of "a *simulation* or a *fraude à la loi* which are quite different concepts"[356], and concluded:

> "It is a general doctrine of French law that, when people try to conceal an operation behind the appearance of another one, for instance, to conceal a gift under the appearance of a sale, the operation should be submitted as regards its substance, if not its form, to the rules governing the operation intended by the parties: this is the doctrine of simulation. Furthermore, people cannot evade the law by doing something for the sole purpose of avoiding a rule of law. For instance, married persons may not change their nationalities for the sole purpose of obtaining a divorce: this would be a *fraude à la loi.* The distinction is very important if we now consider tax law. I understand from the Ward-Cullity paper that abuse of right is used in Canada in the field of tax law. As far as I know, it is not used in France in this field. ... Even the concept of *fraude à la loi* is very narrowly used. It is a well settled doctrine of the Conseil d'Etat that someone trying to reach a certain result may do what is necessary to attain it at the smallest possible tax cost as long as he does not violate the law or dissumulate as to what he is doing."[357]

Fraude à la loi corresponds to fraud on the law while *simulation* corresponds to the English doctrine of sham expounded in chapter eight. Both are different from *abus de droit* or abuse of right.

2.5. FRAUD

The fundamental difference between 'criminal' and 'civil' fraud is that whereas fraud or cheating or dishonesty will be the central issue in relevant criminal proceedings, it has to be pleaded and proved in civil proceedings. In his classic statement in *Davy v Garrett* Thesiger LJ stated:

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[353] (1981), 29 *Can. Tax J*. 451.
[354] *Stubart*, p.575.
[355] (Toronto: Butterworths, 1981) pp.120-149.
[356] 'The French Concept of *abus de droit*', ibid, p.153.
[357] Ibid, p.154.

> "In the Common Law Courts no rule was more clearly settled than that fraud must be distinctly alleged and as distinctly proved, and that it was not allowable to leave fraud to be inferred from the facts. It is said that a different rule prevailed in the Court of Chancery. I think that this cannot be correct."[358]

More recent authority is consistent with the principle that fraud or dishonesty must be pleaded. As Gibson LJ put it in *Wimpey v V. I. Construction*:

> "It is trite law that dishonesty must be pleaded with full particulars and put to the person alleged to be dishonest. This is an essential procedural safeguard on which the courts insist. It is not open to the court to infer dishonesty from facts which have not been pleaded. Nor is it open to the court to infer dishonesty from facts which have been pleaded but are consistent with honesty."[359]

As a tax avoidance scheme is a fraud by design, the application of this procedural safeguard obscures its fraudulent nature as demonstrated in the Introduction. In the words of Lord Denning's classic statement in *Lazarus*:

> "No court in this land will allow a person to keep an advantage which he has obtained by fraud. ... Fraud unravels everything. The court is careful not to find fraud unless it is distinctly pleaded and proved; but once it is proved, it vitiates judgments, contracts and all transactions whatsoever."[360]

By being "careful not to find fraud unless it is distinctly pleaded and proved", therefore, every "court in this land will allow a person to keep an advantage which he has obtained by fraud" in tax avoidance litigation where fraud is not "distinctly pleaded and proved" by the Revenue.

The procedural safeguard thus serves as a protective shield for the tax avoidance industry because members of the Revenue Bar acting on behalf of the Revenue fail to plead fraud in what can be described as doing everything possible to win the battle (against the impugned tax avoidance scheme) whilst doing everything possible not to win the war (against all tax avoidance schemes). This bars the investigation of the fraudulent nature of a tax avoidance scheme and protects the dogma that "tax avoidance is legal and tax evasion is illegal".

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[358] (1878) 7 Ch.D. 473, 489.
[359] [2005] EWCA Civ *77* [31].
[360] [1956] 1 Q.B. 702, 712.

In *Ramsay*, Rossminster's marketing letter to the participating taxpayers[361] (in Appendix 3) shows that the scheme amounted to "prejudice, or ... the risk of prejudicing, the Revenue's right to the tax in question" when it was devised and thus made "capable of implementation in practice", which was well before February 23, 1973 when it was sold to the taxpayer-company and thus "made available for implementation".

The object of what the letter described as "the detailed steps to be taken to implement the Scheme"[362], which are summarised in the letter as "transactions" "(a)" to "(o)", was to create a mismatch between the true position at (a) that exists in the real world and the tax position at (o) that is presented to the Revenue. As Rossminster acknowledged:

> "The Scheme is a pure tax avoidance scheme and has no commercial justification insofar as there is no prospect of T making a profit; indeed he is certain to make a loss representing the cost of undertaking the Scheme."[363]

Nothing, therefore, turned on the way "transactions" (a) to (o) were actually "implemented". According to the Special Commissioners:

> "The object of the tax avoidance scheme summarised in [the] letter was, as the Appellant Company admitted, to manufacture a loss which would reduce a chargeable gain of £187,977 which had accrued to the Appellant Company on the sale of a freehold farm."[364]

Again, "to manufacture a loss which would reduce a chargeable gain of £187,977 which had accrued to the Appellant Company on the sale of a freehold farm" is to cheat the public revenue or "to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question".

Lord Templeman's famous speech in the Court of Appeal demonstrates how the procedural principle that "[t]he court is careful not to find fraud unless it is distinctly pleaded and proved" overrides the substantive principle that "[f]raud unravels everything" and thus obscures the fraudulent nature of tax avoidance in civil proceedings:

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[361] *Ramsay*, pp.109-111.
[362] Ibid, p.109.
[363] *Ramsay*, p.111.
[364] Ibid, p.115.

> "This is a Revenue appeal from Goulding J. The facts as set out in the Case Stated by the Special Commissioners demonstrate yet another circular game in which the taxpayer and a few hired performers act out a play; nothing happens save that the Houdini taxpayer appears to escape from the manacles of tax. The game is recognisable by four rules. First, the play is devised and scripted prior to performance. Secondly, real money and real documents are circulated and exchanged. Thirdly, the money is returned by the end of the performance. Fourthly, the financial position of the actors is the same at the end as it was in the beginning save that the taxpayer in the course of the performance pays the hired actors for their services. The object of the performance is to create the illusion that something has happened, that Hamlet has been killed and that Bottom did don an asses head so that tax advantages can be claimed as if something had happened. The audience are informed that the actors reserve the right to walk out in the middle of the performance but in fact they are the creatures of the consultant who has sold and the taxpayer who has bought the play; the actors are never in a position to make a profit and there is no chance that they will go on strike. The critics are mistakenly informed that the play is based on a classic masterpiece called 'The Duke of Westminster' but in that piece the old retainer entered the theatre with his salary and left with a genuine entitlement to his salary and to an additional annuity. The game now under appeal was put on the market by the tax consultants, Dovercliffe Consultants Ltd., and was bought by the taxpayer, W. T. Ramsay Ltd. The taxpayer arranged to borrow money from the bankers, Slater Walker Ltd., on terms that the money should be used only for the performance and with safeguards which ensured that the bankers would be reimbursed. The taxpayer and the consultants revolved and exchanged money through companies controlled by them or their directors and thereby at negligible cost to the taxpayer and without earning a gain or suffering a loss created for the taxpayer a claim for a non-taxable gain and for a tax deductible loss, thus achieving no result save a manufactured claim to entitlement to tax relief.
>
> The Crown assumed that the majority decision of this Court in *Floor v Davis* was indistinguishable and precluded them from relying on the fact that nothing happened in the present case except the manufacture of a tax advantage. They reserve the right to argue otherwise in the House of Lords. Therefore I concentrate on the capital gain as though it was independent of the capital loss and inspired by commerce."[365]

As expounded in chapter eleven, the two decisions of the Privy Council that established the tax dogma – *Simms v Registrar of Probates*[366] and *Bullivant and Others v Attorney-General for Victoria*[367] – turned on the Revenue's failure to plead fraud. As Lord Halsbury put it in *Bullivant*:

> "[I]n the parallel, but not exactly similar, case in the Privy Council where the word 'evade' was used, the Privy Council held that it must be understood

[365] *Ramsay*, pp.128-129.
[366] [1900] A.C. 323.
[367] [1901] A.C. 196.

> that where it was intended to be an allegation that a fraud had been committed you must allege it and prove it: *Simms*."[368]

More than a century later, the tax dogma continues to rely upon the failure by counsel for the Revenue to plead fraud. In *Ingenious Games LLP v HMRC* Henderson J reversed the decision of the FTT not to permit HMRC to allege dishonesty when questioning witnesses since it failed to make those allegations in its statement of case but acknowledged that:

> "There has also been a recurrent theme of assurances given to the FTT, sometimes in apparently unqualified terms, to the effect that HMRC were not alleging fraud or dishonesty against anybody. While it is true … that HMRC were under no obligation to plead a positive case of fraud or dishonesty … the impression given to a neutral observer by some of HMRC's exchanges with the FTT could be one of ambivalence, even at times evasiveness, and a willingness to wound but not to strike, in an area where openness and clarity should be at a premium unless HMRC had some good reason for wishing to spring a surprise on an unsuspecting witness."[369]

Furthermore, judges occasionally go beyond the procedural safeguard that fraud must be pleaded and proved distinctly to reaffirm the dogma that "tax avoidance is legal" by attesting to the "honesty" of tax avoidance schemes where fraud or dishonesty is not in issue or in evidence. As demonstrated above, Lord Fraser described the scheme in *Burmah* as "perfectly honest" while Lord Brightman described the scheme in *Furniss* as "a simple and honest scheme".

In judicial review, the false representation cases - notably *Preston v IRC*[370], *MFK Underwriting v IRC*[371] and *Matrix-Securities*[372] - resulted from the fact that the Revenue could *not* "rely on the taxpayer's good faith, but more especially on the professional advisers they appoint to act for them" in the words of Lord Farquharson in *Charlton*. According to Simpson:

> "These cases begin to describe – in some detail it must be said – the obligations incumbent on the citizen who seeks clarification of the fiscal consequences of a planned transaction, or who otherwise relies on representations made on behalf of the Revenue. As at the subsequent stage of self-assessment of transactions once they have been carried into

[368] Ibid, p.202.
[369] [2015] UKUT 0105 [76].
[370] [1985] STC 282.
[371] [1989] STC 873.
[372] [1994] STC 272.

> effect, the representation cases recognise the obligations of the citizen to be open and honest when dealing with the taxing machinery."[373]

In all cases, however, the courts applied the pre-existing common law of cheating by reading the overriding duty of honesty into the administrative law doctrine of legitimate expectation despite the concessions by counsel to the Revenue to the contrary. In *Preston*, which involved a failed Rossminster scheme and a former Rossminster employee (Preston), counsel for the Revenue, Charles Potter QC (who acted on behalf of Rossminster in *Ramsay*), argued that Preston acted "innocently". As Lord Templeman stated in his judgment:

> "[C]ounsel for the taxpayer made great play with what he described as a 'concession' volunteered by counsel for the Crown in the course of argument in the Court of Appeal, namely that in the 1978 disclosures and correspondence the taxpayer acted 'innocently'. But the state of mind of the taxpayer in 1978 is not in issue or in evidence in these proceedings. I decline to be influenced by a casual, courteous and irrelevant observation made in argument by one counsel and forensically elevated by another into a 'concession'."[374]

In *Matrix-Securities*, where the dishonesty of the applicant and its professional advisers was even more blatant, as demonstrated above, Lord Jauncey confirmed the principle established in *Preston* and *MFK* that "a breach of representation by the Revenue will not amount to an abuse of power if full disclosure of all relevant material had not been made by the taxpayer prior to the making of the representation"[375] but concluded:

> "I should add that the Revenue have all along accepted both in the courts below and in this House that the applicant has throughout acted in good faith."[376]

Lord Brown-Wilkinson applied the related principle that "a failure by the taxpayer to make full disclosure of the material circumstances is not the only case in which, notwithstanding that the Revenue have given an assurance, it will be no abuse of power for the Revenue to go back on the assurance given"[377] but stated:

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[373] Simpson (2001), p.188.
[374] [1985] STC 282, 296.
[375] [1994] STC 272, 287.
[376] Ibid, p.289.
[377] Ibid, p.291.

> "However, no allegation of bad faith is made against the applicant or its solicitors and, in any event, the conduct of the applicant is not the relevant factor."[378]

As demonstrated above, the applicant's claim for breach of legitimate expectation failed because the false representation built into the scheme by the professional advisers necessitated a false representation to the Revenue. The dishonesty that defeats a judicial review claim by a participating taxpayer for alleged breach of legitimate expectation should also defeat a tax avoidance appeal because it is the defining legal feature of the scheme. This is a corollary of the substantive principle that "Fraud unravels everything" but it is defeated by the procedural principle that:

> "The court is careful not to find fraud unless it is distinctly pleaded and proved".

2.6. CONCLUSION

This chapter fortified the proposed cheating or fraud approach of judging tax avoidance schemes in criminal and civil proceedings on the basis of the legal question whether the enabling professional advisers and the participating taxpayers cheated or defrauded the public revenue in law by demonstrating the inherently fraudulent nature of a tax avoidance scheme in criminal and civil law.

It demonstrated that the corollary of the fundamental principle that cheating and fraud under the common law and fraud under the Fraud Act are 'conduct' offences committed by "deliberate dishonesty to the prejudice of another person's proprietary right"[379] (rather than 'result' offences that require proof of actual loss) is that any professional adviser involved in *devising* a tax avoidance scheme cheats the public revenue or "prejudice[s], or take[s] the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so" in the words of Hardy J's classic definition.

A tax avoidance scheme is, therefore, a fraud and a cheat by design as a matter of law regardless of whether it "works" as a matter of statutory construction under "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant."

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[378] Ibid, p.293.
[379] James J, *R v Sinclair* [1968] 1 W.L.R. 1246, 1250.

CHAPTER THREE

THE FRAUDULENT NATURE OF THE CONDUCT OF LAWYERS INVOLVED IN TAX AVOIDANCE

> **Can it then be said that the communication should be protected because it may lead to the disclosure of an illegal purpose? I think that it cannot; and that evidence which would otherwise be admissible cannot be rejected upon such a ground. On the contrary, I am very much disposed to think that the existence of the illegal purpose would prevent any privilege attaching to the communication. Where a solicitor is party to a fraud no privilege attaches to the communications with him upon the subject because the contriving of a fraud is no part of his duty as solicitor; and I think it can as little be said that it is part of the duty of a solicitor to advise his client as to the means of evading the law.**
>
> Sir G. J. Turner, VC, *Russell v Jackson* (1851) 9 Hare 387, 392-393.

3.1 INTRODUCTION

This chapter develops the inherently fraudulent nature of a tax avoidance scheme established in chapter two by demonstrating the inherently fraudulent nature of the conduct of lawyers involved in devising, marketing, implementing and otherwise facilitating the use of tax avoidance schemes.

Sir George Turner's seminal statement of the principle that where confidential communication between a lawyer and client is for the purpose of obtaining legal advice as to how to commit a fraud or an illegality or an iniquity it is not privileged is usually described as the fraud or illegality or iniquity exception to legal professional privilege (LPP), which comprises legal advice privilege (LAP) and litigation privilege (LP). In fact, such communication does not fall either within the terms of, or the rationale for, LPP because such a lawyer is not acting in his capacity as a lawyer but as a "party to a fraud". The references to "illegal purpose" show that fraud is used in the widest sense that encompasses any illegality. Other authorities refer to "crime or fraud"[380], "criminal or unlawful"[381], "iniquity"[382] and "all forms of fraud and dishonesty such as fraudulent breach of trust, fraudulent conspiracy, trickery and sham contrivances".[383]

As demonstrated in chapter two, a tax avoidance scheme is a "form of fraudulent conduct ... to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in

[380] *R v Cox* (1884) 14 Q.B.D. 153, 165.
[381] *Bullivant*, p.201.
[382] *Ventouris v Mountain* [1991] 1 W.L.R. 607, 611.
[383] *Crescent Farm v Sterling Offices* [1972] Ch. 553, 565.

question"[384] in criminal law and a fraud upon an Act or evading an Act or avoiding an Act in civil law. The conduct of a lawyer involved in devising or marketing or implementing or otherwise facilitating the use of a tax avoidance scheme, therefore, falls within Sir George Turner's statement "because the contriving of a fraud is no part of his duty as [a lawyer]; and it can as little be said that it is part of the duty of a [lawyer] to advise his client as to the means of evading the law" or avoiding the law or defrauding the law or cheating the public revenue.

The prevailing approach to the role of lawyers in avoidance presumes that it is "legal" and thus misconceives its fraudulent nature in both the criminal and civil law. According to McBarnet:

> "Lawyers are not simply means to the implementation of statutory or other ready-made rights, but creators of legal techniques, definitions, and devices. Indeed, far from being means to the implementation of rights, it is lawyers who create the devices which obviate them and render them ineffective. The legal profession, in short, is as much geared to the avoidance of law as it is to its implementation. ... Indeed, it is the creative side of the lawyer's job that is its most prestigious aspect and attracts the highest fees. It is important to give due emphasis to the active and creative role of lawyers in working against the spirit of the law. ...
>
> How can the law be used to avoid the law? This may seem rather a contradiction in terms. But law is a multifaceted phenomenon and one facet can often be used to contradict another. ... Avoidance devices use the legal *techniques* of the legal *profession* to work on the *content* of statutes and cases, to produce a method of literally complying with the words of the law while nonetheless defeating its purpose. This is done in a way which meets the requirements of the *forms* and procedures of law, may even use the *institutions* of law for endorsement, and justifies the whole process via the *ideology* of the rule of law."[385]

As explained in chapter two, the law can be used to avoid the law because avoidance devices are frauds upon an Act which use the letters of an Act to cheat or defraud the general principles of cheating or fraud. The supposed distinction between "the spirit of the law" and "the letter of the law" misconceives the fact that Acts of Parliament are but one part of the law.

The rest of this chapter uses the roles of lawyers in blessing tax schemes, concealing tax schemes, subverting anti-avoidance doctrines and defending tax schemes in

[384] Hardy J, *Less*.
[385] 'Law, Policy, and Legal Avoidance: Can Law Effectively Implement Egalitarian Policies?', *Journal of Law and Society* (1988) 113, 118.

litigation to demonstrate that “working against the spirit of the law” is cheating the public revenue in law; and that it thus dis-applies LPP.

3.2 THE BLESSING OF TAX SCHEMES

In the US where the practice originated, legal opinions are used by the professional enablers to reassure the participating taxpayers that a scheme is “More Likely than Not (MLTN)” to succeed if challenged by IRS. According to paragraph 10 of the indictment in *USA v KPMG*:

> “In order to conceal the true nature of the tax shelter from the IRS and shield the wealthy clients from IRS penalties for underpaying of U.S. individual income taxes, KPMG, and/or a law firm provided the clients with opinion letters containing false and fraudulent representation and statements and claims that the tax shelter losses were ‘more likely than not’ to survive in court if challenged by the IRS. The law in effect from at least in or about August 1997 provided that if a taxpayer claimed a tax benefit that was later disallowed, the IRS would impose substantial penalties, usually at least 20% of the tax deficiency, unless the tax benefit was supported by an independent opinion relied on by the taxpayer in good faith that the tax benefit was ‘more likely than not’ to survive IRS challenge. Thus, the conspirators issued false and fraudulent opinions letters with the intent that the clients would provide the opinion letter and/or the false and fraudulent representations and statements containing therein to the IRS if and when the clients were audited.”

The “Statement of Facts” accompanying the “Deferred Prosecution Agreement between Ernst & Young LLP and the US Department of Justice” dated February 26, 2013, under which Ernst & Young paid $123 million in fines, restitution and penalties, underscores the pivotal role of lawyers in the tax avoidance industry:

> “Beginning in 1999 and ending in 2002, ‘E&Y’, in conjunction with various law firms, banks and investment advisers, developed, marketed and implemented four tax shelter products called COBRA, CDS, CDS Add-On, and PICO. Earlier and at or about the same time, other accounting firms developed similar tax shelter products and marketed them to their clients. E&Y implemented these four tax shelter products for approximately 200 high net worth clients, intending to defer, reduce or eliminate tax liabilities for their clients of more than $2 billion in the aggregate. E&Y prepared tax returns reflecting tax losses claimed to have been derived from those tax shelter products and subsequently defended certain of its clients in connection with audits of those transactions by the IRS. E&Y received gross fees of approximately $123,000,000 with regard to these transactions. ...

> The tax shelter products were implemented with opinion letters from law firms. These legal opinions were intended to provide 'penalty protection' to individual clients in the event that the IRS audited their tax returns. The opinions were premised upon certain taxpayer representations that, in some instances, E&Y employees knew were false. E&Y did not issue opinions with regard to these transactions."[386]

Rossminster's Exempt Debt Scheme in *Ramsay* provided an early example of the adoption of this American innovation in the UK. According to Gillard:

> "During the 1972 and 1973 avoidance seasons Tucker and Plummer – together with Nicholas Pilbrow and a new partner, the solicitor Jerrold Moser – came up with a new offering, devised to avoid capital gains tax. ... Moser provided the legal drafting. ... The concept came from Tucker, while Plummer involved Slater, Walker ... as the bankers. The marketing was to be handled by Pilbrow through his Mayfair tax consultancy, Dovercliffe Consultants. The fee, to be shared among the four partners, was to be 8 per cent of the tax saved. ...
>
> The quartet began selling the latest tax-avoidance scheme in December 1971, including a new sales gimmick – legal opinions from senior members of the Revenue Bar attesting to its likely success. This was to become a hallmark of the Tucker sales pitch, which when coupled with the promise to fight a test case against the Inland Revenue to prove counsel's opinion correct amounted to an irresistible combination. To put a legal seal of approval on the Exempt Debt Scheme, the services were recruited of George Graham QC and a then leading junior barrister, Andrew Park – who was to become a familiar name in the legal opinions that accompanied Tucker sales packages – along with an opinion from a prominent company law-expert, Michael Wheeler QC. Such opinions were traditionally given privately to clients and their solicitors: their use by the clients as marketing tools to sell tax schemes was a novel approach. It seems that there were few objections from the Revenue Bar."[387]

Like Maugham's exposition analysed in the Introduction, the following exchange between the chair of the PAC and the Director of NT [No Tax] Advisers Ltd on December 6, 2012 shows that there remains no real objections to this unlawful, but highly lucrative, practice from the Revenue Bar, the legal profession, the Revenue and the courts:

> "**Q31 Chair**: Can I tell you what really shocked me about you? I have another bit of paper here headed 'Rushmore: the arrangement'. A client signs this document, which says, 'Please accept this as my instruction to create gross tax relief of,' in this case, '£250,000 through the Rushmore income tax and chargeable gains tax mitigation arrangement developed by NT (Jersey) Ltd'. In 2007-08, this person put down £125,000. In 2008-09,

[386] Exhibit B.
[387] Gillard, pp.32–36.

> they wanted £125,000, and they sign it. If the public knew that this was the sort of business you were in – deliberately avoiding tax – they would consider you to be completely, utterly and totally immoral in the work that you are doing.
>
> **Aiden James**: The product has been settled by an eminent QC. Perhaps the week before he settled that opinion, he was working for HMRC. ...
>
> **Q36 Chair**: Again, it seems completely, utterly and totally unacceptable that you just get a lawyer to sign this off, and that gives you the protection to run a business that makes money for you out of this, when this is, I repeat, purely about using tax law to get a tax advantage that Parliament never intended.
>
> **Aiden James**: As I say, the tax legislation is very complicated. It is complicated to the extent that it allows these products to work in the way that they do. As I am sure you are aware, these products have been challenged by HMRC, and the courts have, on a number of occasions, found for the taxpayer, despite the fact that these are blatantly tax avoidance arrangements."[388]

The most senior judges in the civil courts, many of whom rose to the Bench from the Revenue Bar like Andrew Park"[389], "allow these products to work in the way that they do" by persisting with what Lord Diplock condemned in 1965 as "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant", which enables them to find "for the taxpayer, despite the fact that these are blatantly tax avoidance arrangements."

By contrast, in the criminal prosecution in *Charlton*, Cunningham was convicted for "blessing" the schemes. Rejecting "his case that he acted in the best traditions of the Bar"[390], Farquharson LJ stated:

> "The Crown case against Cunningham at the outset of the trial was that he had been active with Charlton in promoting the scheme from the time it was launched. ... There was evidence before the jury in the form of Mr Wheeler's interview that he had been taken by Charlton to meet Cunningham to be reassured that the scheme as sold by Charlton was tax effective. The first conference was said to have taken place at Derby on 19 March 1982 and was relied on in opening by the Crown as being part of a pattern whereby Charlton used Cunningham to reassure any doubting participants. The Crown's case against Cunningham had been that he advised Wheeler that the scheme was effective although to his knowledge it was not."[391]

[388] PAC (2013) EV2-EV3.
[389] Notable examples from the highest court in the land include Lord Templeman, Lord Wilberforce, Lord Nolan, Lord Brightman and Lord Walker.
[390] *Charlton*, p.516.
[391] *Charlton*, p.528.

3.3 THE SUBVERSION OF JUDICIAL ANTI-AVOIDANCE DOCTRINES

In a letter to Lord Kames dated June 30, 1759, Lord Hardwicke reaffirmed the primacy of general principles like the pre-existing common law of cheating and fraud thus:

> "As to relief against frauds, no invariable rules can be established. Fraud is infinite, and were a court of equity to lay down rules, how far they would go, and no farther, in extending their relief against it, or to define strictly the species of evidences of it, the jurisdiction would be cramped, and perpetually eluded by new schemes which the fertility of man's invention would contrive."[392]

In developing the American doctrines that inspired the *Ramsay* principle, such as the sham transaction doctrine, the step transaction doctrine and the business purpose test, the courts chose "to lay down rules, how far they would go, and no farther, in extending their relief against it, or to define strictly the species of evidences of it". This enables the use of legal opinions to defeat them. According to Rostain:

> "Opinion letters are the stock in trade of tax lawyers. Although opinion will devote tens of pages to technical issues, often the critical question comes down to whether a taxpayer had a business reason for engaging in a transaction or was solely motivated by tax considerations. Since the 1930s, a handful of overlapping judicial doctrines have developed to distinguish between bona fide business and investment ventures and abusive tax shelters. These doctrines seek to find a balance between two countervailing principles underlying the American tax system: On one hand, taxpayers are allowed to arrange their affairs to minimize their taxes; on the other, they are not entitled to tax benefits obtained through formal manipulations of tax law that were not intended by Congress. As deals have become increasingly complex, it has become more and more difficult to tell when they are motivated by business rather than purely tax considerations. To be legal, tax products must resemble, as much as possible, bona fide investments. But if they entail significant risk, clients will not be interested in buying them."[393]

Paragraph 19(g) of *USA v KPMG* underscores the fundamental flaw in the use of legal opinions to meet the requirement that "[t]o be legal, tax products must resemble, as much as possible, bona fide investments":

> "The opinion letters stated that the clients were 'more likely than not' to survive an IRS challenge to the transactions based on the 'step

[392] See Yorke, *The Life and Correspondence of Philip Yorke* (Cambridge: The University Press, 1913) p.554.
[393] Rostain, p.6.

> transaction doctrine' – a legal doctrine permitting the IRS to disregard certain transactions having no economic substance or business purpose and the purported tax effects of those disregarded transactions. The assertion was false, as the conspirators well knew. Indeed, a co-conspirator not named as a defendant herein ('CC 1'), who at the time was in charge of CaTS, instructed KPMG partners involved in marketing OPIS not to permit KPMG clients who were pitched OPIS to retain a copy of KPMG's PowerPoint presentation describing the transaction 'under any circumstances' because to do so 'DESTROY any chance the client may have to avoid the step transaction doctrine.'"

The *Ramsay* principle was similarly undermined, particularly by the injection of the requirement of pre-ordainment. In *Fitzwilliam*, therefore, the lawyers devised and implemented the scheme without full prior explanation to, and express instructions from, the client because, to paraphrase KPMG, to do so would "DESTROY any chance the client may have to avoid the [*Ramsay*] doctrine." As Lord Templeman put it:

> "This appeal concerns a tax avoidance scheme which involves two separate devices. The first device consists of self-cancelling payments. ... In *Ramsay* self-cancelling payments were held by this House to be ineffective. The second device consists of carrying out one transaction by means of two transactions. ... In *Furniss* transactions divided into two were held by this House to be ineffective; for the purpose of the tax sought to be avoided, the two transactions are to be regarded as one single transaction carried out by the person who possessed power to effect that one single transaction.
>
> The taxpayer in the present case sought to distinguish *Ramsay* and *Furniss* and other authorities to the same effect on the grounds that on the advice of counsel who drafted and recommended the scheme, no explanation was given to the taxpayer by her legal advisers until after the scheme had been partly implemented. An explanation and advice were then tendered by a second counsel who had not been concerned in the authorship of the scheme. The taxpayer decided to complete and did complete the scheme. The Special Commissioners were not impressed by these suggested distinctions which, however, found favour with Vinelott J and the Court of Appeal. The Crown now appeals."[394]

Lord Templeman's dissenting speech is one the most powerful judicial affirmation of the fundamental thesis that tax avoidance is cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using an individual scheme may or may not be complicit:

[394] [1993] STC 502, 516-517.

“Capital transfer tax would be payable out of the estate before Lady Hastings came into her inheritance. The rate was 75%. Lady Fitzwilliam, Lady Hastings and the independent trustees hoped that their solicitors Currey & Co would find some way in which Lady Hastings could inherit the estate but avoid the payment of tax.

Curreys consulted Mr Walker, now a Queen’s Counsel, practising at the Chancery Bar and specialising in trusts and tax avoidance to see if he could find a way. Curreys first consulted Mr Walker on 11 October 1979 with a proposal for a tax avoidance scheme. Counsel amended the scheme from time to time and finally advised the implementation of the scheme by steps to be taken in accordance with an arranged timetable. The scheme was accepted by Curreys and was carried out between 20 December 1979 and 7 February 1980. On 18 January 1980, after step 3, Mr Herbert of counsel was asked by Curreys to advise Lady Hastings. Mr Herbert was a member of Mr Walker’s chambers. Mr Herbert was ... asked ... to ... advise only on steps 4 and 5 and to discuss the matter with Mr Walker. ...

[Counsel for the taxpayers] submitted that the scheme was not a preordained series of transactions because Lady Hastings was ‘separately advised’ after step 3. ... The ‘separate advice’ given to Lady Hastings as part of Mr Walker’s scheme did not convert steps 2, 3, 4 and 5 from a preordained series of transactions into separate transactions.

In my opinion a solicitor owes his client a duty not to embroil the client in a tax avoidance scheme or any other substantial transaction without full prior explanation and express instructions. A taxpayer who is kept in ignorance by his own solicitors when taking part in transactions which when completed form a preordained series of transactions for his benefit cannot thereafter claim that the transaction did not constitute a preordained series of transactions because of his initial ignorance. ...

People should be judged by the results of their actions and not by the language of documents intended to mislead. ...

Legal advisers should not conceal their activities from their clients in the hope of deceiving the Revenue. A client who subsequently adopts, ratifies and claims the benefit of the actions of his solicitors cannot deny the real consequences or avoid the fiscal consequences on the grounds of personal ignorance. Lord Keith does not condemn the concealment practised by Curreys with the approval of Mr Walker and does not even acknowledge that Lady Hastings was the client of Curreys and Mr Walker although the scheme was planned, concealed, implemented and completed for the benefit of Lady Hastings and nobody else.

Mr Walker’s scheme which trembled on the brink of a sham employed the devices which proved ineffective in *Ramsay* and *Furniss v Dawson*. ...

All decisions of this House are founded on justice, principle and precedent. If an individual taxpayer employs a device to avoid tax the result is unjust because the Revenue are deprived of money intended by Parliament to be available for the common good. A decision in favour of the taxpayer, Lady Hastings in this case, would enable an individual taxpayer to drive a coach and horses through any Revenue legislation by ingenious drafting and nothing else. ...

> In common with my predecessors **I regard tax avoidance schemes of the kind invented and implemented in the present case as no better than attempts to cheat the Revenue**."[395]

The professional enablers did "cheat the Revenue" because honest people do not "conceal their activities from their clients in the hope of deceiving the Revenue." As Lord Nicholls stated in his exposition of the test of "how an honest person would behave" in *Royal Brunei*:

> "Honest people do not intentionally deceive others to their detriment. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless."[396]

The Special Commissioners, whose decision Lord Templeman upheld, based it upon strikingly similar findings of fact in relation to both the professional enablers and the participating taxpayers:

> "Non-disclosure of the circumstances in which each of the five steps was taken was, we find, an essential tactic adopted in an endeavour to secure the successful implementation of the overall tax-saving plan. There was no difficulty in this respect so far as Lady Fitzwilliam was concerned because she had such complete confidence in Currey & Co, whom she regarded as very erudite and whose advice she would follow implicitly, that she gave them carte blanche to make all necessary tax arrangements. She did not wish to be concerned with the details. As to Lady Hastings she was content that Currey & Co should proceed with the tax saving arrangements without reference to her where her participation was not required. ... Lady Hastings acknowledged that she knew that Mr Powell was looking into means of reducing CTT. The evidence as a whole, however, goes further than that and leads us irresistibly to the conclusion, and we so find, that Lady Hastings was at all relevant times aware that Mr Powell was putting into effect a tax-saving scheme and that she did not know what form that scheme took because she did not at any time inquire. She hoped, however, that whatever was being done would enable Milton Hall to be retained in the family."[397]

Lord Templeman, however, concluded that Mr Walker's "blessing" immunised the taxpayer-trustees from complicity in the "attempts to cheat the Revenue", stating:

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[395] [1993] STC 502, 519-535. Emphasis supplied.
[396] *Brunei*, p.389.
[397] [1990] STC 65, 76-77.

> "The advice of Mr Walker that such a scheme could properly be implemented for the purpose of avoiding capital transfer tax for the benefit of Lady Hastings was a complete protection for all the trustees."[398]

More significantly, his decision to "regard tax avoidance schemes of the kind invented and implemented in the present case as no better than attempts to cheat the Revenue" effectively reaffirms the fallacy that "tax avoidance is legal" because it maintains the possibility that tax avoidance schemes of the kind invented and implemented in other cases are not "attempts to cheat the Revenue".

It was precisely the same false distinction drawn by the judges between "tax avoidance schemes of the kind invented and implemented in" *Ramsay* and *Furniss* and other types of tax avoidance schemes that enabled the majority in *Fitzwilliam* to uphold it. To adopt the words of Lord Macnaghten in *Reddaway v Banham*:

> "That was a gross case, no doubt. But fraud is infinite in variety. Sometimes it is audacious and unblushing; sometimes it pays a sort of homage to virtue, and then it is modest and retiring; it would be honesty itself if it could only afford it. But fraud is fraud all the same; and it is the fraud, not the manner of it, which calls for the interposition of the Court."[399]

3.4 THE CONCEALMENT OF TAX SCHEMES

Paragraphs 28 and 29 of the Information in *USA v KPMG* demonstrate how KPMG failed to register the schemes as required by the taxpayer and material advisor disclosure provisions introduced by sections 6011 and 6112 of the US Internal Revenue Code 1986[400]:

> "Under the law in effect at all times relevant to this Information, an organizer of a tax shelter was required to 'register' the shelter by filing a form with the IRS describing the transaction. The IRS in turn would issue a number to the shelter, and all individuals or entities claiming a benefit from the shelter were required to include with their income tax return a form disclosing that they had participated in a registered tax shelter, and disclosed the assigned registration number. Notwithstanding these legal requirements, KPMG and its co-conspirators decided not to register as required any of the tax shelters KPMG devised, marketed and implemented, and thereby ensured that registration numbers would not be included on returns relating to unregistered shelters.

[398] Ibid, p.526.
[399] [1896] AC 199, 221.
[400] Repealed and replaced by the American Jobs Creation Act 2004 from October 22, 2004. See Granwell and McGonigle, 'US tax shelters: a UK reprise?' [2006] *B.T.R.* 170.

> Thus, KPMG decided not to register FLIP, OPIS, or BLIPS based on a 'business decision' that to register the shelters would hamper KPMG's ability to sell them, and that the IRS penalties applicable to a failure to register would be dwarfed by the lucrative fees KPMG stood to collect from selling unregistered tax shelters. Indeed, CC 1 wrote a memorandum to a member of KPMG's tax leadership arguing that, assuming OPIS was required to be registered, KPMG should make a 'business decision' not to register OPIS because (i) registering the shelters would put KPMG at a competitive disadvantage as compared to other accounting firms, law firms and other firms that were promoting tax shelters; and (ii) selling unregistered shelters would be so lucrative that the benefits outweighed the risk of civil penalties that might be imposed. Moreover, KPMG's office of general counsel, among others, advised that by deciding not to register tax shelters, KPMG risked criminal prosecution, but like the CaTS group, advised that KPMG's tax leadership could nevertheless 'make a business decision to not register the activity as a tax shelter.'"[401]

The memorandum referred to is *The Concealment Letter in the KPMG Case* in Appendix 4.

The PAC's report of the use of legal opinions to defeat the DOTAS legislation in Part 7 of the Finance Act 2004, which originated in section 6011, shows that the same objective can be achieved in the UK without any penalty simply by procuring the "blessing" of leading counsel "who retail opinions"[402] and "who prostitute themselves to these schemes"[403]:

> "The purpose of DOTAS was to provide early information about tax avoidance schemes to HMRC, identify the users of tax avoidance schemes and reduce the supply of avoidance schemes by altering the balance of financial advantage gained from avoidance. DOTAS requires the promoter of certain types of avoidance schemes to disclose information about the scheme to HMRC within five days of making it available for use. Taxpayers who use these schemes are required to report the scheme reference number on their tax return. ...
>
> HMRC has only issued 11 penalties for £5,000 to promoters for non-disclosure of a scheme under DOTAS since its introduction. The maximum penalty was increased to £1 million in 2010, but HMRC has yet to apply this. HMRC has also yet to apply a penalty to an individual taxpayer for failing to disclose a scheme on their tax return.
>
> We were alarmed that promoters have been able to use some QCs' opinions' to protect themselves from fines for not disclosing schemes under DOTAS. HMRC is not able to fine promoters or taxpayers for not disclosing

[401] Emphasis supplied.
[402] Lord Wilberforce.
[403] Margaret Hodge.

> a scheme where they have a legal opinion that the scheme does not need to be disclosed as it constitutes a 'reasonable excuse' for not disclosing."[404]

The *KPMG* case shows that HMRC can achieve its objective by taking enforcement actions against the lawyers involved.

The Promoters of Tax Avoidance Schemes (POTAS) legislation in Part 5 and Schedules 34 to 36 Finance Act 2014, which originated in section 6012 of the IRC, does not achieve this objective.

3.5 THE ENGLISH PRACTICE

As part of the promise to fight a test case against the Revenue to vindicate counsel's opinion, the absent professional enablers usually pull the strings of the participating taxpayers by, amongst other things, choreographing their witness statements under the so-called "English practice".

In her minority decision in *Murray Group v HMRC* (the "Rangers Big Tax Case") Judge Poon stated:

> "A body of evidence that is not narrated in the majority decision, which seeks to give a judgment in principle on the efficacy of the trust arrangements as a tax avoidance scheme, is of critical relevance in forming my view of the transactions in their real terms. On the whole ... I place more reliance than my colleagues do, on the documentary evidence. As regards the oral evidence, so far as the corporate witnesses and the trustee representative of the appellants are concerned, their witness statements convey to me an element of choreography, perhaps due to the active involvement of counsel in their preparation. More specifically, I have reservations about the credibility of certain witnesses, namely, Mr Red, Mrs Crimson and Mr Scarlet. The oral evidence has already been narrated in the majority decision, and the respondents' major concern is noted regarding 'the English practice (followed here) of counsel drafting the initial form of witness statements'. In making my extra findings in fact, I have accorded greater coverage therefore to the admitted documentary evidence as providing a more realistic record of the nature of the transactions. Obliterated in some instances and by no means complete, none the less the documentary evidence that spans over a decade provides a contemporary record of the transactions as they happened at the time, and affords an account of the true intention and role of the participants in the scheme."[405]

[404] PAC (2013) pp.10-11.
[405] [2013] SFTD 149, 203.

If the oral evidence prepared with "the active involvement of counsel" and other professional enablers and presented to the court by the participating taxpayer with a view to gaining a tax advantage is dishonest, that is a "form of fraudulent [or] dishonest conduct by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so"[406] in the words of Justice Hardy's definition of cheating the public revenue.

Justice Poon's description of the role of the mastermind of the schemes shows that the supposed distinction between the conduct of the accountants, lawyers and other professional advisers involved in devising, marketing and implementing tax avoidance schemes and the conduct of members of the Revenue Bar and other lawyers whose "work involves acting in courts and tribunals for taxpayers who have engaged in what are called (in the trade) 'marketed tax avoidance schemes'"[407] is a distinction with no real difference in law:

> "The name of Paul Baxendale-Walker came up repeatedly in the course of the hearing. He loomed large in the background as the architect of the trust scheme with a continuing input into the operation of the scheme beyond its inception. Significantly, he was not called as a witness. References were made in the cross-examination of various witnesses to the fact that Mr Baxendale-Walker was suspended by the Law Society in England from practice for three years on 30 March 2003 and was eventually struck off on 29 September 2006. According to the evidence from Mr Red and Mrs Crimson, the group continued to seek the advice of Baxendale-Walker during the period of his suspension through a firm of solicitors bearing his name that operated until 30 March 2006 (the end of the suspension period). Subsequent to Baxendale-Walker being struck off by the Law Society, the appellants sought his advice through a multi-disciplinary limited liability partnership bearing his name, and of which the legal profession was not one of the disciplines."[408]

As "the operation of the scheme beyond its inception" merges with the resultant litigation, each constitutes a "form of fraudulent [or] dishonest conduct by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question".

Despite the adverse findings of fact against the participating taxpayers and the professional enablers in *Murray*, the majority in the First-Tier Tribunal and the Upper

[406] *Less*.
[407] Maugham (2015).
[408] Ibid, p.208.

Tribunal[409] upheld the scheme under the constructional approach that "allows these products to work in the way that they do."

3.6 THE FRAUD EXCEPTION TO LEGAL PROFESSIONAL PRIVILEGE

3.6.1 The Principle

The fraudulent nature of a tax avoidance scheme extinguishes LPP because of "the principle that nobody may benefit from his own civil *or* criminal wrong".

3.6.2 Legal Advice Privilege (LAP)

The leading case of *Bullivant*, which is one of the two decisions of the Privy Council that established the dogma "tax evasion is illegal but tax avoidance is legal", originated from an information filed in the Supreme Court of Victoria by the respondent on behalf of the Queen against the executors of the testator on the grounds that he conveyed estates to certain persons (including the appellants) "with intent to evade the payment of duty" contrary to section 115 of the Administration and Probate Act, 1890 of the Colony of Victoria. The issue was whether the defendant was entitled to withhold relevant documents on the grounds of LAP. Judge Mathew held that the fraud exception to LAP applied to compel disclosure. The Court of Appeal agreed.[410]

The House of Lords did not disturb the decision of the Court of Appeal in principle but reversed it on the procedural ground that fraud was not pleaded and proved distinctly. As Lord Halsbury put it:

> "I think the broad propositions may be very simply stated: for the perfect administration of justice, and for the protection of the confidence which exists between a solicitor and his client, it has been established as a principle of public policy that those confidential communications shall not be subject to production. But to that, of course, this limitation has been put, and justly put, that no Court can be called upon to protect communications which are in themselves parts of a criminal or unlawful proceeding. Those are the two principles. ... The line which the Courts have hitherto taken, and I hope will preserve, is this - that in order to displace the primâ facie right of silence by a witness who has been put in the relation of professional confidence with his client, before that confidence can be broken you must have some definite charge either by way of allegation or affidavit or what not. ...

[409] [2014] UKUT 0292.
[410] *Bullivant*, p.165.

> I find no such definite charge at all. ... In the parallel, but not exactly similar, case in the Privy Council where the word 'evade' was used, the Privy Council held (I myself was a party to that judgment) that it must be understood that where it was intended to be an allegation that a fraud had been committed you must allege it and prove it: *Simms*. That being so, it appears to me that it would be an abandonment of the principle which has been held sacred in this country if, when a person has done that which in itself may be innocent, you should simply, because you choose to suggest that it was done with the view of evading the payment of a tax, require the witness to disclose the whole of his affairs, and enable the private communications between himself and his solicitor to be displayed to the Court."[411]

The Keith Committee, which devoted a whole chapter to 'Confidentiality and legal professional privilege'[412], found that LAP was being used to prevent the Revenue from being aware of the facts by, for example, setting out the steps in a scheme in counsel's opinion, but adopted a similar "balancing approach" because it worked on the basis of the fallacy that "tax avoidance is legal":

> "26.6.1. The Committee accept that the general law about legal professional privilege, so far as it relates to contemplated or pending litigation, should continue to be as fully applicable to proceedings before Appeal Commissioners and the VAT Tribunal as it is to proceedings in a court of law. We are not, however, satisfied that the rationale which lies behind the extension of the privilege to *all* communications between a client and his legal advisers is fully applicable to the circumstances which exist in the tax context. As we have observed, the relationship between the revenue gathering Department and the taxpayer is materially different from that which prevails between two potential litigants. The Department starts with the disadvantage that it knows nothing about the affairs of the taxpayer except what the latter chooses to tell it. The Department's information powers exist to secure that it can get to know matters which, in some instances at least, the taxpayer would prefer it not to know. **Legal professional privilege is capable of being manipulated so as to assist in keeping the Department in a state of ignorance, and there is some evidence that this does occur in connection with tax avoidance schemes**. We consider that in certain cases the privilege in its broader aspect can have the effect of denying to the Department access to factual material which it is reasonable that they should be permitted to know about. If, for example, facts relevant to tax liability are recorded only in a communication to the taxpayer's solicitor, it is hard to perceive any substantial practical objection to allowing the Department to see such parts of the communication as are purely factual. **There could be no question, of course, of allowing the Department access to the legal advice as such, even though this might reveal chinks in the taxpayer's armour of which they might otherwise be unaware.**

[411] Ibid, pp.200-202.
[412] Chapter 26, pp.537-549.

> 26.6.2. It seems to the Committee that the most helpful approach to the broad problems raised by these considerations lie in devising mechanisms whereby the proper balance between the competing public interests involved can be developed on a case by case basis. This is a familiar exercise in the field of public interest immunity."[413]

LAP gives lawyers in the tax avoidance industry a huge advantage over other professional advisers involved in devising, marketing, implementing and otherwise facilitating the use of tax avoidance schemes precisely because it "is capable of being manipulated so as to assist in keeping the Department in a state of ignorance, and there is some evidence that this does occur in connection with tax avoidance schemes." As the Association of Her Majesty's Inspectors of Taxes stated in its evidence to the Committee:

> "With highly complex tax avoidance schemes, deliberate attempts are often made to prevent the Inspector being aware of all the transactions in the scheme. Secrecy is often an important part of the scheme and there will be a reluctance to provide information and documentation on a voluntary basis."[414]

Contrary to the Committee's conclusion, therefore, "there could be no question … of [**not**] allowing the Department access to the legal advice as such [because this would] reveal chinks in the taxpayer's armour of which they might otherwise be unaware." As the Committee, itself, stated:

> "It seems to us wrong in principle that a claim to relief from tax should depend in any way for its success upon the Inspector's state of ignorance in regard to any part of it. All the cards should be placed upon the table by the taxpayer. The Inspector is then free either to accept the claim, secure in the knowledge that all the relevant circumstances have been drawn to his attention, or to challenge it on the grounds that he is not satisfied that the relief claimed is due."[415]

The way to give effect to the proposition that "All the cards should be placed upon the table by the taxpayer" is to insist that a taxpayer who chooses to get involved in a tax avoidance scheme forfeits the right to LAP in relation to that scheme.

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[413] Ibid, pp.544-545. Emphases supplied.
[414] *The Quarterly Record*, June 1981, pp.86-87.
[415] Keith, pp.161-162. Emphasis supplied.

The proposed approach is more analogous to public interest immunity (formerly known as Crown privilege). In the words of Rigby LJ in *Attorney General v Mayor and Corporation of Newcastle-Upon-Tyne*:

> "The law is that the Crown is entitled to full discovery, and that the subject as against the Crown is not. That is a prerogative of the Crown, part of the law of England, and we must administer it as we find it. I may say that in these days the prerogative of the Crown is about equivalent to the rights of the public, and, therefore, there is nothing so very hard in it."[416]

In other words, as the words imply, public interest immunity protects the public interest rather than a private right. According to Viscount Simon in *Duncan v Cammell Laird*:

> "The principle to be applied in every case is that documents otherwise relevant and liable to production must not be produced if the public interest requires that they should be withheld."[417]

Today, however, the question is no longer whether lawyers involved in cheating the public revenue by devising, marketing, implementing and otherwise facilitating the use of tax avoidance schemes should be allowed to continue to use LAP to conceal their fraud from the Revenue in the manner the Keith Committee reported, but whether accountants and other tax professionals should be permitted to participate in the lucrative practice. As Lord Neuberger put it in the landmark *Prudential* case:

> "The specific issue raised by this appeal is whether, following receipt of a statutory notice from an inspector of taxes to produce documents in connection with its tax affairs, a company is entitled to refuse to comply on the ground that the documents are covered by legal advice privilege (LAP), in a case where the legal advice was given by accountants in relation to a tax avoidance scheme."[418]

As a result of the inherently fraudulent nature of a tax avoidance scheme demonstrated in chapter two and the fraud exception to legal professional privilege, the true issue should have been "whether, following receipt of a statutory notice from an inspector of taxes to produce documents in connection with its tax affairs, a company is entitled to refuse to comply on the ground that the documents are covered by legal advice privilege (LAP), in a case where the legal advice was given ... in relation to a tax avoidance scheme" whether the legal

[416] [1897] 2 QB 384, 395.
[417] [1942] AC 624, 636.
[418] [2013] UKSC 1 [1]. Emphasis supplied.

advice was given by a member of the legal profession or a member of any other profession.

Lord Nuerberger's summary of the factual background is consistent with the Keith Committee's report that "[l]egal professional privilege is capable of being manipulated so as to assist in keeping the Department in a state of ignorance, and there is some evidence that this does occur in connection with tax avoidance schemes" and shows why the fraud exception should override LAP regardless of whether the legal advice was given by a member of the legal profession or a member of any other profession:

> "PricewaterhouseCoopers ('PwC'), devised a marketed tax avoidance scheme ('the scheme'). In accordance with the requirements of Pt 7 of the Finance Act 2004, PwC disclosed the scheme to the Commissioners for Inland Revenue, or Her Majesty's Revenue and Customs ('HMRC') as they became a year later and as I will refer to them. At about that time the Prudential group of companies instructed PwC to advise them in connection with certain overseas holdings, and PwC identified that the scheme could be adapted for their benefit. Thereafter the Prudential group implemented the scheme, which involved a series of transactions ('the Transactions').
>
> The details of the scheme and the Transactions do not matter for present purposes. It is enough to say that the aim of the scheme was to give rise to a substantial tax deduction in Prudential (Gibraltar) Ltd, a subsidiary company of Prudential plc, which could then be set off against the profits of that company, which profits were ordinarily chargeable to corporation tax in this country.
>
> Mr Pandolfo, the inspector of taxes responsible for this aspect of the Prudential group's tax liabilities, considered it necessary to look into the details of the Transactions (for reasons which are not challenged). To that end, he served notices under s 20B(1) on Prudential (Gibraltar) Ltd and Prudential plc (together 'Prudential') giving them the opportunity to make available specified classes of documents in relation to the Transactions prior to his serving notices under s 20(1) and (3). Prudential disclosed many of the documents requested by Mr Pandolfo, but refused to disclose certain documents ('the disputed documents') on the ground that Prudential was entitled to claim legal advice privilege in respect of them.
>
> Mr Pandolfo considered that questions were raised by the documents which were disclosed, and he sought authorisation from the Special Commissioners under s 20(7) to require Prudential to disclose the disputed documents. Such authorisation was given, and, on 16 November 2007, Mr Pandolfo served notices under s 20(1) and (3) on Prudential (Gibraltar) Ltd and Prudential plc respectively, requiring disclosure of the disputed documents.
>
> Prudential then issued the present application for judicial review challenging the validity of those notices on the ground that they sought disclosure of documents which related to the seeking (by Prudential) and

> the giving (by PwC) of legal advice in connection with the Transactions, which were therefore said to be excluded from the disclosure requirements of s 20 by virtue of LAP, in accordance with the decision of the House of Lords in *Morgan Grenfell*.
>
> That application came before Charles J, who rejected it on the ground that, although the disputed documents would have attracted LAP (and would have been thereby excluded from the disclosure requirements of s 20) if the advice in question had been sought from, and provided by, a member of the legal profession, no such privilege extended to advice, even if identical in nature, provided by a professional person who was not a qualified lawyer. His decision, [2009] EWHC 2494 (Admin), was upheld, substantially for the same reasons, by the Court of Appeal (Mummery, Lloyd and Stanley Burnton LJJ), [2010] EWCA Civ 1094.
>
> Prudential now appeal to this court."[419]

In other words, like the House of Lords and the Inland Revenue in *R (Morgan Grenfell) v Special Commissioner of Income Tax*[420] and indeed all other cases since *Bullivant*, the Supreme Court (and all the courts below) and HMRC accepted the prevailing practice that "following receipt of a statutory notice from an inspector of taxes to produce documents in connection with its tax affairs, a company is entitled to refuse to comply on the ground that the documents are covered by LAP, in a case where the legal advice was given by [a lawyer] in relation to a tax avoidance scheme."

The only issue was, therefore, whether this licence to cheat should be extended to accountants and other professional advisers in the tax avoidance industry. In the words of Lord Neuberger:

> "The more general question raised by this issue is whether LAP extends, or should be extended, so as to apply to legal advice given by someone other than a member of the legal profession, and, if so, how far LAP thereby extends, or should be extended."[421]

As if to confirm the inestimable value of LAP in the tax avoidance industry, the Law Society of England and Wales, the General Council of the Bar of England and Wales and the Legal Services Board intervened to oppose the extension of LAP to other professionals while the Institute of Chartered Accountants in England and Wales intervened to support it.

[419] Ibid [10]-[16].
[420] [2002] UKHL 21.
[421] [2013] UKSC 1 [1].

By a majority, the Supreme Court decided to maintain the *status quo*. Lord Neuberger (with whom Lords Mance, Reed, Mance and Hope agreed) stated:

> "[I]t seems to me that this appeal gives rise to an issue, possibly a series of issues, of policy, which constitutes an area into which the courts should generally be reluctant to tread. Rather than extending LAP beyond its present accepted boundaries, we should leave it to Parliament to decide what, if anything, it wishes to do about LAP.
>
> Much of what is said in the preceding section of this judgment demonstrates that quite wide questions of public policy may be thrown up by Prudential's argument. The general implications of extending the generally understood limits of LAP as suggested by that argument could clearly have significant implications, which, at least in my view, would be very difficult to identify, let alone to assess. To put it at its lowest, they may well have significant consequences which should be considered through the legislative process, with its wide powers of inquiry and consultation and its democratic accountability."[422]

On the other hand, Lord Sumption (with whom Lord Clarke agreed) held that LPP should be extended to every professional advising on tax law, including every professional adviser involved in devising, marketing, implementing and otherwise facilitating the use of tax avoidance schemes:

> "In my opinion the law is that legal professional privilege attaches to any communication between a client and his legal adviser which is made (i) for the purpose of enabling the adviser to give or the client to receive legal advice, (ii) in the course of a professional relationship, and (iii) in the exercise by the adviser of a profession which has as an ordinary part of its function the giving of skilled legal advice on the subject in question. The privilege is a substantive right of the client, whose availability depends on the character of the advice which he is seeking and the circumstances in which it is given. It does not depend on the adviser's status, provided that the advice is given in a professional context. It follows, on the uncontested evidence before us, that advice on tax law from a chartered accountant will attract the privilege in circumstances where it would have done so had it been given by a barrister or a solicitor. They are performing the same function, to which the same legal incidents attach."[423]

In the US, the sort of tinkering envisaged by the majority in the Supreme Court in *Prudential* resulted in the principle in *USA v Kovel*[424] under which communications by non-lawyers are protected under LPP when they are working under the direction of lawyers. Paragraph 31 of the indictment in *USA v KPMG*, which underscores the use

[422] Ibid [61]-[62].
[423] Ibid [114].
[424] 296 F. 2d 918 (2d Cir. 1961).

of LAP to conceal the fraudulent nature of tax avoidance schemes, shows how KPMG used this principle to defraud the IRS:

> "The conspirators also attempted to conceal their fraudulent tax shelters activities by attempting to cloak communications regarding those activities and certain of the activities themselves with the attorney-client privilege, although the communications in question were not privileged. For example, CC 2 attempted to conceal his activities in this manner by purporting to have KPMG clients engage a law firm to provide legal advice, which law firm would then purport to engage KPMG to work under the direction of the law firm. Under *United States v. Kovel,* communications by non-lawyers professionals such as accountants are protected under the attorney-client privilege when the accountant is in fact working under the direction of an attorney. Numerous *Kovel* arrangements established by CC 2 were sham arrangements because the clients did not directly engage the law firm, in many instances never even spoke to the lawyers who they had purportedly engaged, and CC 2'S work was done outside of the purported lawyer-client privilege. The purpose of this fraudulent conduct was to enable the client, with the assistance of CC 2 and the law firm, to conceal the fraudulent tax shelter from the IRS by attempting to cloak all of the work for the shelter in the attorney-client privilege."[425]

3.6.2 Litigation Privilege (LP)

Because of the fraudulent nature of a tax avoidance scheme, a lawyer involved in defending a scheme in court is also not entitled to LP. Indeed, conducts such as the "English practice" underscore the need for the disapplication of LP in these circumstances.

3.7 CONCLUSION

This chapter underscored the inherently fraudulent nature of tax avoidance schemes and the inherently fraudulent nature of the conduct of the lawyers involved in devising, marketing, implementing and otherwise facilitating their use, including by defending them in court. In the words of IRS Commissioner Everson:

> "At some point such conduct passes from clever accounting and lawyering to theft from the people. ... Accountants and attorneys should be the pillars of our system of taxation, not the architects of its circumvention."[426]

Even in the cases involving accountancy firms, the "theft from the people" was masterminded by lawyers. According to Rostain:

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[425] Emphasis supplied.
[426] *KPMG to Pay $456 Million for Criminal Violations*.

> "Although KPMG is an accounting firm, it was lawyers at the firm, as at the other former Big Five, who were the main players in the shelter industry."[427]

It is difficult to escape the conclusion that the specious distinction between "legitimate" and "illegitimate" tax avoidance schemes, which underlies the fallacy that "tax avoidance is legal", results from the fact that lawyers, whether practising lawyers or judges involved in tax avoidance while in practise, find it difficult to countenance the *possibility* that every tax avoidance scheme, including the ones they were involved in, could be fraudulent as a matter of law.

Lord Templeman's supposed distinction in *Fitzwilliam* between "tax avoidance schemes of the kind invented and implemented in the present case" which he regarded as "attempts to cheat the Revenue" and "tax avoidance schemes of the kind invented and implemented in" other cases which could conveniently be regarded as *not* "attempts to cheat the Revenue" effectively maintained the fallacy that "tax avoidance is legal" and put the schemes he was involved in the latter category. In an obituary, the *Daily Telegraph* newspaper noted that Lord Templeman "was promoted to the Court of Appeal in 1978, where he gained a reputation, among other things, for his implacable opposition to artificial tax avoidance schemes — although as a QC in the 1960s his practice had involved helping some of his clients to avoid estate duty."[428]

Lord Walker, who, as Mr Walker QC, was the subject of Lord Templeman's stinging criticism in *Fitzwilliam* alluded to Lord Templeman's tax avoidance practice in his 2004 article 'Ramsay 25 years on: some reflections on tax avoidance'[429]. Citing the case of *IRC v Holmden*[430] he stated:

> "It is interesting to note that in *Holmden* the successful taxpayer was represented by two leading counsel, Mr John Brightman Q.C. and Mr Sydney Templeman Q.C."[431]

Mr John Brightman Q.C., was of course, the Lord Brightman that injected the ill-fated requirement of pre-ordainment into the *Ramsay* principle in his leading speech in *Furniss v Dawson*.[432]

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[427] Rostain, p.1.
[428] 'Lord Templeman – obituary', Daily Telegraph, June 11, 2014.
[429] [2004] L.Q.R. 412.
[430] [1968] A.C. 685.
[431] Ibid, p.421.
[432] [1984] STC 153, 166-167.

In his commentary on *Fitzwilliam* in 1997, long before Lord Walker was appointed to the House of Lords, Venables noted that his career and that of his colleague (Mark Herbert) who provided the "separate advice" were not damaged by their involvement in the case:

> "The other four members of the Appellate Committee were so far from considering there to have been a sham that they found that both schemes worked. Nor do the counsel who advised on the schemes appear to have been in any way discredited, as Robert Walker QC has since been appointed a Chancery judge and Mark Herbert has taken silk."[433]

Mark Herbert not only provided the "independent advice" but also appeared for the taxpayers in the litigation, which was overseen by Currey & Co, the solicitors involved in the scheme.

The fact that barristers and solicitors (and increasingly other professional advisers) who were involved in devising, marketing, implementing and otherwise facilitating the use of tax avoidance scheme in practice, including by defending them in court, go on to become the judges that decide tax avoidance cases, including in the highest court in the land, does not support the fallacy that "tax avoidance is legal". To the contrary, it means that their decisions and dicta in support of the fallacy that "tax avoidance is legal" should not necessarily be taken at face value.

[433] Venables (1997) p.28.

CHAPTER FOUR

THE EQUATION OF 'TAX EVASION' AND TAX FRAUD TO CHEATING BY FRAUDULENT CONCEALMENT

> **I shall not attempt to construct a definition which will meet every case which might be suggested, but there is little danger in saying that whenever the words 'fraud' or 'intent to defraud' or 'fraudulently' occur in the definition of a crime two elements at least are essential to the commission of the crime: namely, first, deceit or an intention to deceive or in some cases mere secrecy; and, secondly, either actual injury or possible injury or an intent to expose some person either to actual injury or to a risk of possible injury by means of that deceit or secrecy.**
> Stephen, *History of the Criminal Law of England* (London: Macmillan, 1883) p. 121.

4.1. INTRODUCTION

This chapter unravels the reliance of the dogma "tax evasion is illegal but tax avoidance is legal" on the equation of 'tax evasion' to tax fraud and the equation of both to cheating the public revenue by fraudulent concealment.

"The classic statement of the nature of fraud"[434] by Stephen cited above (which was analysed in chapter one) emphasises that fraud or cheating may be perpetrated by fraudulent misrepresentation (or false representation under section 2 of the Fraud Act) without fraudulent concealment (or failing to disclose information under section 3 of the Fraud Act) and that an intent to defraud or cheat need not necessarily involve an intent to conceal; and vice versa.

Lord Templeman's classic statement in *Challenge*, however, shows that the sole focus on the taxpayer and the failure to consider the role of the professional enablers of tax avoidance results in the equation of tax evasion and tax fraud to cheating by fraudulent concealment or cheating "accompanied with no manner of artful contrivance, but wholly depends on *a bare naked lie"*[435] or fraud by failing to disclose information under section 3 of the Fraud Act and the consequent substitution of the supposedly "legal" tax avoidance for cheating by fraudulent misrepresentation or cheating "by means of *some artful device*, contrary to the plain rules of common honesty"[436] or fraud by false representation under section 2 of the Fraud Act:

> "Evasion occurs when the commissioner is not informed of all the facts relevant to an assessment of tax. ...

[434] Law Commission, p.836.
[435] Hawkins.
[436] Hawkins.

> In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax."[437]

The rest of this chapter unravels this misconception and uses legislation, administrative practice, and academic research to demonstrate it.

4.2. TAX EVASION

4.2.1. Failing to Make a Return by a Taxpayer

Mavji shows that cheating by deliberately failing to make a return of the relevant tax liability is best described as fraudulent concealment or fraud by failing to disclose information under section 3 of the Fraud Act. The taxpayer was convicted of cheating the public revenue by deliberately failing to make a return of VAT liability, but contended in the Court of Appeal that:

> "At neither trial did the prosecution allege either in the particulars of offence, in its evidence or in its submissions that the appellant had used deception. The judge at the second trial erred in law in ruling that deception was not a necessary ingredient of the crime of cheating the revenue."[438]

Rejecting the defendant's contention, Davies J emphasised that concealment was sufficient:

> "In our judgment, 'cheating the revenue' can take place without any positive act of deceit or, to adopt and respectfully endorse the words of Drake J. when ruling on this matter in the appellant's first trial: 'the common law offence of cheating does not necessarily require a false representation, either by words or conduct. Cheating can include any form of fraudulent conduct which results in diverting money from the revenue and in depriving the revenue of money to which it is entitled.'
>
> This appellant was in circumstances in which he had a statutory duty to make value added tax returns and to pay over to the Crown the value added tax due. He dishonestly failed to do either. Accordingly, he was guilty of cheating HM The Queen and the public revenue. No further act or omission required to be alleged or proved."[439]

[437] *Challenge*, pp.554-555.
[438] *Mavji*, p.1390.
[439] Ibid, pp.1391-1392.

4.2.2. Making a False Return by a Taxpayer

Hudson shows that cheating by deliberately making a false return of the relevant tax liability without using a tax scheme is best described as fraudulent misrepresentation or fraud by false representation under section 2 of the Fraud Act. As Goddard CJ stated:

> "We think that the offence here consisted of sending in documents to the inspector of taxes which were false and fraudulent to the appellant's knowledge ... for the purpose of avoiding the payment of tax. That is defrauding the Crown and defrauding the public."[440]

4.3. THE INTERACTION BETWEEN TAX EVASION AND TAX AVOIDANCE

The *actus reus* of a taxpayer who *evades* tax by deliberately making a false return without using a tax scheme (like the taxpayer in *Hudson*) and a taxpayer who *avoids* tax by making a false return on the basis of a tax avoidance scheme (like the directors of the taxpayer-companies in *Charlton*) is identical. Citing *Hudson*, Stuart-Smith LJ stated in *Hunt*:

> "In *R v Hudson* this court held that the offence of making a false statement tending to prejudice the Queen and the public revenue with intent to defraud the Queen is, and always has been, a common law misdemeanour and includes the offence of causing to be delivered to an inspector of taxes accounts relating to the profit of a business which falsely and fraudulently state the profits to be less than they actually were."[441]

In *Charlton*, where the professional enablers were prosecuted, the accounts and returns similarly did "falsely and fraudulently state the profits to be less than they actually were". In the words of Farquharson LJ:

> "It was the case for the Crown that the accounts presented to the Revenue by the United Kingdom companies were false in that by using Charlton's scheme to transfer part of their profits to the Jersey companies they were not disclosing the full extent of the profits they had made. It was this lack of disclosure which formed the basis of the false representations alleged in the indictment. Each of the Appellants was charged in the relevant counts with cheating the Revenue by '... falsely representing that the apparent

[440] *Hudson*, pp.261-262.
[441] *Hunt*, p.826.

> purchases (by the United Kingdom company) from (the Jersey company) were bona fide commercial transactions'."[442]

The underlined terms confirm that concealment and misrepresentation are not mutually exclusive, and that tax avoidance, like tax evasion, can be described in both terms. The difference is in the *mens rea* caused by the use of a tax scheme and the involvement of the enabling professional advisers which potentially protects the taxpayer involved in tax avoidance cases like *Charlton* from complicity in the fraud.

4.4. TAX AVOIDANCE

As demonstrated in chapter two, a defining feature of a tax avoidance scheme is the creation by the professional enablers of a mismatch between the true or economic position that exists for other purposes and the false or fiscal position that is presented to the Revenue for tax purposes. The full disclosure by the participating taxpayer to the Revenue of the false or tax position devised by the enabling professional advisers is, therefore, still a concealment or misrepresentation of the true or economic position that exists in the real world for other purposes.

The frequent argument that tax avoidance could not be fraudulent because the participating taxpayer makes a full disclosure of the scheme to the Revenue misconceives the fundamental mismatch between the true and tax positions, which characterises every tax avoidance scheme, as demonstrated in chapter two.

That inbuilt deceit that defines a tax avoidance scheme makes it a classic case of fraudulent misrepresentation. In *Charlton*, concealment or failing to disclose by the professional advisers was, therefore, just one *actus reus*. According to Farquharson LJ:

> "The case for the prosecution was that Charlton had devised a dishonest, tax-avoidance scheme for the benefit of some of the firm's clients and that the Appellants were involved with the implementation of the schemes or the concealment from the Revenue of the existence of the fraud."[443]

This conviction of the professional advisers, who did not submit any returns or accounts to the Revenue, for "cheating the Revenue by '... falsely representing that the apparent

[442] *Charlton*, p.506. Emphases supplied.
[443] Ibid, p.505. Emphases supplied.

purchases (by the United Kingdom company) from (the Jersey company) were bona fide commercial transactions'"[444] shows that devising the scheme constituted the decisive false representation that consummated the offence. It also shows that the familiar argument that tax avoidance could not be fraudulent because the participating taxpayer makes a full disclosure of the scheme misconceives the fundamental fact that the scheme already constituted a cheat and a fraud when it was devised and long before the taxpayer disclosed it to the Revenue, as demonstrated in chapter two.

4.5. LEGISLATION

The statutory tax evasion offences encompass cheating by failing to make a return and cheating by making a false return, and refer to, but do not define, "fraudulent evasion". Because they derive from Lord Templeman's statement in *Challenge*, however, they are described in terms of failing to make a return or fraudulent concealment only.

The "offence of fraudulent evasion of income tax" created by section 144 of Finance Act 2000, now section 106A of Taxes Management Act 1970, derived from the Grabiner report into "the informal, or hidden economy [where] people conceal their income or the record of what they have sold in order to evade income tax and VAT".[445] Section 144(1) provides that:

> "A person commits an offence if he is knowingly concerned in the fraudulent evasion of income tax by him or any other person."[446]

During the proceedings in the House of Commons the Paymaster General confirmed that "fraudulent evasion" originated from Lord Templeman's statement:

> "People may ask why we have put the words 'fraudulent' and 'evasion' together. I am reliably informed by people who know better than I do that, in English usage, 'to evade' can mean to dodge, without any dishonest intent. Although 'evasion' has come to imply dishonesty in the context of tax, the Bill needs to be drafted tightly. 'Fraudulent' may not appear to add much to 'evasion', but the expression 'fraudulent evasion' is well precedented and subject to interpretation by the courts."[447]

[444] Ibid, p.507.
[445] *The Informal Economy*, p.ii.
[446] Repealed by Taxation (International and Other Provisions) Act 2010, Sch.10(12).
[447] HC Debs, Standing Committee H, June 29, 2000, col. 1010.

Section 114(1) of the Social Security Administration Act 1992, which relates to national insurance contributions, provides that:

> "Any person who is knowingly concerned in the fraudulent evasion of any contributions which he or any other person is liable to pay shall be guilty of an offence."

Section 72(1) of the Value Added Tax Act 1994 similarly provides that "any person ... knowingly concerned in, or in the taking of steps with a view to, the fraudulent evasion of VAT by him or any other person" shall be guilty of an offence.

4.6. REVENUE PRACTICE

4.6.1. The Inland Revenue and HMRC

The Inland Revenue's (and since 2005 HMRC's) practice is based on the dogma that "tax avoidance is legal and tax evasion is illegal" because it equates tax evasion and tax fraud to fraudulent concealment by the taxpayer.

Inland Revenue Tax Bulletin, Issue 49, which dealt with the proceedings in the House of Commons during the passage of section 144 of Finance Act that created the "offence of fraudulent evasion of income tax", stated:

> "**The borderline between avoidance and evasion**
>
> In the same debate at least one Member raised the subject of the impact of the new offence on tax advisers, especially those involved in advising on arrangements which could be characterised as tax avoidance. We do not consider that the new offence has led to any change in the law in this area.
>
> Where a scheme labelled as 'avoidance' by its participants and their advisers admittedly fails, the key issue as a matter of criminal law would be whether they have been dishonest in the unsuccessful effort to reduce the relevant tax liability. It would be for the courts to decide as a question of fact whether that is the case.
>
> Concern has been expressed in some quarters that as a result the decision will not normally be taken by those with professional experience of tax matters and, given the highly technical nature of much tax law, that state of affairs may lead to injustice. That is an issue well beyond the scope of this article, but it may be helpful to remember that possible dishonesty becomes a consideration in this context only in certain circumstances. That is where there is some suggestion that the participants in an avoidance scheme are not merely relying on the intrinsic technical soundness of the arrangements actually put in place to reduce the liability, but also on <u>concealment of the</u>

> true facts from the inspector. If so, then, if the scheme fails, it is perfectly possible that the criminal courts may find there has been an offence. But, conversely, where there is no trace of any concealment of the true facts of arrangements for which there is a respectable technical case, it is hard to imagine how a criminal offence can have been committed."[448]

Apart from the misconception of the meaning of a crime, as explained above *Charlton* demonstrates that the consideration of the role of the professional enablers of tax avoidance schemes shows that the full disclosure by the participating taxpayer of the false position devised by the professional enablers is still a concealment ("not disclosing" and "lack of disclosure") or misrepresentation ("false representations" and "falsely representing") of the true position in the words of Farquharson LJ:

> "It was the case for the Crown that the accounts presented to the Revenue by the United Kingdom companies were false in that by using Charlton's scheme to transfer part of their profits to the Jersey companies they were not disclosing the full extent of the profits they had made. It was this lack of disclosure which formed the basis of the false representations alleged in the indictment. Each of the Appellants was charged in the relevant counts with cheating the Revenue by '... falsely representing that the apparent purchases (by the United Kingdom company) from (the Jersey company) were bona fide commercial transactions'."[449]

4.6.2. The Internal Revenue Service

The *Internal Revenue Manual* of the Internal Revenue Service relies on the same misconceptions:

> "**Avoidance Distinguished from Evasion**
>
> Avoidance of taxes is not a criminal offense. Any attempt to reduce, avoid, minimize, or alleviate taxes by legitimate means is permissible. The distinction between avoidance and evasion is fine, yet definite. One who avoids tax does not conceal or misrepresent. He/she shapes events to reduce or eliminate tax liability and, upon the happening of the events, makes a complete disclosure. Evasion, on the other hand, involves deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events or to make things seem other than they are."[450]

The IRS's Information in *KPMG* shows that avoidance of taxes is "a criminal offense". Paragraph 8 shows that the crime is committed by the professional enabler who "shapes events to reduce or eliminate tax liability" and enables the participating

[448] (October 2000), p.783. Emphases supplied.
[449] *Charlton*, p.506. Emphases supplied.
[450] *Internal Revenue Manual*, (05-15-2008). https://www.irs.gov/irm/part9/irm_09-001-003.html

taxpayer to “conceal or misrepresent”. When the professional adviser “shapes events to reduce or eliminate tax liability” he does “misrepresent” by creating the mismatch between the true position that exists for other purposes and the false position that is presented to the Revenue. When the taxpayer, “upon the happening of the events, makes a complete disclosure” of the false position, the taxpayer does “conceal or misrepresent” the true position, and the professional advisers cause the taxpayer to “conceal or misrepresent” the true position.

In all circumstances, therefore, both the professional advisers and the taxpayer do “conceal or misrepresent”. As the prosecution of the professional enablers in KPMG but not the taxpayers in *KPMG* shows, however, while the concealment or misrepresentation by the professional advisers is invariably fraudulent, the concealment or misrepresentation by the taxpayer can be honest or negligent or fraudulent depending on his knowledge, abilities and circumstances.

The defining mismatch between the tax and true positions in tax avoidance means that, like tax evasion, it invariably “involves deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events or to make things seem other than they are.”

4.7 THE KEITH COMMITTEE

The Committee’s terms of reference was based broadly on the fraud-negligence-honesty trichotomy:

> “To enquire into the tax enforcement powers of the Board of Inland Revenue and the Board of Customs and Excise, including ... powers relating to cases of fraud, wilful default or neglect and to cases of reckless action”.[451]

The Committee, however, did not base its work on these three legal concepts but on tax evasion and tax avoidance. Relying on the 1955 Royal Commission’s definitions which, as demonstrated in the Introduction, are fundamentally flawed by the sole focus on the taxpayer, it stated in the only chapter that dealt with tax avoidance:

> “This Report’s concern is principally with the Revenue Departments’ powers against tax evasion but here we consider tax avoidance. The distinction was defined by the 1955 Royal Commission as follows:

[451] Keith, pp.3-4.

> '[Tax evasion] denotes all those activities which are responsible for a person not paying the tax that the existing law charges upon his income. *Ex hypothesi* he is in the wrong, though his wrong-doing may range from the making of a deliberately fraudulent return to a mere failure to make his return or to pay his tax at the proper time. By tax avoidance, on the other hand, is understood some act by which a person so arranges his affairs that he is liable to pay less tax than he would have paid but for the arrangement. Thus the situation which he brings about is one in which he is legally in the right, except so far as some special rule may be introduced that puts him in the wrong.'[452]

> The relevance of the topic concerns the means by which the Revenue can police such special rules which put the taxpayer in the wrong. ... Avoidance is, however, by no means confined to attempts to prevent the taxpayer falling foul of specific anti-avoidance provisions. Opportunities are taken in respect of the basic tax provisions, seeking to sidestep liabilities or attract relief. This means that policing must extend to any debatable area where, in attempting to avoid or reduce liability, the taxpayer may have given himself the benefit of the doubt about whether his dispositions are effective."[453]

In its evidence to the Committee, the Association of Her Majesty's Inspectors of Taxes identified the pivotal role of concealment in devising, implementing and otherwise facilitating the use of tax avoidance schemes but, crucicially and characteristically, failed to specify that this is done primarily by the professional enablers:

> "With highly complex tax avoidance schemes, deliberate attempts are often made to prevent the Inspector being aware of all the transactions in the scheme. Secrecy is often an important part of the scheme and there will be a reluctance to provide information and documentation on a voluntary basis."[454]

By similarly focusing on the taxpayer and failing to consider the role of the professional enablers, the Committee equated "fraud" and "tax evasion" to fraudulent concealment by the taxpayer. As it put it in its recommendation that relied upon a wildly optimistic and ultimately misconceived view of the then recent decisions of the House of Lords in *Ramsay* and *Burmah* that invented the Ramsay principle had killed off marketed tax avoidance:

> "The reason why this change of approach is particularly significant for our consideration is that a number of witnesses confirmed that they considered that there was now no future for marketed tax avoidance schemes. In the circumstances some of the problems which they created can now be ignored. In particular, a taxpayer entering into such a transaction will no

[452] Royal Commission, paras 1016-1017.
[453] Keith, p.155. Emphases supplied.
[454] *The Quarterly Record*, June 1981, pp.86-87.

longer be able to obtain clear advice that what he has done does not result in a charge to tax, and it will therefore be less easy for him to justify the omission of any reference to the transaction in his tax return.

The fact that tax avoidance schemes no longer create a special problem does not remove the general problem of what a taxpayer should disclose in his return. A taxpayer may be advised by his accountant that certain items are probably allowable as business expenses, whereas if the full facts were known the Inspector might well challenge the deduction. ... One of our witnesses put it particularly graphically:

> 'the taxpayer builds a taxproof castle; if the Inspector could see inside it he would see the weaknesses in the castle's structure, but the taxpayer does all he can to make sure that the Inspector never sees inside it.' ...

It seems to us wrong in principle that a claim to relief from tax should depend in any way for its success upon the Inspector's state of ignorance in regard to any part of it. All the cards should be placed upon the table by the taxpayer. The Inspector is then free either to accept the claim, secure in the knowledge that all the relevant circumstances have been drawn to his attention, or to challenge it on the grounds that he is not satisfied that the relief claimed is due. The kind of obligation we have in mind might with advantage be particularized in the shape of a direct question incorporated in the tax return on the following lines:

> 'In making this return have you taken the benefit of any doubt about whether any item ought to be declared, or any relief or deduction allowed? If so give brief details.'

At present there is no legal basis for imposing an obligation to answer such a question. *We recommend* that such an obligation be enacted. ...

This should serve as a further incentive to make returns 'in utmost good faith', and to emphasise that **concealment of materials facts, leading to an underassessment, marks the point at which avoidance crosses the borderline and becomes evasion**." [455]

Clearly, the critical "concealment of materials facts, leading to an underassessment" is caused by the enabling professional adviser who 'builds a taxproof castle" and who "does all he can to make sure that the Inspector never sees inside it."

Despite the subsequent retreat from the *Ramsay* principle and the consequent resurgence of marketed tax avoidance schemes, the Keith Committee's recommendation was never enacted into law. The DOTAS legislation falls short of the recommendation.

[455] Keith, pp.161-162. Emphasis supplied.

Farquharson LJ's statement of the overriding duty of honesty imposed by the pre-existing common law of cheating in *Charlton*, however, shows that it already provides the "obligation to answer such a question" and "to make returns 'in utmost good faith'", and that contrary to the Committee's sole focus on the taxpayer, the duty of honesty extends *a fortiori* to the professional advisers:

> "It is a feature, no doubt, of the tax or Revenue law of any country that it must, to a large extent, in its tax-gathering activities, rely on the truthfulness of the taxpayer in indicating the extent of his income or whatever other matter is relevant to the particular statute being considered. It follows also that the Revenue not only have to rely on the taxpayer's good faith, but more especially on the professional advisors they appoint to act for them."[456]

4.8 ACADEMIC RESEARCH

In the 2004 article that emerged from her inaugural lecture, Freedman criticised *Inland Revenue Tax Bulletin, Issue 49* but similarly equated tax evasion and tax fraud to fraudulent concealment by the taxpayer:

> "For many tax advisers and taxpayers, the line that is seen to matter is that to be drawn between avoidance and evasion, with only evasion being illegal. <u>All forms of avoidance, be they described as aggressive, acceptable or unacceptable, are legal and for the adviser the question is whether or not they work technically</u>. ...
>
> It has been uncontroversial in the past to describe the boundary between evasion and avoidance as a straightforward one, with evasion being illegal and avoidance being legal. In the past few years there has been a concern in the tax community that in Tiley's words, tax evasion has developed frayed edges and that the revenue authorities are encouraging this development.
>
> It is understandable that the revenue authorities, concerned by criticism that they are not doing enough to combat revenue loss, are arguing that failed avoidance schemes could become evasion, but this is unhelpful in relation to the complaint majority without giving any teeth to the fight against the non-compliant. ...
>
> **The common thread in all cases of evasion is concealment, but not all evasion is criminal.** ...
>
> The Inland Revenue has indicated that there should be no criminal offence where there is no trace of any concealment of the true facts of arrangements for which there is a 'respectable technical case'. The problem is, who is to decide whether there is a respectable technical case?

[456] *Charlton*, p.532.

> The complexity of the tax system is such that there may well be reasonable different views on whether a scheme will work. How definite must advisers be that there is a reasonable case? *BMBF*, was decided against the taxpayers by the Special Commissioners and a very experienced High Court Judge but the decision was reversed by an equally experienced Court of Appeal. How should a company director or even a tax adviser decide whether there is a respectable technical case in these circumstances?"[457]

As demonstrated above, *Charlton* shows that "[t]he common thread in all cases of [avoidance] is concealment" or misrepresentation of the true position that exists for other purposes caused by the professional enablers that used the scheme to create the false position presented to the Revenue for tax purposes, which is criminal in criminal law and civil in civil law.

The underlined contradictory expressions demonstrate the interaction between the legal fiction of statutory construction and the equation of tax evasion and tax fraud to fraudulent concealment by the taxpayer. In other words, the invariably "different views on whether a scheme will work" as a matter of statutory construction, which was underscored by *BMBF*, undermine the dogma that: "All forms of avoidance ... are legal ... the question is whether or not they work technically."

The "concern in the tax community that in Tiley's words, tax evasion has developed frayed edges and that the revenue authorities are encouraging this development"[458], like Bowler's claim that "increasingly the distinction between tax avoidance and tax evasion has been blurred, at least by the tax authorities, and tax avoidance has been treated with some of the disapproval previously reserved for tax evasion"[459], reflects an apologist refusal to acknowledge the reliance of the dogma 'tax avoidance is legal and tax evasion is illegal' on the Revenue's selective prosecution policy. As Rhodes et al pointed out in their 1998 article on Charlton which was the case that triggered the "concern in the tax community":

> "There is no clear dividing line and there appears to be no reason why the Inland Revenue could not seek to apply the criminal law to many other types of tax avoidance scheme should they choose to do so. *Charlton* tells us clearly that sitting on top of a set of artificial arrangements waving a flag saying 'tax avoidance scheme' will not necessarily provide either the taxpayer or his professional advisers with immunity from prosecution."[460]

[457] Freedman [2004] pp.335-348. Emphases supplied.
[458] Freedman p.347.
[459] Bowler (2009) p.10.
[460] Rhodes, p.203.

In 2012 the NAO commissioned the Oxford University Centre for Business (OUCBT) "to draw up an academic review of the DOTAS and the tax avoidance landscape."[461] The review formed part of the evidence base behind the NAO's report "*Tax avoidance: tackling marketed avoidance schemes*"[462], which underpinned the PAC's inquiry "*Tax avoidance: tackling marketed avoidance schemes*".[463] In the paper which "aims to inform the important debate on tax avoidance by exploring the language used and setting this in context"[464], Freedman et al effectively recognised that it is a legal nonsense but excluded tax evasion from consideration by equating it and tax fraud to concealment by the taxpayer and thus failing to consider the conduct of the professional enablers of *marketed tax avoidance schemes*:

> "'Tax avoidance' has no fixed legal meaning, although courts have sought to elucidate it in some cases and, for example, to distinguish tax avoidance from tax planning or tax mitigation. Matters are often complicated but not usually clarified by the addition of adjectives such as 'aggressive', 'abusive' or 'unacceptable' to the term.
>
> **Distinguishing Evasion**
>
> Practically every media report on avoidance now starts with the statement that the activities it is discussing are legal but still amount to avoidance. It is well understood that there is a difference between evasion, which involves non-disclosure or concealment, be it fraudulent or not and which is illegal; and avoidance, which is 'legal'. Evasion needs to be tackled by strong enforcement of the existing law. This is an important topic, highly relevant to the Tax Gap figures, but is not the topic of this paper, which deals only with avoidance. ... By saying that avoidance is legal, we mean that it involves no criminal activity, and no failure to make a required disclosure."[465]

Farquharson's statement in *Charlton* cited and analysed above shows that tax avoidance "involves non-disclosure or concealment" by the taxpayer (which may be honest or negligent or fraudulent) caused by the professional enablers; and "involves ... criminal activity" by the professional enablers "and ... failure to make a required disclosure" by the taxpayer (which may be honest or negligent or fraudulent).

[461] Freedman et al, *Tax Avoidance*, p.1.
[462] November 21, 2012.
[463] February 19, 2013.
[464] Freedman, p.3.
[465] Ibid.

4.9 CONCLUSION

This chapter used the concepts of fraudulent misrepresentation and fraudulent concealment to expound both tax avoidance (**cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using an individual scheme may or may not be complicit**) and tax evasion (**cheating the public revenue by a taxpayer who deliberately fails to make a return of the relevant tax liability or by a taxpayer who deliberately makes a false return of the relevant tax liability without using a tax scheme**) to demonstrate the fundamental flaw in the orthodox equation of tax evasion and tax fraud to fraudulent concealment.

It showed that the fundamental distinction is not between fraudulent misrepresentation and fraudulent concealment (which can be used interchangeably) but between the conduct of the taxpayer (which is invariably fraudulent in tax evasion but can be fraudulent or negligent or honest in tax avoidance) and the conduct of the professional advisers (which is invariably fraudulent in tax avoidance). In other words, the corollary of the proposition that a tax avoidance scheme is a cheat and a fraud by design established in chapter two is that the fraudulent nature of tax avoidance does not depend on any subsequent concealment by the professional advisers or by the taxpayer.

CHAPTER FIVE

THE SELECTIVE PROSECUTION POLICY

> **The Revenue operate a selective policy of prosecution. They do so for three main reasons: first their primary objective is the collection of revenue and not the punishment of offenders; second they have inadequate resources to prosecute everyone who dishonestly evades payment of taxes; and third and perhaps most importantly they consider it necessary to prosecute in some cases because of the deterrent effect that this has on the general body of taxpayers, since they know that if they behave dishonestly they may be prosecuted. It is inherent in such a policy that there may be inconsistency and unfairness as between one dishonest taxpayer and another who is guilty of a very similar offence.**
>
> Stuart-Smith LJ, *R v IRC, ex parte Mead and Cook* [1992] STC 482, 492.

5.1 INTRODUCTION

This chapter uses a historical analysis of the Revenue's "highly selective" prosecution policy to demonstrate that the dogma "tax avoidance is legal and tax evasion is illegal" rests for its support upon a fundamental misunderstanding of the fact in all cases of tax fraud "it is entirely within the discretion of the tax authorities whether they take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-fraud penalties or simply establishing tax liability without fines or penalties".[466]

Lord Justice Stuart-Smith's distinction between "the collection of revenue" and "the punishment of offenders" is artificial because of "the deterrent effect that [prosecution] has on the general body of taxpayers." As the 1905 Departmental Committee on Income Tax stated:

> "Turning to the case of fraudulent evasion, we desire to record our opinion that energetic action should be taken wherever there is reasonable suspicion of fraud. The occasional failure of a prosecution would not be so great an evil as the immunity which is now too often accorded to continued dishonesty."[467]

In other words, tax morale, which can be defined as "the deterrent effect that [prosecution] has on the general body of taxpayers", unites "the collection of revenue" and "the punishment of offenders". According to the Keith Committee:

> "While the majority of taxpayers meet their obligations with fairly good grace, some do not. Enforcement powers are therefore necessary not only

[466] Wisselink, p.203.
[467] Report, p.vii.

> to coerce the dishonest and the neglectful, but to encourage the honest and conscientious."[468]

The level of prosecution "necessary not only to coerce the dishonest and the neglectful, but to encourage the honest and conscientious" does not seem to have ever been considered, let alone determined, but is beyond the scope of this thesis.

These authorities referred to 'evasion' and 'taxpayer' because under the dogma that "tax avoidance is legal and tax evasion is illegal" the selective prosecution policy is applied to tax evasion (or cheating by a taxpayer who deliberately fails to make a return of the relevant tax liability or who deliberately makes a false return of the relevant tax liability without using a tax scheme) but not tax avoidance (or cheating by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using a specific scheme may or may not be complicit).

The rest of this chapter expounds the selective prosecution policy and uses its historical application to demonstrate that tax evasion and tax avoidance amount to cheating the public revenue in law.

5.2 THE POLICY

5.2.1 Inland Revenue

The statutory basis of the Inland Revenue's selective prosecution policy was section 1 of the Taxes Management Act 1970, which provided that:

> "(1) It shall be lawful for Her Majesty the Queen to appoint persons to be Commissioners for the collection and management of inland revenue, and the Commissioners shall hold office during Her Majesty's pleasure.
>
> (2) The Commissioners shall have all necessary powers for carrying into execution every Act of Parliament relating to inland revenue".

According to Lord Diplock's classic statement of the nature and scope of this provision in *IRC v National Federation of Self-Employed and Small Businesses*[469] ('the *Fleet Street Casuals* case'):

[468] *Final Report*, p.3.
[469] [1981] STC 260.

> "[T]he Board are charged by statute with the care, management and collection on behalf of the Crown of income tax, corporation tax and capital gains tax. In the exercise of these functions the Board have a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge the highest net return that is practicable having regard to the staff available to them and the cost of collection."[470]

The Inland Revenue explained its selective prosecution policy to the 1978 Royal Commission on Criminal Procedure thus:

> "In England and Wales the Commissioners of Inland Revenue, known as the Board, are a prosecuting authority, deciding themselves whether or not to prosecute and attending themselves to the conduct of the prosecution. But ... some prosecutions for revenue matters are undertaken by the Police.
>
> In the main, however, the Department deals with the tax evader not by prosecution but by imposing money penalties graded according to the gravity of the offence. Moreover in the majority of cases the amount of the penalty is agreed informally between the Department and the taxpayer without recourse to formal proceedings. It follows that criminal prosecution for tax fraud is undertaken only in a small minority of cases.
>
> The Board's practice of accepting pecuniary settlements in the majority of cases is widely known amongst accountants and taxation advisers. But if an investigation is dealt with by Enquiry Branch ... the Board's practice is explained by handing to the taxpayer a leaflet referred to in the Department as the 'Hansard Extract' [that] contains a reference to section 34 of the Finance Act 1942 which makes provision for the admissibility in evidence of a disclosure notwithstanding that it has been drawn to the taxpayer's attention that the Board may accept pecuniary settlements instead of instituting proceedings and may be influenced by a full confession. Section 34 was replaced by section 504 of the Income Tax Act 1952, which was replaced by section 105 of the Taxes Management Act 1970."[471]

Like the Royal Commission, the Keith Committee considered and approved the policy on the basis that it applies only to tax evasion:

> "**Departmental views**
>
> 22.1.4. The Inland Revenue explained and justified their prosecution policy to us in the same terms as they had used to the Royal Commission on Criminal Proceedings. They noted first, that the tax legislation contains (civil) money penalties for many offences, up to and including fraud. As they said: 'It clearly envisages that severe money penalties will be the common punishment of the tax evader'. They also fully acknowledged 'the practical consideration that the burden of preparing a large number of prosecutions

[470] Ibid, p.269.
[471] EV No 145.

to the required standard and of seeing them through the courts would require many more trained and qualified staff'. They stressed the importance of prosecution as a deterrent, and that there should be no categories of offence where the weapon was never deployed 'because it is the possibility of prosecution which prevents the spread of tax fraud to unacceptable limits'. They pointed out that 'simple objective criteria such as the amount of tax evaded' might be used to set de minimis limits to exclude the smaller cases, but were unsuited to be the sole basis for decisions to prosecute. While recognising, therefore, the possible pitfalls in selectivity, the Department sought to avoid them by reserving the decision to prosecute to officials at Under Secretary or Deputy Secretary level.

Discussion and conclusions

22.1.5. We had no hesitation in rejecting the extreme alternatives of 'prosecute all or none'. We found no reason to disturb the settled practice of over fifty years of Inland Revenue taking civil money penalties for the overwhelming majority of detected offences of tax evasion. We regard as justified the Department's view that an ultimate sanction of prosecution is essential to protect the integrity of a tax system which is primarily dependent upon the accuracy of information passed to it by its taxpayers and others. When asked to sign a declaration on a tax return, the taxpayer is faced with the admonitory statement 'false statements can result in prosecution'. It follows that, if the deterrent is to retain its credibility, prosecution ought to follow in, as the Department put it, 'some examples of all classes of tax fraud'."[472]

5.2.2 HMRC

HMRC's powers are provided by section 5 of the Commissioners for Revenue and Customs Act 2005 ('CRCA'). Section 51, which provides that "responsibility for collection and management of revenue has the same meaning as references to responsibility for care and management of revenue in enactments passed before this Act", effectively preserved the principle derived from the *Fleet Street Casuals* case. The principle was reaffirmed explicitly by the House of Lords in *Wilkinson v IRC*"[473] and by the Supreme Court in *Davies v HMRC*; *Gaines-Cooper v HMRC*.[474]

Section 206 of Finance Act 2003 amended section 105 TMA to substitute the prevailing Code of Practice 9. According to *HMRC Criminal Investigation Policy*:

> "HMRC aims to secure the highest level of compliance with the law and regulations governing direct and indirect taxes and other regimes for which they're responsible. Criminal investigation, with a view to prosecution by the Crown Prosecution Service in England and Wales, the Crown Office

[472] Keith, pp.456-457.
[473] [2003] EWCA Civ 814 [43]-[45].
[474] [2011] UKSC 47.

and Procurator Fiscal Service in Scotland, and the Public Prosecution Service Northern Ireland is an important part of HMRC's overall enforcement strategy.

It's HMRC's policy to deal with fraud by use of the cost effective civil fraud investigation procedures under Code of Practice 9 wherever appropriate. Criminal investigation will be reserved for cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate."[475]

5.3 TAX EVASION

5.3.1 Criminal Prosecution

According to the Inland Revenue's evidence to the 1978 Royal Commission on Criminal Procedure:

"It is not known when the Board started to institute criminal proceedings against taxpayers for offences in relation to Inland Revenue. The principle that in relation to such proceedings tax law is not something apart, but is an integral part of the general legal code, received statutory recognition in Section 14 of the Revenue Act 1899, now section 104 of the Taxes Management Act 1970, which stipulates: 'The provisions of the Taxes Acts shall not, save so far as is otherwise provided, affect any criminal proceedings for any misdemeanour.' ...

Only since 1916 have criminal proceedings for tax offences reached a significant level. In that year the Board first used the provisions of the Perjury Act 1911 in cases of false returns. But the Act could not be used to catch false statements made in company accounts delivered to an Inspector of Taxes to evade Excess Profits Duty (a widespread problem during the 1914-18 War) or only made in a letter or orally to the Department.

From 1917 onwards, therefore, in cases that could not be brought within the Perjury Act, it became the practice to charge the taxpayer with cheating in relation to the Public Revenue, i.e. with the common law misdemeanour of making or causing to be made, with intent to defraud, a false statement tending to prejudice the Crown and the Inland Revenue. A charge in this form was based on precedents and dicta stretching back for centuries and its validity was upheld by Justice Bray in *R v Bradbury and Edlin* and by the Court of Appeal in *R v Hudson*."[476]

In *Bradbury and Edlin*[477], the defendants were charged at Winchester Assizes in July 1920 on separate indictments with conspiracy to cheat the public revenue of income

[475] September 4, 2018.
[476] EV No 145, paras 3.1-3.4.
[477] (1921) 1 KB 562.

tax, excess profits duty and super-tax by making false statements and returns; making false statements in returns of income tax contrary to section 5 of the Perjury Act; and delivering false returns tending to prejudice the public revenue contrary to the common law. Five of the common law charges were alternatives to the Perjury Act charges. Two related to the submission of false trading and profit and loss accounts of the business of a company of which the defendants were directors. They objected to the counts of cheating on the ground that it is not an indictable offence. Bray J rejected the objections, and confirmed that the common law offence operates on a juristic basis independent of the civil fraud penalty legislation:

> "All these cases affecting the Crown and the public at large are indictable, and in my opinion, therefore, these common law counts stand, save for one other argument. By section 178 of the Income Tax Act, 1842, it is provided that if there is such a fraudulent representation a certain penalty is provided. The penalty is that an offender shall, on proof before the commissioners acting for the district, be charged in excess treble the amount of duty escaped by the fraudulent representation. It is suggested that because there was an additional penalty imposed upon persons who offended against the Act, in their having to pay treble the duty evaded, that that repealed the common law of England. In my opinion it certainly did not. It added an additional burden or obligation if you like, but it never did take away the right to proceed against an offender by indictment under the common law of England, and therefore these objections fail."[478]

In *Hudson* the taxpayer was convicted at Nottingham Assizes in December 1955 on an indictment containing eight counts of cheating the public revenue. He appealed on the ground that while the submission of false accounts ought to be an offence, Parliament had not made it so. The Court of Appeal rejected the appeal. Goddard CJ stated:

> "It seems to me perfectly clear that the *communis opinio* among lawyers has been that Bray J.'s decision was right, and I cannot see any ground upon which we can say that the authorities upon which he acted, and upon which we are acting today, have ever been limited or dissented from. In Northern Ireland the same view was taken in *Rex v. 'J.,'*[479] ... We think that the offence here consisted of sending in documents to the inspector of taxes which were false and fraudulent to the appellant's knowledge. That is a material part of the offence, and the jury found it proved. They had a very clear summing-up from Slade J., who took the same view as Bray J. took, and as this court is taking. The jury must be taken to have found that the documents sent in by the appellant were not only false and fraudulent to his knowledge, but they must have taken the view, and the only possible view, that he did it for the purpose of avoiding the payment of tax. That is defrauding the Crown and defrauding the public. ... This is and has always been a common law offence. It is not necessary for this court to make a new offence and we are

[478] [1956] 2 Q.B. 262, 263-264.
[479] [1933] N.I. 73

not doing so. We are merely reaffirming what the common law has, in our judgment, always been on this matter."[480]

Hudson highlighted the subversion of the rule of law by the selective prosecution policy. As "Watchful" put it in a commentary:

> "All taxation is the creature of statute, and so far as income tax is concerned the relevant statutes are comparatively modern. Yet in the recent case of *R v Hudson*, which was a criminal prosecution arising out of acts alleged to have been done by the defendant in relation to his income tax affairs, all the counts of the indictment were laid at common law under a precedent traceable to the fourteenth century. This is not quite the paradox it seems if we remember that the Tax Acts are but a part of the general law of the land. Just as, on the one hand, nobody can be taxed otherwise than in accordance with the law, so it can and should be insisted that the whole of that law is relevant in any question concerning taxation."[481]

5.3.2 Contract Settlement and Civil Litigation

According to the Inland Revenue's evidence to the 1978 Royal Commission on Criminal Procedure:

> "When a tax fraud is discovered, the Board are not bound to prosecute but may effect a pecuniary settlement instead. The main legislation about penalties is contained in Sections 93 - 107 of the Taxes Management Act 1970."[482]

In *R v IRC, ex parte Knight*, where the taxpayer cheated by failing to make a return and making a deliberately false return without using a tax scheme like the taxpayers in *Bradbury* and *Hudson*, the Revenue chose not to prosecute but to "effect a pecuniary settlement instead." Rejecting the taxpayer's appeal, Russell LJ stated:

> "This is an appeal from a refusal of the Divisional Court to accede to an application for a writ of prohibition directed to the General Commissioners for the Havering District, to prevent those commissioners from adjudicating on a summons dated 11 June 1971, demanding penalties under s 95 of the Taxes Management Act 1970 on the ground that the taxpayer, in submitting in November 1956 accounts of his trade as a cattle dealer in the four years 1950-51 to 1953-54, had fraudulently or negligently submitted incorrect accounts. ... These assessments, being otherwise out of time, were based on allegations of fraud or wilful default by the taxpayer; and, as we understand it, those allegations were related to those same incorrect November 1956 submitted accounts. On an appeal by the taxpayer, the

[480] *Hudson*, pp.261-262.
[481] "Watchful".
[482] EV No 145.

> Special Commissioners found wilful default. They made, as I understand it, no finding one way or the other as to fraud. ...
>
> Then it is said ... that wilful default is not within s 95; it is neither fraud nor negligence. I think ... that when s 95 refers to fraud or negligence, it cannot sensibly be thought to exclude wilful default in that bracket. It would be, in my view, quite absurd to hold under s 95 that it embraces careless breach of duty – that is to say, negligence – but not careful breach of duty – that is to say, wilful default."[483]

5.3.3 The Tax Dogma

Lord Hodge's restatement of the dogma in his recent lecture demonstrates its reliance on the failure to consider the professional enablers of tax avoidance and the Revenue's selective prosecution policy:

> "One of the principles which I was taught when reading law at Edinburgh University in 1978 was that tax avoidance was legal, while tax evasion was not. Avoidance is obtaining a tax advantage within the rules. Acting in the genuine but mistaken belief that a tax advantage can legally be obtained may be seen as avoidance or at least not criminal evasion. Knowingly acting to evade taxes is often a criminal offence. ... But some forms of evasion, while illegal, are dealt with by civil penalties rather than the criminal law."[484]

"Knowingly acting to evade taxes is often a criminal offence" where the taxpayer is prosecuted as was the case in *Bradbury* and *Hudson*. "But some forms of evasion, while illegal, are dealt with by civil penalties rather than the criminal law" as was the case in *Knight*.

"Acting in the genuine but mistaken belief that a tax advantage can legally be obtained may be seen as avoidance or at least not criminal evasion" because of the principle that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return, he will not be liable" for negligence or fraud if the advice proves to be wrong.

5.4 TAX AVOIDANCE

5.4.1 Criminal Prosecution

[483] *Knight*, pp.566-571.
[484] 'The RFC case, tax avoidance schemes and statutory interpretation: offside goals, yellow cards and own goals', Edinburgh Tax Network Annual Lecture, December 14, 2017, p.1.

The prosecution in *Charlton* highlighted the inherently fraudulent nature of a tax avoidance scheme and showed that criminal prosecution can be brought in every case. As Cunningham put it in his article:

> "From February 1994 until August 1994, the writer had the inglorious distinction of being a participant in the longest ever prosecution by the Inland Revenue ... as a defendant! He was convicted on two counts of cheating the Inland Revenue. ... There was an assessment under appeal in relation to the United Kingdom company when Enquiry Branch raided the premises of the accountants and the company and others (not the writer's chambers). The result was that the pending appeal hearing was replaced by a criminal trial."[485]

A fortiori, a criminal trial can be brought **after** a successful civil litigation. According to Ormerod:

> "Could schemes which have been held to be ineffective tax avoidance *really* be prosecuted? Consider *Ramsay* in which the House of Lords held ineffective a scheme which created a loss to offset chargeable gains. There is no doubt that the planners had but one aim: to reduce the amount of tax paid. Moreover, it could be said that the steps inserted into the scheme which created the loss were of such an artificial nature as to be almost illusory. Lord Wilberforce alluded to this in his speech: 'although sums of money, sometimes considerable, are supposed to be involved in individual transactions, the taxpayer does not have to put his hand in his pocket.'
>
> Given the admitted intention of those involved to attempt to reduce the tax paid, it is not unimaginable that a jury of ordinary people would find such behaviour to be dishonest. ... This is exacerbated by the fact that the activities of the tax planners will often appear to be artificial and unreal to the average lay person. As Lord Bridge noted in another leading avoidance case, *Furniss v Dawson*: 'It would need no more than a cursory exposition of the avoidance scheme in *Ramsay* … to lead any intelligent *layman* [read juror] to the conclusion that the scheme was not designed to achieve any substantial effect *in the real world.*'[486] Although expert evidence may be received on revenue practices, the dishonesty issue is within the common experience and understanding of the jury and ought not to be the subject of expert evidence."[487]

There is, however, no record of any such **post-litigation** prosecution in the UK. The Revenue does not seem to have ever exercised its discretion to do so. The Courts do not seem to have referred any case for prosecution in the exercise of their inherent jurisdiction, despite the clear findings of fraud in many cases. Parliament has never

[485] Cunningham, pp.329-333.
[486] [1984] STC 153, 159.
[487] Ormerod (1998) p.638.

legislated for post-litigation prosecution, and did not include it in the civil penalty regime for the enablers and users of defeated schemes introduced by Finance (No. 2) Act 2017.

5.4.2 Contract Settlement and Civil Litigation

5.4.2.1 *Inland Revenue*

In his article that "examine[d] the meaning of tax avoidance and the future role of the Revenue in preventing it"[488], Gribbon (then Director of the Inland Revenue's Compliance Division) demonstrated that the Revenue's policy and practice rest upon the fallacy that "tax avoidance is legal":

> "**How might tax avoidance be defined?**
>
> The question requires us to draw a distinction between tax avoidance and tax planning. Many schemes which the Courts strike down clearly fall within the former category. But so – as Judges themselves have frequently recognised – do many schemes which the Courts feel unable to strike down under the law as it stands. The Government's remedy for these is to ask Parliament to change the law. There are many schemes which do not reach the Courts because it is clear to the Inland Revenue that the Courts are likely to find in the taxpayer's favour (just as there are others where taxpayer and their advisers concede without litigating).
>
> A universally accepted definition of avoidance does not exist and one cannot therefore be offered to provide a touchstone in determining what schemes the Government ought to consider stopping through new legislation. ...
>
> **What is the distinction between avoidance and evasion?**
>
> If there is a grey area between the two, as has been suggested by some recent commentators, this arises not from confusion, on the part of the Inland Revenue, between legality and illegality but from the means adopted by some to achieve what they describe as tax avoidance. If an 'avoidance' scheme relies on misrepresentation, deception and concealment of the full facts, then avoidance is a misnomer; the scheme would be more accurately described as fraud, and would fall to be treated as such. Where fraud is involved, it cannot be recharacterised as avoidance by cloaking the behaviour with artificial structures, contrived transactions and esoteric arguments as to how the tax law should be applied to these structures and transactions. Fraud is fraud, common cheat is common cheat and the application of tax law to 'pretend' situations is something of an irrelevance....
>
> **What is the role of the Inland Revenue?**

[488] 'A Sterile Activity', *Tax Journal*, 22 September 1997, p.3.

> As far as the Inland Revenue is concerned, in the context of its responsibilities for countering avoidance, its role is to administer the legislation enacted by Parliament, and to inform and advise Ministers where the purpose of the legislation is being or appears to be undermined.
>
> In relation to tax avoidance the Inland Revenue's role involves ascertaining the facts (which may require full and detailed investigation) and exercising first judgment as to the interpretation of law and its application to those facts. The determination of the facts and law is, of course, ultimately for the Appeal Commissioners and Courts, but it is very much the minority of cases that come before the Commissioners and the Courts and in practice, therefore, they operate as a check on the Inland Revenue's function.
>
> Just as the Courts, in interpreting legislation, will not confine themselves to a close literal interpretation, so the Inland Revenue will seek to ascertain the intention of Parliament when applying legislation to novel situations. ...
>
> The Inland Revenue's role of advising Ministers is twofold. On the one hand, the impetus for advice and reform may come from the Government and here the Inland Revenue's function is to advise Ministers on how their policy objectives may be pursued and implemented, and to provide information on their likely effects. On the other hand, advice may emanate from the Inland Revenue as it draws to the attention of Ministers matters emerging from its day-to-day experience of dealing with taxpayers' affairs and from its contacts with outside organisations. As part of its advice the Inland Revenue will draw the attention of Ministers to those areas where behavioural patterns and perceived inadequacies in the law are having an adverse effect on the yield to the Exchequer."[489]

Regarding the distinction between avoidance and evasion, the underlined sentence shows that the Revenue's practice and the tax dogma involve the failure to "remember that the Tax Acts are but a part of the general law of the land". "Fraud is fraud, common cheat is common cheat and the application of tax" *legislation*, which is but one part of tax *law*, to tax avoidance schemes that amount to fraud and common cheat under the general tax law, is not just "something of an irrelevance" but a subversion of the rule of law. As demonstrated in chapters three and four, every tax avoidance scheme "relies on misrepresentation, deception and concealment of the full facts" caused by the enabling professional advisers and "would be more accurately described as fraud". As demonstrated in this chapter, therefore, contrary to Gribbon's assertion, "[w]here fraud is involved" invariably in tax avoidance, it is "recharacterised as avoidance by cloaking the behaviour with artificial structures, contrived transactions and esoteric arguments as to how the tax law should be applied to these structures and transactions."

[489] Ibid, pp.3-5.

By purporting "to ascertain the intention of Parliament when applying legislation to novel situations" the Revenue facilitates tax avoidance like the courts. In the words of Lord Diplock:

> "Do not let us deceive ourselves with the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant. Anyone who has decided tax appeals knows that most of them concern transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all. Some of the transactions are of a kind which had never taken place before the Act was passed: they were devised as a result of it."[490]

By concluding that "[t]he Government's remedy for these is to ask Parliament to change the law", the Revenue perpetuates tax complexity. In the words of Lord Diplock:

> "This should be borne in mind when one complains of the complexity of taxing statutes. They should be drafted so as to leave no room for dispute as to the application to particular transactions. The history of tax legislation is thus the history of an attempt to deal specifically with the liability to tax of every kind of financial transaction which people enter into. And it is a history of failure."[491]

5.4.2.2 *HMRC*

Tailby (the pioneer Director of HMRC's Anti-avoidance Group) confirmed that HMRC adopted the Inland Revenue's ineffectual approach rather than the Customs & Excise's more effective approach:

> "At the end of December 2004 the Revenue and Customs & Excise formed the Anti-Avoidance Group to develop and deliver the HMRC anti-avoidance strategy. ...
>
> Merging the anti-avoidance work of the two Departments led to the exposure of differences in approach. In VAT, the approach to avoidance schemes was not to settle for less than the full amount of tax due and to challenge any scheme which the Department considered to be abusive. This approach, together with the development of innovative technical challenges such as the *Halifax* 'abuse' principle has had a notable effect on reducing the appetite for avoidance in the indirect tax field. One key drawback, though, to the uncompromising approach taken in indirect tax was the huge number of cases litigated, leading to a combative relationship between taxpayer and tax administration.
>
> In direct tax the approach to resolving avoidance cases was more settlement-driven. Customers who were serial avoiders would carry out a

[490] Diplock.
[491] Ibid.

> number of schemes and then offer the Inland Revenue a 'deal'. Some schemes would be conceded by both sides so that a compromise would be reached. The difficulty with this approach from an anti-avoidance strategy point of view is that it does not change behaviour on either side. The Revenue might be tempted to pursue a weak case in the hope of getting some 'go away' money, and promoters and avoiders might be tempted to continue to promote and execute schemes even if the chances of ultimate success are low because there is no 'downside' for failure. If there is a discount of 10% or 20% of the tax given with every scheme which the Revenue believes does not work, there is no cost to the customer (actually a bonus) and therefore no incentive to stop avoidance.
>
> The potential downsides of both the direct and indirect tax approaches needed to be addressed, taking into account the effects on avoidance behaviours. Work on this was taken forward, eventually informing HMRC's Litigation and Settlement Strategy (LSS). But although the LSS recognises the importance of obtaining a full settlement where appropriate, it is equally important that HMRC does not pursue cases where it does not have a strong argument."[492]

With the introduction of DOTAS, therefore, HMRC exacerbates the vicious cycle of tax avoidance and tax complexity in its role of advising Ministers. According to Tailby:

> "The introduction of DOTAS has really sharpened up HMRC's act. Changes in legislation can now be made extremely swiftly. In January 2009 intelligence was received by HMRC about a scheme which would deplete the Exchequer of some £200 million. A team of specialists from HMRC and HMT worked on the scheme and amendments to relevant legislation were quickly identified. As a result, the Financial Secretary was able to announce blocking legislation to take effect on 12 January, a mere five days from when the information was received. Work on further information led to a variant scheme being closed - again with effect from 12 January, this time retrospectively."[493]

The NAO's 2012 assessment of the DOTAS regime highlighted the scale of tax avoidance in the UK and the fundamental flaw in this approach:

> "DOTAS has been effective in providing early warning of large numbers of schemes. A total of 2,289 schemes had been disclosed under DOTAS by the end of 2011-12. After a high number of initial disclosures, the number of schemes disclosed has levelled off at between 118 and 177 a year since 2008-09. When HMRC receives a disclosure about a scheme that exploits a specific aspect of tax law, it is often able to address it by making a simple change to the legislation.
>
> Advised by HMRC, Parliament have initiated 93 changes to tax law to tackle avoidance since the introduction of DOTAS in 2004, though some of

[492] 'Tax Avoidance - Then and Now', *Tax Journal*, 22 June 2009.
[493] Ibid.

these may have been introduced without the early warning that DOTAS provided. ...

Introducing narrowly targeted changes to legislation that stop particular schemes is not always effective and has disadvantages, such as increasing the length and complexity of tax law. They can also open new opportunities for avoidance."[494]

5.4.3 The Tax Dogma

Masters, who based his expert evidence in *Charlton* on the tax dogma, was right to argue that the Revenue deviated from its policy and practice, but wrong to conclude that it could not do so in law:

"I can see a general move to blur what is a very clear distinction between illegal evasion and legal avoidance, a move in which the Inland Revenue itself has had a hand as can be seen from the case. ...

During the case I was at great pains to point out the distinction between tax-avoidance and tax evasion, whereas the Inland Revenue appeared to be doing its best to confuse the two concepts in the minds of the judge and jury. It was one of the bizarre aspects of the whole process that I could not directly give evidence as to the true distinction between avoidance and evasion because that is a matter of law and the court is presumed to know the law. ...

A large number of tax mitigation arrangements of many types were implemented in the period covered by the Charlton transactions: from 1978 to 1990 (and indeed in the years before and after that period). Many were accepted by the Inland Revenue as effective, and some were endorsed by the courts. In fact, schemes using structures set up in Jersey and elsewhere were so widespread and so successful that a great deal of specific anti-avoidance legislation has to be introduced over the past two decades. ...

Most major firms of solicitors and accountants advised clients on tax haven operations during the period covered by the indictment. Many would have been involved in arrangements similar to Mr Charlton's schemes. A lot of schemes failed to achieve their objective but that was because they were caught by one or more of the many anti-avoidance provisions now to be found in the tax legislation, or because of the unfavourable approach of the courts to what is now perceived as 'unacceptable', albeit legal, tax avoidance.

Yet, in the *Charlton* case, the impression given by the Inland Revenue, who knew that the matter would be put before a judge and jury who were not versed in the intricacies of tax law, is that the taxpayers and their advisers were involved in crafty tax dodges and that it should not be allowed."[495]

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[494] NAO, pp.20-23.
[495] Masters, pp.388-390.

Charlton simply demonstrated that "the true distinction between avoidance and evasion ... is a matter of law" and not a matter of dogma. According to Rhodes et al:

> "It is a commonly held belief among professional advisers that tax avoidance is legal and tax evasion is illegal. Tax avoidance schemes may fail but the taxpayers and their advisers have, until now, been secure in the knowledge that the worst that can happen is the receipt of a large bill for tax and interest. ...
>
> Amongst professional tax advisers, alarm and concern have been expressed at the approach of the Revenue and the conduct of the case. It has been argued that there is a general move to 'blur' the 'very clear' distinction between legal tax avoidance and illegal evasion. However, it might well be suggested that the distinction is not and has never been as clear as many professional advisers (and their clients) would like to believe. Where avoidance arrangements are wholly artificial and have no substance then clearly it is and always has been open to the Revenue and the courts to consider whether they are in fact 'devices to cheat the public revenue'. What perhaps has confused the issue is the Revenue's highly selective policy on prosecutions. Although the Revenue are a law enforcement agency, their principal purpose is to collect taxes. Accordingly, historically, they have only been interested in invoking the criminal law where they consider that they will be successful and the case will generate publicity which will serve as a warning to other taxpayers or professional advisers. Should this attitude change, and should the Revenue seek to act as a law enforcement agency on the lines adopted so successfully many years ago by the US Internal Revenue Service, then many more taxpayers and their professional advisers may find that they are at risk."[496]

The fact that schemes "were accepted by the Inland Revenue as effective, and some were endorsed by the courts" under "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant" does not mean that they do not amount to cheating under the law.

As demonstrated in chapter one, the fact "that a great deal of specific anti-avoidance legislation has to be introduced" means that they amount to cheating because anti-avoidance legislation codifies and decriminalises cheating. According to Rhodes et al:

> "It has also been argued that the Revenue and the court were in error in seeking to apply criminal law instead of challenging the arrangements under civil revenue law, such as the transfer pricing provisions of s 770 Income & Corporation Taxes Act 1988. Again, such an argument is fallacious as it would be a cardinal error to assume that, simply because an arrangement can either be challenged under civil law or prosecuted under criminal law, the Inland Revenue and the courts have some overriding

[496] Rhodes, pp.203-206. Emphases supplied.

> obligation to deal with the matter under the former category. Indeed, common sense would suggest that in such instances criminal law should take precedence."[497]

The fallacious notion of "'unacceptable', albeit legal, tax avoidance" cited by Masters results from the absence of the post-litigation prosecution of the enablers of defeated schemes to determine the question of criminal liability.

5.5 CONCLUSION

This chapter underscored the proposition that the dogma that "tax avoidance is legal and tax evasion is illegal" does "involve substituting 'the incertain and crooked cord of discretion' for 'the golden and streight metwand of the law.'"[498]

[497] Rhodes, p.219.
[498] Tomlin, *Westminster*, p.19.

CHAPTER SIX

SWEETHEART TAX DEALS

> **The primary duty of the Revenue is to collect taxes which are properly payable in accordance with current legislation but it is also responsible for managing the tax system: section 1 of the Taxes Management Act 1970. Inherent in the duty of management is a wide discretion. Although the discretion is bounded by the primary duty, it is lawful for the Revenue to make concessions in relation to individual cases or types of case which will, or may, result in the non-collection of tax lawfully due provided that they are made with a view to obtaining overall for the national exchequer the highest net practicable return: *IRC v National Federation of Self-employed and Small Businesses Ltd* [1982] AC 617, 636 per Lord Diplock.**
> Lord Wilson, *R (Davies) v HMRC; R (Gaines-Cooper) v HMRC* [2011] UKSC 47, paragraph 26.

6.1. INTRODUCTION

This chapter uses HMRC's recent sweetheart tax deals to demonstrate that the dogma "tax avoidance is legal and tax evasion is illegal" rests for its support upon a fundamental misunderstanding of the fact in all cases of tax fraud "it is entirely within the discretion of the tax authorities whether they take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-fraud penalties or simply establishing tax liability without fines or penalties".[499]

Sweetheart tax deals can be defined as, and are used in this thesis to refer to, "concessions in relation to individual cases or types of case which will, or may, result in the non-collection of tax lawfully due provided that they are made with a view to obtaining overall for the national exchequer the highest net practicable return." It should be noted that in order to be "lawful" in administrative law, it is sufficient that a sweetheart tax deal was "made *with a view to obtaining* overall for the national exchequer the highest net practicable return." The authorities show that there is no requirement to prove that a deal *succeeded* in "obtaining overall for the national exchequer the highest net practicable return."

Despite the differences in the facts and decisions in both cases, the proposition used by Lord Diplock to uphold the Revenue's sweetheart tax deal in *National Federation* was precisely the same proposition used by Lord Diplock to overrule the Revenue's assessment in *Vestey v IRC* where he stated:

[499] Wisselink, p.203.

> "Taxes are imposed on subjects by Parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer, and the amount of his liability is clearly defined. A proposition that whether a subject is to be taxed or not, or that, if he is, the amount of his liability is to be decided (even though within a limit) by an administrative body, represents a radical departure from constitutional principle. It may be that the Revenue could persuade Parliament to enact such a proposition in such terms that the courts would have to give effect to it; but unless it has done so, the courts, acting on constitutional principles, not only should not, but cannot validate it. ... This would be taxation by self asserted administrative discretion and not by law."[500]

As the cases analysed in this chapter demonstrate, sweetheart tax deals or "concessions in relation to individual cases or types of case which will, or may, result in the non-collection of tax lawfully due provided that they are made with a view to obtaining overall for the national exchequer the highest net practicable return" rest upon the "proposition that whether a subject is to be taxed or not, or that, if he is, the amount of his liability is to be decided (even though within a limit) by an administrative body" and thus constitute "taxation by ... administrative discretion and not by law" and "represent a radical departure from constitutional principle."

On December 16, 2011, HMRC's then Permanent Secretary for Tax (Mr Hartnett) highlighted the significance of sweetheart tax deals in a memorandum to the Exchequer Secretary to the Treasury:

> "In 2006 HMRC adopted a new approach to reaching tax settlements with large business, through building constructive relationships and encouraging mutual openness and transparency, increasing certainty for business and reducing the time taken to resolve issues. Alongside this general strategy we introduced the intensive High Risk Corporates Programme for the most aggressive companies, which has already secured well over £9bn of additional revenue for the UK that might not otherwise have been secured. Settlements of above £1bn are now not uncommon, and £4.5bn (in addition to the £9bn) has come from just four settlements with bespoke governance."[501]

The frequent claim that any amount recovered in a tax deal is "additional revenue for the UK that might not otherwise have been secured" is disingenuous and leads to the absurd conclusion that it would have been appropriate for the High Risk Corporates Programme to accept £9 instead of £9 billion merely because £9 is better than nothing.

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[500] [1980] STC 10, 18-19.

[501] 'Strong Statement in Support of HMRC when the PAC Report on Large Business Settlements is Released next Tuesday 20th December 2011'. See Syal, 'Revealed: 'Sweetheart' tax deals each worth over £1bn', *The Guardian*, April 29, 2013.

As the chair of the PAC stated in relation to the "four settlements made with bespoke governance" (which are deals Hartnett struck without following HMRC's rules):

> "If we got £4.5bn in, how much did we not get? That is what taxpayers will want to know. ... Whilst it is in the interest of the government to collect monies, these are huge sums. If there were deals involved, we need to know that the companies paid a fair amount on the profits they made from their businesses in the UK."[502]

As explained in chapter one, Lord Mansfield upheld the conviction in *Bembridge* by applying the common law offence of cheating the public revenue to misconduct in a public office in order to protect the public interest in tax deals, stating:

> "In 6 Modern, folio 96, the court says: 'If a man be made an officer by act of parliament, and misbehave himself in his office, he is indictable for it at common law; and any public officer, is indictable for misbehaviour in his office,' and there is no doubt but at all times, more especially in this, <u>they whose offices give them such power over the public revenue, the public are extremely interested in</u>; therefore I am of opinion, that the crime found by the jury is an indictable offence."[503]

The fortification of the common law protection of the public interest in tax settlements by fraud by abuse of position under section 4 of the Fraud Act underscores the proposition that "they whose offices give them such power over the public revenue ["Settlements of above £1bn are now not uncommon, and £4.5bn ... has come from just four settlements with bespoke governance"], the public are extremely interested in".

The rest of this chapter critiques the legal bases of sweetheart tax deals; demonstrates that they breach HMRC's Criminal Investigation Policy; and uses the offshore tax evasion settlement with HSBC and the offshore tax avoidance settlements with Vodafone and Google to demonstrate that tax evasion and tax avoidance amount to cheating the public revenue in law.

6.2. REVENUE'S DISCRETION

The landmark judicial review in *National Federation* involved a tax evasion sweetheart deal. As Lord Wilberforce explained:

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[502] Syal, ibid.
[503] *Bembridge*, p.157. Emphasis supplied.

> "The respondent federation ... is asking for an order on the Commissioners of Inland Revenue to assess and collect arrears of income said to be due by a number of people compendiously described as 'Fleet Street casuals'. These are workers in the printing industry who, under a practice sanctioned apparently by their unions and their employers, have for some years been engaged in a process of depriving the Inland Revenue of tax due in respect of their casual earnings. This they appear to have done by filling in false or imaginary names on the call slips presented on collecting their pay. The sums involved were very considerable. The Inland Revenue, having become aware of this, made an arrangement ... under which these workers are to register in respect of their casual employment, so that in the future tax can be collected in the normal way. Further, arrears of tax from 1977-78 are to be paid and current investigations are to proceed, but investigations as to tax lost in earlier years are not to be made.
>
> This arrangement, described inaccurately as an 'amnesty', the federation wishes to attack. It asserts that the Revenue acted unlawfully in not pursuing the claim for the full amount of tax due. It claims that the Board exceeded its powers in granting the 'amnesty'; alternatively that, if it had power to grant it ... the Board ought to act fairly as between taxpayers and has not done so; and that the Board is under a duty to see that income tax is duly assessed, charged and collected."[504]

In the courts below, the issue was whether the federation had standing to bring a judicial review. The High Court held that it did not. The Court of Appeal disagreed. The House of Lords considered it relevant to decide whether the Revenue acted beyond its powers under section 1 of TMA in the context of section 13(1) which provided that:

> "The Commissioners shall collect and cause to be collected every part of inland revenue, and all money under their care and management".

Their lordships found for the Revenue on both grounds, without any evidence that Parliament has ever qualified section 13(1) of TMA. According to Lord Diplock's classic statement applied by Lord Wilson in *Gaines-Cooper*:

> "[T]he Board are charged by statute with the care, management and collection on behalf of the Crown of income tax, corporation tax and capital gains tax. In the exercise of these functions the Board have a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge the highest net return that is practicable having regard to the staff available to them and the cost of collection. ... I do not doubt, however, and I do not understand any of your Lordships to doubt, that if it were established that the Board were proposing to exercise or to refrain from exercising their powers not for reasons of 'good management' but for some extraneous or ulterior reason that action or inaction of the Board would be ultra vires and would be a proper matter for judicial review if it were brought to the attention of the

[504] [1981] STC 260, 263-264.

court by an applicant with 'a sufficient interest' in having the Board compelled to observe the law."[505]

The decision of Justice Nicol in the recent judicial review in *UK Uncut Legal Action v HMRC*, which resulted from Hartnett's decision to let Goldman Sachs off some £20 million due in interests *after* the company had lost its appeal and without consulting the lawyers dealing with the matter[506], underscores the breadth of this judge-made "wide managerial discretion":

> "The settlement with Goldman Sachs was not a glorious episode in the history of the Revenue. The HMRC officials who negotiated it had not been briefed by the lawyers who were litigating against Goldman Sachs. They relied on their belief or recollection that there was a barrier to the recovery of interest on the unpaid NICs. That was erroneous. HMRC accepts now that there was no such barrier. The officials who negotiated the agreement overlooked the need for approval from the Programme Board in relation to an agreement over £100 million. HMRC now accepts that they should have appreciated this. Because the officials did not have this requirement to mind, they said nothing about it to Goldman Sachs and created the impression that the agreement was a done deal by the end of the meeting on 19th November. HMRC accepts that was an error. Furthermore, HMRC did not appear to have taken a contemporaneous note as to the agreement which was reached on 19th November. That allowed a degree of uncertainty to prevail for a time as to what precisely had been agreed. In the end that has been resolved but in the course of the hearing, HMRC accepted that it would have been a good idea for a contemporaneous record to have been kept. Next, by his own admission, when he decided to approve the settlement on 9th December 2010, Mr Hartnett took into account the potential embarrassment to the Chancellor of the Exchequer if Goldman Sachs were to withdraw from the Tax Code. HMRC accepts that was an irrelevant consideration and should not have featured in his decision-making process.
>
> However, my task is to decide whether the decisions of HMRC under challenge were unlawful. As Simon J. said when granting permission to apply for judicial review, 'maladministration and illegality are separate issues.' He was echoing the sentiments expressed by Lord Scarman in the *Fleet Street Casuals* case. ...
>
> But it is worth remembering that Lord Scarman's rhetoric was directed at the argument that the National Federation's claim could not be examined because it lacked standing to apply for judicial review. When the claim was examined, he, like the other members of the House of Lords, concluded that it was not sustainable. Similarly, [counsel for HMRC] did not suggest that I should retreat from the 'commanding heights of the law', but rather I should conclude that the Claimant's arguments that HMRC had erred in

[505] Ibid, p.269.
[506] *Goldman Sachs v HMRC* [2009] UKUT 290. See, Osita Mba, Written Evidence and Further Written, PAC, *HM Revenue & Customs 2010–11 Accounts: Tax Disputes*, EV 71-EV 142.

> law, as well as making the errors which he admitted, were not made out. For all of the reasons which I have given above, I agree."[507]

Just like a decision that a scheme "works" as a matter of statutory construction, a decision that a tax deal is within the Revenue's "wide managerial discretion" as a matter of administrative law does not justify the blanket label that it is "lawful" because it does not decide the question of cheating the public revenue or misconduct in a public office under the common law or fraud by abuse of office under section 4 of the Fraud Act.

There is no suggestion of the commission of a crime, but, leaving aside the question of dishonesty, failing to collect tax because of "the potential embarrassment to the Chancellor of the Exchequer" is within the ambit of section 4 of the Fraud Act because it is not necessary for the defendant "to make a gain for himself" in terms of section 4(1)(c)(i); it is sufficient "to cause loss to another or to expose another to a risk of loss" in terms of section 4(1)(c)(ii). In the words of Goddard CJ's summary of *Bembridge* in *Hudson*:

> "The matter came before the Court of King's Bench in *Rex v. Bembridge* in 1783, when a public officer, one Charles Bembridge, was indicted for a fraud on the Crown because he had knowingly and wrongly certified the amount due from the late Paymaster-General, Lord Holland, to the Crown. It does not appear that he had gained anything from it, but he did it and did it fraudulently, as the jury found."[508]

6.3. TREASURY DIRECTIONS

Section 11 of the CRCA, which enacted the provision for treasury directions embodied in section 1(3) TMA, provides that:

> "In the exercise of their functions the Commissioners shall comply with any directions of a general nature given to them by the Treasury."

During the passage of the CRCA, the Attorney-General explained in a letter to the Chairman of the House of Lords' Constitution Committee that:

> "[I]t is intended that the Treasury – as currently – should have an overall power to give general direction to the Commissioners in the exercise of their functions. This recognises that Treasury Ministers retain overall accountability for the UK tax system as a whole and must retain oversight

[507] *UK Uncut Legal Action v HMRC* [2013] EWHC 1283 [66]-[68]. Emphases supplied.
[508] *Hudson*, pp.259-260.

> of HMRC, but that this is subject to the vital principle that Ministers should not intervene in the affairs of individual taxpayers and should not attempt to influence the way a particular taxpayer is dealt with."[509]

HMRC's "light touch" approach to the taxation of large businesses reflects the policies of successive governments which it is bound to enforce under Treasury directions.[510] In fact, the sweetheart tax deals Hartnett described are traceable to the famous speech by the then Chancellor of the Exchequer to the Confederation of British Industry on November 28, 2005:

> "In the old regulatory model – and for more than one hundred years – the implicit principle from health and safety to the administration of tax and financial services has been, irrespective of known risks or past results, 100 per cent inspection whether it be premises, procedures or practices. ...
>
> This approach, followed for more than a century of regulation by governments of all parties is outdated. The better, and in my opinion the correct, modern model of regulation – the risk based approach – is based on trust in the responsible company, the engaged employee and the educated consumer, leading government to focus its attention where it should: no inspection without justification, no form filling without justification, and no information requirements without justification, not just a light touch but a limited touch.
>
> The new model of regulation can be applied not just to regulation of environment, health and safety and social standards but is being applied to other areas vital to the success of British business: to the regulation of financial services and indeed to the administration of tax."[511]

The financial crisis of 2007-2008, which resulted from the "light touch" approach "to the regulation of financial services", was a major contributing factor to the emergence of the Coalition Government in 2010. *The Corporate Tax Road Map* published by the Treasury under that Government, however, stated:

> "**The administration of business tax**
>
> The Government sees continuing to develop an enhanced relationship between HMRC and large businesses as a priority. Openness and transparency are not just important when considering policy issues but also

[509] APPENDIX 4: Correspondence on the Commissioners for Revenue and Customs Bill, February 21, 2005.
https://www.publications.parliament.uk/pa/ld200405/ldselect/ldconst/78/7807.htm

[510] *Large Business Taxation: The Government's strategy and corporate tax reforms*, 2001; Hartnett's *Inland Revenue's Review of Links with Business*, 2001 and Varney's *Review of Links with Large Business*, 2006.

[511] https://www.ft.com/content/9073a120-600d-11da-a3a6-0000779e2340#axzz3z6uubbEy Emphases supplied.

> play a role in tax administration, in building an understanding of the framework within which businesses operate and make decisions on tax. ...
>
> A stable and sustainable corporate tax system will also require responsible judgements from both large businesses and HMRC as to how the law is interpreted on a day-to-day basis."[512]

Taxation on the basis of "responsible judgements from both large businesses and HMRC as to how the law is interpreted on a day-to-day basis" is "taxation by ... administrative discretion and not by law" and "represents a radical departure from constitutional principle."

6.4. HMRC'S CRIMINAL INVESTIGATION POLICY

6.4.1. Criminal Attacks

As the exposition in chapter one shows, marketed tax avoidance masterminded by the tax avoidance industry and offshore tax evasion masterminded by the private banking or wealth management industry fall within HMRC's description of 'criminal attacks':

> "Organised criminal gangs undertake co-ordinated and systematic attacks on the tax system. This includes smuggling goods such as alcohol or tobacco, VAT repayment fraud and VAT Missing Trader Intra-Community (MTIC) fraud."[513]

6.4.2. Marketed Tax Avoidance

The Information in *USA v KPMG* (Appendix 1) proves that in marketed tax avoidance "[o]rganised criminal gangs undertake co-ordinated and systematic attacks on the tax system." As IRS Commissioner Everson stated while announcing the deferred prosecution of KPMG:

> "Today's actions demonstrate our resolve to hold accountable those who play fast and loose with the tax code. At some point such conduct passes from clever accounting and lawyering to theft from the people. ... Accountants and attorneys should be the pillars of our system of taxation, not the architects of its circumvention."[514]

[512] *Part I*, November 29, 2010, p.16.
[513] HMRC, p.20.
[514] "KMPG to Pay $456 Million for Criminal Violations".

To "play fast and loose with the tax code" or to circumvent the "system of taxation" is to "undertake co-ordinated and systematic attacks on the tax system", which is cheating the public or "theft from the people" as a matter of law. According to Baker:

> "On one view tax advisors destroy the planned progressivity in the tax system."[515]

6.4.3. Offshore Tax Evasion

The Information in *USA v Sethi* (Appendix 2) proves that in offshore tax evasion "[o]rganised criminal gangs undertake co-ordinated and systematic attacks on the tax system."

HMRC's specific reference to "smuggling goods such as alcohol or tobacco, VAT repayment fraud and VAT MTIC fraud" perpetrated by low level criminals in its definition but not offshore tax evasion perpetrated by respectable professional advisers in the private banking industry such as the "senior vice president" and "high-ranking executive" of HSBC referred to in paragraphs 17 and 18, which is universally accepted as a crime, underscores the double standard that underlies the administration of the UK's tax system.

6.4.4. HMRC's Policy

The proposition that marketed tax avoidance and offshore tax evasion constitute conspiracies in which "[o]rganised criminal gangs undertake co-ordinated and systematic attacks on the tax system" is highly significant because according to *HMRC Criminal Investigation Policy*:

> "Examples of the kind of circumstances in which HMRC will generally consider starting a criminal, rather than civil investigation are in cases of organised criminal gangs attacking the tax system or systematic frauds where losses represent a serious threat to the tax base, including conspiracy."

The sweetheart tax deals HMRC concluded in the cases of offshore tax evasion and offshore tax avoidance analysed in this chapter show that HMRC does not comply with this policy, which is a ground for judicial review.

[515] Baker, p.6.

6.5. OFFSHORE TAX AVOIDANCE

6.5.1. HMRC's Practice

The "Luxembourg Leaks" – the disclosure in November 2014 by the ICIJ of 548 letters between PriceWaterhouseCoopers (PwC) and the Luxembourg Inland Revenue showing that PwC secured tax deals or advance planning arrangements for 343 multinational companies between 2002 and 2010 – confirms that offshore tax avoidance amounts to marketed tax avoidance. According to the PAC:

> "Large accountancy firms advise multinational companies on complex strategies and contrived structures which do not reflect the substance of their businesses and are instead designed to avoid tax. In light of the publication of leaked documents detailing some of the tax advice it has given to its multinational clients, we took evidence from PwC. PwC did not convince us that its widespread promotion of schemes to numerous clients, based on artificially diverting profits to Luxembourg through intra-company loans, constituted anything other than the promotion of tax avoidance on an industrial scale. ... The tax arrangements PwC promoted in Luxembourg bear all the characteristics of a mass-marketed tax avoidance scheme."[516]

The PAC's 2012 report fortifies the proposition that HMRC should be "starting a criminal, rather than civil investigation":

> "In 2011-12, £474.2 billion of total tax revenue accrued to HMRC which was £4.5 billion higher than for 2010-11.Yet there was a decrease in corporation tax revenue of £6.3 billion. ...
>
> We were not sufficiently convinced by the Department's assertion that it was pursuing all the tax due from big businesses given the reduction in corporation tax revenue from last year. There is genuine public anger and frustration because there is an impression that rigorous action is taken against ordinary people and small businesses and British companies based wholly in the UK but, apparently, lenient treatment is given to big corporations, of which almost half have a head office overseas. ...
>
> HMRC acknowledged that it has to maintain broad confidence and credibility in its administration of the tax system to maintain the very high levels of compliance that there is in the UK. However, we felt that this was undermined by the Department's use of selective prosecutions; a practice which it could not clearly justify to the Committee. HMRC had not carried out any analysis into the effect high-profile cases of large companies avoiding tax could be having on the compliance rate of individuals and small and medium companies. Multinational companies appear to be using transfer pricing, payment of royalties for intellectual property or franchise payments to other group companies to artificially reduce their profits in the

[516] *Tax avoidance: the role of large accountancy firms (follow–up)*, 6 February 2015, pp.3&5.

> UK or to remove them to lower tax jurisdictions. We were not convinced that HMRC has the determination to robustly challenge the practices of these companies."[517]

6.5.2. The Vodafone Deal

The Vodafone deal is one of Hartnett's "four settlements with bespoke governance." According to a newspaper report:

> "Controversial tax boss Dave Hartnett agreed a deal to let Vodafone off a £6bn tax bill. ... The agreement between HMRC and Vodafone came after negotiations between revenue officers and John Connors, Vodafone's head of tax. Until 2007, Mr Connors was a senior official at HMRC, where he worked closely with Mr Hartnett.
>
> The saga began a decade ago when Vodafone bought German engineering firm Mannesmann for 180bn euros. Wanting to route the purchase through an offshore company to avoid paying UK taxes, it set up a subsidiary in Luxemburg where profits would be taxed at less than 1%. But it was ruled that the deal broke anti-tax avoidance rules.
>
> Nevertheless, Mr Hartnett took the Vodafone case away from his team of lawyers and gave it to another negotiating team, which said the phone company could get away with paying a lump sum of £800,000 and a further £450,000 over five years. HMRC also agreed that the firm would no longer have to pay tax on its Luxembourg subsidiary's profits. The deal is understood to include some other tax avoidance ruses by Vodafone. One former HMRC chief told *Private Eye* magazine the deal was an 'unbelievable cave-in'."[518]

Vodafone's annual report for the year ended March 31, 2010 provided this technical background:

> "In October 2004, one of our subsidiaries, Vodafone 2, instigated a legal challenge to an enquiry ('the Vodafone 2 enquiry') by HMRC with regard to the UK tax treatment of its Luxembourg holding company, Vodafone Investments Luxembourg SARL ('VIL'), under the CFC Regime. Vodafone 2 argued that the CFC Regime was incompatible with EU law and the Vodafone 2 enquiry ought to be closed.
>
> In September 2006, the European Court of Justice determined in the *Cadbury Schweppes* case (C-196/04) that the CFC Regime would be incompatible with EU law unless it could be interpreted as applying only to wholly artificial arrangements intended to escape national tax normally payable ('wholly artificial arrangements'). On 22 May 2009, the Court of Appeal ('CoA') held that the CFC Regime could be so interpreted by reading a new exemption into the CFC Regime in respect of subsidiaries

[517] *HMRC: Annual Report and Accounts 2011–12*, December 3, 2012, pp.7-8.
[518] Martin, 'Taxman let Vodafone off £6bn bill', *Daily Mail*, September 16, 2010.

> which are 'actually established' in another EU Member State and carry on 'genuine economic activities' there. The CoA ruled that the Vodafone 2 enquiry should be allowed to continue on this basis. The CoA's decision became final when, on 17 December 2009, the Supreme Court refused Vodafone 2 permission to appeal.
>
> The Vodafone 2 enquiry and other enquiries involving similar holding companies in Luxembourg are ongoing. The outcome of these enquiries, including whether further legal proceedings will be required to ultimately resolve them, is uncertain at this stage. We carried provisions of £2.2 billion in respect of the potential UK corporation tax exposure at 31 March 2010."[519]

On July 23, 2010 Vodafone issued an Interim Management Statement disclosing the details of the settlement:

> "On 22 July 2010 Vodafone reached agreement with the UK tax authorities with respect to the UK Controlled Foreign Company ('CFC') tax case. Vodafone will pay £1.25 billion to settle all outstanding CFC issues from 2001 to date and has also reached agreement that no further UK CFC tax liabilities will arise in the near future under current legislation.
>
> Longer term, no CFC liabilities are expected to arise as a consequence of the likely reforms of the UK CFC regime due to the facts established in this agreement. The settlement comprises £800m in the current financial year with the balance to be paid in instalments over the following five years. "[520]

Whether or not Hartnett "let Vodafone off £6bn bill", by accepting "£1.25 billion to settle all outstanding CFC issues from 2001 to [22 July 2010]" when Vodafone "carried provisions of £2.2 billion in respect of the potential UK corporation tax exposure at 31 March 2010", and by accepting "instalments over the following five years" without interest, it is difficult to see how HMRC can be said to have succeeded in "obtaining for the national exchequer ... the highest net return that is practicable".

Furthermore, the inclusion of the terms – "no further UK CFC tax liabilities will arise in the near future under current legislation" and "no CFC liabilities are expected to arise as a consequence of the likely reforms of the UK CFC regime" – arguably makes the agreement "an example of a 'forward tax agreement' which, in the present context, is an agreement in terms of which an individual will pay, and the [Revenue] will accept, a specified sum in respect of designated future years of assessment in full and final

[519] https://www.vodafone.com/content/annualreport/annual_report10/financials/note29.html

[520] https://www.vodafone.com/content/annualreport/annual_report11/downloads/vf_ar2011_taxation.pdf

settlement of ... tax to which the individual might otherwise have been liable" in the words of Lord Cullen in *Al Fayed v Advocate General for Scotland*[521] where such an agreement was held *ultra vires*.

6.5.3. The Google Deal

Google's statement illustrates the taxation on the basis of "responsible judgements from both large businesses and HMRC as to how the law is interpreted on a day-to-day basis":

> "After a six-year audit we are paying the full amount of tax that HM Revenue & Customs agrees we should pay, including £130m in additional back tax. Governments make tax law, the tax authorities independently enforce the law, and Google complies with the law."[522]

There is, of course, a fundamental distinction between "the full amount of tax that HMRC agrees" and the full amount of tax determined by a court of law. As the *Financial Times* stated in an editorial:

> "These so-called commissionaire arrangements depend on the polite fiction that the business is genuinely done in Ireland. Yet this is hard to square with Google's large British payroll. It is also undermined by the 2013 admission of Matt Brittin, its European boss, before a parliamentary committee that Google's UK staff not only talk regularly to big clients but do much of the marketing, including the negotiation and agreement of sales. Other countries are increasingly questioning the legitimacy of these tactics. France is said to be pursuing a settlement with Google worth three times the UK's amount, even though the company's operations there are smaller. Were Britain to follow Paris and argue that Google had a 'permanent establishment' in Britain, the tax position could be transformed. It would raise the possibility of taxing a greater proportion of Google's notional £1bn of UK profits. ...
>
> This deal may indeed be the best that Britain can get. But before signing up to it, HMRC should test the real extent of Google's UK liabilities. Public confidence would be served were it to bring a case before the courts to judge whether the company has a UK permanent establishment and what impact this might have on its tax liabilities."[523]

The PAC's 2013 report underscored the absence of any judicial involvement in the process:

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[521] [2004] ScotCS 278 [4].
[522] 'Governments make tax law, Google complies' *Financial Times*, January 27, 2016.
[523] 'Google's tax deal should face a proper legal test', January 26, 2016.

"**HMRC has not been sufficiently challenging of multinationals' manifestly artificial tax structures**. We accept that HMRC is limited by resources but it is extraordinary that it has not been more challenging of Google's corporate arrangements given the overwhelming disparity between where profit is generated and where tax is paid. Inconsistencies between the form of the company's structure and the substance of its activities only came to light through the efforts of investigative journalists and whistleblowers. Any common sense reading of HMRC's own guidance and tests suggests HMRC should vigorously question Google's claim that it is acting lawfully. We note that HMRC has never challenged an internet-based company in the Courts on the question of its permanent establishment."[524]

HMRC's written submission to the PAC for the purposes of its hearing on 11 February 2016 (Appendix 4) shows that it decided that Google "is not resident in the UK for tax purposes" on the basis of "legal advice":

"HMRC formally opened an enquiry into Google UK Ltd (GUK)'s returns in March 2010 after having carried out a detailed risk review. We concluded our enquiry in January 2016, when we reached agreement with GUK about additional tax that was due. There were two agreements between GUK and HMRC; one covered the period 1 January 2004 to 31 December 2004, and the second covered 1 January 2005 to 30 June 2015.

We examined whether there was a permanent establishment of Google lnc or Google lreland Ltd (GIL) in the UK. We also examined the transfer pricing methodology applied to transactions between GUK and other group companies. ...

For each year covered by the enquiry, we secured additional tax reflecting the full value of the economic activities carried on by Google in the UK.

In the course of our enquiry, we:

- questioned senior Google executives, managers, customer-facing staff, customers and intermediaries, such as advertising agencies
- visited Google lreland Ltd's Dublin offices to understand better the business being carried on there and to talk to lrish employees
- analysed information from many sources about the business, its profits and activities in the UK, including documents provided by a whistle-blower
- exchanged information with tax authorities in other countries to obtain information and documents to help us understand Google's global arrangements and profitability in relation to the UK business

[524] *Tax Avoidance–Google*, June 13, 2013, p.5. Emphasis supplied.

- took extensive legal advice, including consulting external leading Counsel on matters such as whether the activities of Google's staff in the UK gave rise to a permanent establishment of Google lreland Ltd."[525]

Michel Sapin, French finance minister, said that the settlement "seems more the product of a negotiation than the application of the law" and added that:

> "The French tax administration does not negotiate the amount of taxes owed. It applies the rules."[526]

Indeed, on May 24, 2016 dozens of French police raided Google's Paris headquarters as part of an investigation into aggravated tax fraud and the organized laundering of the proceeds of tax fraud.[527]

The PAC's report effectively concluded that HMRC did not succeed in "obtaining for the national exchequer ... the highest net return that is practicable":

> "A six year investigation by HM Revenue & Customs (HMRC) has resulted in Google paying a further £130 million to settle its corporation tax liabilities over the last 10 years. This vindicates the previous Committee's concerns in 2012 and 2013 that Google did not appear to be paying the full tax it owed in the UK. However, in the absence of full transparency over the details of this settlement and how it was reached we cannot judge whether it is fair to taxpayers. The sum paid by Google seems disproportionately small when compared with the size of Google's business in the UK, reinforcing our concerns that the rules governing where corporation tax is paid by multinational companies do not produce a fair outcome. Google's stated desire for greater tax simplicity and transparency is at odds with the complex operational structure it has created which appears to be directed at minimising its tax liabilities. Google admits that this structure will not change as a result of this settlement."[528]

6.5.4. The Profit Diversion Compliance Facility

The Profit Diversion Compliance Facility published on January 10, 2019 (which is an 'amnesty' for multinational companies that used Transfer Pricing (TP) to cheat the public revenue) vindicates the PAC's criticisms which HMRC and the Treasury had hitherto denied. In the *Profit Diversion Compliance Facility Guidance* HMRC stated:

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[525] *Supplementary written evidence from HM Revenue and Customs*, 10 February 2016. Emphasis supplied.
[526] Bowers, 'French finance minister blasts UK's £130m Google tax deal', *The Guardian*, February 2, 2016.
[527] Rose, 'Investigators raid Google Paris HQ in tax evasion inquiry', *Reuters*, May 24, 2016.
[528] *Corporate tax settlements*, 24 February 2016, p.3.

> "Our investigations into Profit Diversion to date have established that in a large number of cases the factual pattern outlined to HMRC at the start of an enquiry does not stand up to scrutiny once tested. That may be a result of a careless error (for example individuals within a group being unaware of what the actual facts are) but it may also be a result of a deliberate behaviour, that is a group knowingly submitting a TP methodology in a Corporation Tax Return based on a false set of facts. A common issue is an overstatement of functions performed, assets used and risks assumed in entities taxed at lower rates, and an understatement of the functions performed, assets used and risks assumed in the UK.
>
> Where HMRC suspects there has been an attempt by a group to deliberately mislead, then we will refer the issue to Fraud Investigation Service for consideration of a criminal investigation or civil investigation into fraud."[529]

The first paragraph shows that these are "cases of organised criminal gangs attacking the tax system or systematic frauds where losses represent a serious threat to the tax base, including conspiracy" and thus "the kind of circumstances in which HMRC will generally consider starting a criminal, rather than civil investigation" under *HMRC Criminal Investigation Policy*.

The carefully-worded second paragraph, however, shows that this policy is not complied with.

6.6. OFFSHORE TAX EVASION

6.6.1. HMRC's Practice

The "Swiss Leaks" – the disclosure by the ICIJ of some 30,000 secret bank accounts holding almost £78 billion of assets in HSBC Private Bank (Suisse) – underscores the proposition that offshore tax evasion constitutes 'criminal attacks'. According to the ICIJ:

> "The bank repeatedly reassured clients that it would not disclose details of accounts to national authorities, even if evidence suggested that the accounts were undeclared to tax authorities in the client's home country. Bank employees also discussed with clients a range of measures that would ultimately allow clients to avoid paying taxes in their home countries. This included holding accounts in the name of offshore companies to avoid

[529] Para. 4.4.1.

> the European Savings Directive, a 2005 Europe-wide rule aimed at tackling tax evasion through the exchange of bank information."[530]

More than 3,600 bank accounts belonged to UK taxpayers. The PAC's 2015 report shows why HMRC should deal with cases of offshore tax evasion by "starting a criminal, rather than civil investigation":

> "**The number of criminal prosecutions for offshore tax evasion is still woefully inadequate.** HMRC's investigations do not lead to sufficient prosecutions to provide an effective deterrent, particularly for wealthy individuals who hide their assets offshore. In December 2013, we argued that HMRC needed to demonstrate that it deals robustly with individuals and companies who deliberately mislead it and that HMRC should be more willing to pursue prosecutions against both individuals and businesses. Regrettably, since then HMRC appears either to have ignored our recommendation or to have made little progress.
>
> Incredibly, there have been only 11 prosecutions in relation to offshore tax evasion since 2010, and only one individual from the Falciani list (of some 3,600 potential UK tax evaders whose Swiss bank account details were leaked by a former employee of HSBC) has been prosecuted. HMRC told us that it had now exhausted its use of the Falciani data, which did not meet the standards required for UK evidence. It said that offshore tax evasion is one of the toughest areas to prosecute, with people deliberately disguising their activities, while those who facilitate this form of tax evasion were careful not to enter the United Kingdom.
>
> HMRC has offered disclosure facilities with reduced penalties for people who come forward and provide information on assets held offshore. We are in no doubt that the use of these disclosure facilities is not an adequate substitute for the deterrent effect of prosecution."[531]

In fact, the "one individual from the Falciani list" or "Swiss Leaks", who pleaded guilty to one count of cheating the public revenue at Wood Green Crown Court on July 4, 2012, was prosecuted because he lied to HMRC in a previous *civil* investigation. According to HMRC's press release dated July 5, 2012:

> "Michael Shanly previously failed to disclose a Swiss offshore account to HMRC, during a civil enquiry where he was found to owe HMRC around £1·5m. This was discovered when information about UK taxpayers with HSBC bank accounts in Geneva was handed over to HMRC. Checks were then made to establish whether these account holders had declared and paid what they owed."

[530] ICIJ.

[531] HM Revenue & Customs Performance in 2014–15, November 3, 2015. https://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/393/39305.htm#_idTextAnchor005

Furthermore, paragraph 18 of the Information in *Sethi*, which revealed the involvement of "a high-ranking executive of [HSBC] and the head of a cross-border banking group within its private bank division that focused on developing and servicing clients worldwide ... based in [HSBC]'s London ... office" shows that, contrary to HMRC's claim "that offshore tax evasion is one of the toughest areas to prosecute" because "those who facilitate this form of tax evasion were careful not to enter the United Kingdom", the pivotal role of London in the private banking industry means that "those who facilitate this form of tax evasion" worldwide tend to operate from the UK.

6.6.2. The HSBC Deal

Contrary to HMRC's protestations, including the claim that "the Falciani data ... did not meet the standards required for UK evidence", none of the other "3,600 potential UK tax evaders" was prosecuted because, unlike the IRS that conducted "more than 100 prosecutions of evaders and 50 of their banking facilitators"[532], including *Sethi*, HMRC granted HSBC, their accomplices and customers immunity from prosecution.

The "*Agreement between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on Cooperation in the area of Taxation*" was signed in London on October 6, 2011. The Treaty[533], comprising the Agreement and the related Protocol and Exchange of Notes, entered into force on January 1, 2013 when the enabling UK legislation at Schedule 36 to the Finance Act 2012 took effect.

The "*Side Letter of the Competent Authority of the United Kingdom on Criminal Investigation*", which HMRC issued presumably under Treasury direction, states:

> "In view of the signing of the Agreement between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on cooperation in the area of taxation, the competent authority of the United Kingdom (the Commissioners for Her Majesty's Revenue and Customs – hereinafter referred to as 'HMRC') wishes to set out its position in relation to the criminal investigation of relevant persons for past liabilities incurred before the date of this Agreement in respect of relevant assets.
>
> Provided that a relevant person agrees either to make a one-off payment in accordance with Article 9 of this Agreement or to make a voluntary disclosure in relation to his/her relevant assets in accordance with Article 10 of this Agreement and fully cooperates with HMRC, that person is highly unlikely to be subject to a criminal investigation by HMRC for a tax-related

[532] *Private Eye*, 2 October 2015, page 37.
[533] Treaty Series No. 9 (2013). Cm 8579.

> offence for past liabilities in respect of relevant assets from the date he or she irrevocably opted for one of the options, unless either his/her relevant assets represent the proceeds of crime (other than crime connected to a tax-related offence) or represent the proceeds of crime connected to criminal tax-related offences punishable by two years or more imprisonment.
>
> Professional advisers, Swiss paying agents and their employees will need to comply with their legal obligations in respect of money laundering. Whilst it is never possible to provide an absolute assurance against a criminal investigation, it is highly unlikely to be in the public interest of the United Kingdom that professional advisers, Swiss paying agents and their employees will be subject to a criminal investigation by HMRC."[534]

No reason was given for the conclusion that, unlike other countries like the US, France, Belgium and Argentina, it was "highly unlikely to be in the public interest of the United Kingdom" for HSBC, its employees and co-conspirators to be subjected "to a criminal investigation by HMRC". In a letter to the Chairman of The Federal Reserve System on September 10, 2012, however, the Chancellor of the Exchequer (George Osborne) stated:

> "The ongoing US investigations into HSBC and SCB for breaches of US anti-money laundering (AML) and sanctions regulations have attracted significant market attention in the UK and elsewhere. Following publication of the Order by the New York Department for Financial Services (DFS) on 6 August, SCB's share price fell by almost 30% in a single day of trading. Even though SCB's market value has now recovered much of this loss, the incident raises broader concerns, and gives us an opportunity to reflect more generally on how we might collectively ensure that regulatory and enforcement action does not lead to unintended consequences.

The letter (Appendix 6) described each bank as "a systemically important financial institution". Even if HSBC was considered to be beyond prosecution as "a systemically important financial institution", however, HMRC could have entered into a deferred prosecution agreement to extract fines and an undertaking for better behaviour. Under the agreement between the IRS and KPMG:

> "The agreement provides that prosecution of the criminal charge against KPMG will be deferred until Dec. 31, 2006 if specified conditions – including payment of the $456 million in fines, restitution, and penalties – are met. The $456 million penalty includes: $100 million in civil fines for failure to register the tax shelters with the IRS; $128 million in criminal fines representing disgorgement of fees earned by KPMG on the four shelters; and $228 million in criminal restitution representing lost taxes to the IRS as a result of KPMG's intransigence in turning over documents and

[534] Emphases supplied.

> information to the IRS that caused the statute of limitations to run. If KPMG has fully complied with all the terms of the deferred prosecution agreement at the end of the deferral period, the government will dismiss the criminal information.
>
> To date, the IRS has collected more than $3.7 billion from taxpayers who voluntarily participated in a parallel civil global settlement initiative."[535]

By 2014, it had become clear that the HSBC deal did not succeed in "obtaining for the national exchequer ... the highest net return that is practicable". According to the *International Business Times*:

> "Britain is failing to rake in as much money as Chancellor George Osborne had promised from taxpayers who are sheltering their money in Switzerland's secretive banking system, with a shortfall of £2.3bn. Under the deal between the UK and Switzerland, British domiciles started to be taxed on their banking deposits in Swiss institutions. Just £818m was collected during the whole of 2013 after the tax agreement started on 1 January, according to the Office for National Statistics (ONS). This is against a forecast in Osborne's 2012 Autumn Statement of £3.12bn being raised during the 2013/14 financial year. When announcing the deal, Osborne said it would raise £5bn for the Treasury's coffers over the six years to the end of 2018."[536]

Following the media coverage of the "Swiss Leaks" in 2015, HMRC claimed that it "requested copies of the data from *The Guardian*, *BBC Panorama* and the ICIJ."[537] But according to the *Declaration of the United Kingdom concerning the acquisition of customer data stolen from Swiss banks* dated October 6, 2011:

> "The Government of the United Kingdom declares on the occasion of the signing of the Agreement between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on cooperation in the area of taxation that it will not actively seek to acquire customer data stolen from Swiss banks."

The timeline of the Swiss Leaks provided by *The Guardian* shows the need to consider the criminal law implications of sweetheart tax deals:

> "**Early 2010**
> French tax authorities begin informing other tax authorities around the world of the existence of the HSBC files.

[535] IRS.
[536] Croucher, 'UK-Swiss Tax Deal Falls £2.3bn Short of George Osborne Promise', January 22, 2014.
[537] *Statement by HMRC on tax evasion and the HSBC Suisse data leak*, February 14, 2015.

February 2010
Dave Hartnett, head of tax at HMRC, meets HSBC. He refuses to say what was discussed at the meeting.

April 2010
HMRC receives the HSBC files.

July 2010
The Financial Times reports that HSBC had asked the French courts to prevent the country's tax authority handing files to HMRC.

September 2011
Hartnett informs the Treasury select committee: 'I think the whole nation probably knows that our department has a disc from the Swiss – from the Geneva branch of a major UK bank – with 6,000 names, all ripe for investigation.'

January 2013
Six months after retiring from HMRC, Hartnett joins HSBC as a consultant."[538]

6.7. CONCLUSION

This chapter demonstrated that sweetheart tax deals obscure the fraudulent nature of tax avoidance and tax evasion because they constitute "taxation by ... administrative discretion and not by law" and "represent a radical departure from constitutional principle" in the words of Lord Wilberforce in *Vestey*. In the words of Walton J which he cited with approval:

> "One should be taxed by law, and not be untaxed by concession."[539]

[538] See Leigh, 'HSBC files timeline: from Swiss bank leak to fallout', March 13, 2015.
[539] [1977] STC 414, 439.

PART THREE

THE ANTIDOTE TO TAX AVOIDANCE

CHAPTER SEVEN

THE EQUALITY OF TAXATION

> **The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim, consists what is called the equality or inequality of taxation.**
>
> Adam Smith, *The Wealth of Nations* (1776) Book V, Chapter II.

7.1 INTRODUCTION

This chapter demonstrates that the proposed cheating or fraud approach to tax avoidance will give effect to the principle of the equality of taxation.

Adam Smith propounded the equality of taxation as the first maxim of taxation because it is the basis of taxation. According to his famous classification "OF THE SOURCES OF THE GENERAL OR PUBLIC REVENUE OF THE SOCIETY"[540]:

> "The revenue which must defray, not only the expense of defending the society and of supporting the dignity of the chief magistrate, but all the other necessary expenses of government, for which the constitution of the state has not provided any particular revenue may be drawn, either, first, from some fund which peculiarly belongs to the sovereign or commonwealth, and which is independent of the revenue of the people; or, secondly, from the revenue of the people."[541]

"Taxes"[542] or "the revenue of the people" corresponds to "the king's extraordinary revenue" under Blackstone's earlier exposition 'OF THE KING'S REVENUE'[543]:

> "The king's ordinary revenue ... was very large formerly, and capable of being increased to a magnitude truly formidable. ... But, fortunately for the liberty of the subject, this hereditary landed revenue [became] alienated from the crown: in order to supply the deficiencies of which we are now obliged to have recourse to new methods of raising money, unknown to our early ancestors; which methods constitute the king's *extraordinary* revenue. For, the public patrimony being got into the hands of private subjects, it is but reasonable that private contributions should supply the public service.

[540] Title of Chapter II of Book V.
[541] Emphasis supplied.
[542] Part II of Chapter II is entitled "Of Taxes".
[543] *Commentaries*, p.281.

> The thing therefore to be wished and aimed at in a land of liberty is by no means the total abolition of taxes, which would draw after it very pernicious consequences, and the very supposition of which is the height of political absurdity. For as the true idea of government and magistracy will be found to consist in this, that some few men are deputed by many others to preside over public affairs, so that individuals may the better be enabled to attend their private concerns, it is necessary that those individuals should be bound to contribute a portion of their private gains, in order to support that government, and reward that magistracy, which protects them in the enjoyment of their respective properties."[544]

The second paragraph justified "the king's *extraordinary* revenue" or taxes on the basis of the equality of taxation.

The rest of this chapter demonstrates that the equality of taxation underpins the proposed cheating or fraud approach to tax avoidance and demonstrates that the prevailing constructional approach enforces the inequality of taxation by explaining its manifestations in the perverse 'certainty' argument, the objections to retrospective anti-avoidance legislation and the fallacy of profit maximisation.

7.2 THE PRESUMPTION FOR EQUALITY

Blackstone's statement of the equality of taxation above is consistent with his subordination of the individual's right to property to the public revenue or taxation:

> "The third absolute right, inherent in every Englishman, is that of property: which consists in the free use, enjoyment, and disposal of all his acquisitions, without any control or diminution, save only by the laws of the land. ...
>
> For no subject of England can be constrained to pay any aids or taxes, even for the defence of the realm or the support of government, but such as are imposed by his own consent, or that of his representatives in parliament."[545]

These statements correspond to the two classic paragraphs of modern human rights legislation, such as Protocol 1 to Article 1 of the European Convention on Human Rights:

> "(1) Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the

[544] Blackstone, pp. 306-307. Emphases supplied.
[545] Ibid, pp.138-140.

> public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> (2) The preceding provisions shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

The interpretation of this provision by the European Court of Human Rights in *Gasus Dosier-und Fördertechnik GmbH v Netherlands* corresponds to Blackstone's and Smith's statements of the equality of taxation:

> "According to the Court's well-established case law, the second paragraph of Article 1 of Protocol No. 1 must be construed in the light of the principle laid down in the Article's first sentence. Consequently, an interference must achieve a 'fair balance' between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights. The concern to achieve this balance is reflected in the structure of Article 1 as a whole, including the second paragraph: there must therefore be a reasonable relationship of proportionality between the means employed and the aim pursued."[546]

Adam Smith's third and fourth maxims are also reformulations of Blackstone's statement of the equality of taxation:

> "Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. ...
>
> Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state."

Following the commencement of appeal to the High Court by way of case stated in 1874, the first volume of the resultant official Reports of Tax Cases published in 1875 contained two decisions that recognised the equality of taxation as an overriding principle of statutory construction despite the fact that no scheme or arrangement was involved.

In *Case Stated on the Appeal of the Scottish Widows' Fund and Life Assurance Society*, Lord Ardmillan said:

> "When a court of law is called to decide a question affecting the incidence and distribution of taxation, the question is necessarily important. We have

[546] (1995) 20 EHRR 403, 435, para 62.

> been told that a taxing statute must be construed liberally and favourably to the subjects. In one sense that is true, and the remark is well founded, but on the other hand equality and impartial justice in the incidence of taxation are of greater moment, and the statute should be construed so as to promote that equality and that impartiality of justice. There is no presumption in favour of the exemption of the few from the incidence of the general tax. I think the presumption is for equality, and rather against the partiality which is involved in special exemptions."[547]

Rejecting the taxpayer's argument in *Captain H. Young, Master Mariner*, Lord Ardmillan stated:

> "There is no doubt that an Act which taxes is to be strictly construed. Where there is an Act taxing a particular body, or laying a tax upon a particular article, of course that Act is to be strictly construed, but where there is an Act taxing the whole of Her Majesty's subjects, and the question is, whether it is to be construed so as to sustain the equality of the incidence of the tax, I think there is no presumption in favour of that exemption and against the equality of the incidence of the taxation. <u>It is the next and soundest principle of taxation to be as equal as possible</u>, and I cannot recognize, as a presumption against that equality, what has been urged today, or that from what has been urged we are to favour the Appellant with exemption."[548]

In his judgement in *Partington v Attorney General*, which "[t]he books tend to cite ... as delivering the first authoritative guidance on how to construe a taxing statute"[549], Lord Cairns applied the equality of taxation to *impose* tax. According to Monroe:

> "The claim was for probate duty. Two ladies had died intestate, the second to die being the next-of-kin of the first. The children of the second sought to recover the assets of the first and the Revenue sought probate duty, twice over. The claim sounded harsh, though reasonable enough by reference to the scheme of the tax."[550]

Delivering the judgment of the House of Lords in favour of the Revenue, Lord Cairns said in response to the distinction sought to be drawn between 'form' and 'substance':

> "I do so both upon form and also upon substance. I am not at all sure that, in a case of this kind – a fiscal case – form is not amply sufficient; because, as I understand the principle of all fiscal legislation it is this: If the person sought to be taxed comes within the letter or 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

[547] 1 TC 7, 10.
[548] 1 TC 57, 62. Emphasis supplied.
[549] *Intolerable Inquisition*, p.49.
[550] Ibid.

> 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, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."[551]

In *Pryce v Monmouthshire Canal and Railway Companies*, Lord Cairns *refused* to apply "the principle that no charge could be imposed on the public but by the clearly expressed intention of the Legislature."[552] He clarified that:

> "The cases which have decided that Taxing Acts are to be construed with strictness, and that no payment is to be exacted from the subject which is not clearly and unequivocally required by Act of Parliament to be made, probably meant little more than this, that, inasmuch as there was not any *à priori* liability in a subject to pay any particular tax, nor any antecedent relationship between the tax-payer and the taxing authority, no reasoning founded upon any supposed relationship of the tax-payer and the taxing authority could be brought to bear upon the construction of the Act, and therefore the tax-payer had a right to stand upon a literal construction of the words used, whatever might be the consequence. I cannot think that this principle applies."[553]

In *Commissioners for Special Purposes of Income Tax v Pemsel*, where the House of Lords rejected the taxpayer's contention for exemption, Lord Halsbury stated:

> "There is no purpose in a Taxing Act but to raise money, and an exemption is just as much within this criticism as any other part of the Act, since every exemption throws an additional burden on the rest of the community."[554]

It should be noted that none of the cases involved a tax avoidance scheme or *two or more interrelated transactions of a kind which had never taken place before the tax Act it was devised to cheat or defraud was passed devised as a result of it. A fortiori*, the equality of taxation should be applicable in cases that involve tax avoidance schemes devised to cheat the public revenue.

7.3 THE PERVERSE 'CERTAINTY' ARGUMENT

The authorities cited in support of the inequality of taxation undermine, rather than support, it. According to Adam Smith's second maxim of taxation:

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[551] (1869) L.R. 4 H.L. 100, 122.
[552] (1879) 4 AC 197.
[553] Ibid, pp.202-203.
[554] [1891] AC 531, 551.

> "The tax which each individual is bound to pay ought to be certain and not arbitrary. The form of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself."

The uncertainty under criticism concerned the then widely abused practice of tax farming.[555] As judges are not tax administrators, let alone corrupt tax gatherers, this maxim cannot be regarded as a derogation from the equality of taxation expounded in the first maxim.

Dicey's statement, which is also cited in support of the inequality of taxation, shows that the relevant certainty is settled by the enactment of the tax Act:

> "Taxes are made payable in two different ways, i.e. either by permanent or by yearly Acts. ... This distinction between revenue depending upon permanent Acts and revenue depending upon temporary Acts is worth attention, but the main point, of course, to be borne in mind is that all taxes are imposed by statute, and that no one can be forced to pay a single shilling by way of taxation which cannot be shown to the satisfaction of the judges to be due from him under Act of Parliament."[556]

Dicey's statement "that no one can be forced to pay a single shilling by way of taxation which cannot be shown to the satisfaction of the judges to be due from him under Act of Parliament" does not impel the corollary that in the words of Wheatcroft:

> "There is no common law of taxation: all taxes derive their authority from statute law."[557]

This is, however, the *non sequitur* that is used to justify the perverse 'certainty' argument. According to Simpson:

> "There is one further level to which the argument against judicial involvement has been taken, which is almost to suggest that there can be *no* judge-made, common law of taxation at all. There are, of course, particular judicial statements which at first sight lend some credence to the point of view. Perhaps most notable is a passage from the judgment of Rowlatt J. in *Cape Brandy Syndicate v IRC* that has frequently been cited since. The role of the judge is: '… to look merely at what is clearly said.

[555] It originated in Rome and was adopted by mediaeval English kings who frequently made grants "in fee-farm".
[556] Dicey, pp.200-202.
[557] 'The Present State of the Tax Statute Law' [1968] *B.T.R.* 377.

> There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.'[558]
>
> This *dictum,* however, needs to be handled with considerable care, and certainly cannot be taken too readily to suggest that there can be no judge-made tax law *at all.* To begin with, Rowlatt J.'s remarks deserve to be read in full. What he in fact said was this:
>
> > 'It is urged by Sir William Findlay that in a taxing Act clear words are necessary in order to tax the subject. Too wide and fanciful a construction is often sought to be given to that maxim, which does not mean that words are to be unduly restricted against the Crown, or that there is to be any discrimination against the Crown in those Acts. It simply means that in a taxing Act one has to look merely at what is clearly said. There is no … [see above]'
>
> Vitally, therefore, Rowlatt J. was in fact seeking to *restrict* 'too wide and fanciful' a view of the 'clear words' requirement, and it is unfortunate should his words ever be used as part of such a fanciful argument. Certainly today it is very difficult, without pulling the wool over one's own eyes, to maintain that there is *no* common law of taxation."[559]

Indeed, Rowlatt J. described the taxpayer-company's contention as "reducing the whole thing to the most artificial construction of an Act of Parliament that is to be found even in an age when artificial constructions by reference in this sort of way are, with increasing frequency, imposed upon us."[560] He then held that the taxpayer-company was liable to tax.

The statement by Lord Wilberforce in *Vestey* shows that the question of certainty is settled by the enactment of the relevant tax legislation:

> "Taxes are imposed on subjects by Parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer, and the amount of his liability is clearly defined."[561]

"*Taxes are imposed on subjects by Parliament*." The perverse 'certainty' argument, however, converts cheating the public revenue by tax avoidance into a right to property by perverting Dicey's statement "*that no one can be forced to pay a single shilling by way of taxation which cannot be shown to the satisfaction of the judges to be due from him under Act of Parliament*" to contend that a taxpayer "*designated in clear terms by*

[558] [1921] 1 KB 64, 71.
[559] Simpson [2004] p.369.
[560] 12 TC 358, 366.
[561] [1980] STC 10, 18.

a taxing Act as a taxpayer" but who deliberately uses a tax avoidance scheme (or two or more interrelated transactions of a kind which had never taken place before the taxing Act it was devised to cheat or defraud was passed devised as a result of it) to cheat the public revenue of "*the amount of his liability*" is entitled to succeed because: "*A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer, and the amount of his liability is clearly defined*."

In his article entitled "Unacceptable Discretion: Countering Tax Avoidance and Preserving the Rights of the Individual"[562] and headlined with a quote of Adam Smith's second maxim, Troup acknowledged that the constructional approach is the recipe for the judge-induced disease of tax avoidance and tax complexity but justified it on the grounds of this perverse certainty argument despite the fact that it creates tax uncertainty. Citing Rowlatt J in the manner rebutted by Simpson, he stated:

> "The existence of the concept of tax avoidance in the UK is itself indicative of the approach to tax collecting here. The implication of the word 'avoidance' is that there is something to avoid – in this case an intention of the law to catch the taxpayer which has failed. While such an intent undoubtedly exists behind every taxing statute, its existence is studiously ignored by the Courts. This apparently curious result has grown out of the approach of the UK Courts to the interpretation of tax law.
>
> Judges have been quite categorical that the collection of tax must be by the clear words of the taxing statute regardless of any purpose or mischief which may lie behind it. The stated rationale for this approach was the need for certainty – a taxpayer must be clear as to what his liability to tax is. In one very well-worn phrase, 'There is no room for any intendment; there is no equity about a tax: there is no presumption as to a tax; you read nothing in; you imply nothing.'
>
> This approach – although perhaps slightly modified in recent years – has formed the basis for all tax avoidance arrangements and has, no doubt, led to the frustration of legislators and administrators.
>
> It has also led to the somewhat complicated games of avoidance schemes and countering legislation which has characterised the development of so much tax legislation this century. These games are played in somewhat slow time – not least because of the speed (or lack of it) of the legislative process, but also because of the slow reaction of the legislature to countering specific avoidance schemes which ... meant that for many years the boot tended to be firmly on the taxpayer's foot."[563]

[562] *Fiscal Studies* (1992).
[563] Ibid, pp.129-130. Emphases supplied.

The continued existence of tax avoidance and the tax avoidance industry shows that, just as the boot has always been firmly on the foot of sports cheats and their medical and legal advisers under the prevailing approach of banning specified performance enhancing substances in sports, the boot has always been firmly on the foot of the tax avoidance industry and their clients under "the somewhat complicated games of avoidance schemes and countering legislation". As Lyness put it in 2012:

> "It's a game of cat and mouse. The Revenue closes one scheme, we find another way round it. It's like a sat-nav. I'm driving to Manchester, get a message saying there's a smash at Stoke, press this button to re-route. That's all we do with tax avoidance. The Revenue puts a block in, we just go round the block."[564]

The 'certainty' argument is manifestly perverse because a taxpayer who does not use a tax avoidance scheme (or two or more interrelated "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it") to cheat the public revenue in law and "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" in fact, will "be clear as to what his liability to tax is." In the words of O'Donnell J in *O'Flynn*:

> "Certainty in tax matters is difficult to achieve and the desire to provide certainty to those who wish to avoid a taxation regime which applies to others similarly situated to them, is something which ranks low in the objectives which statutory interpretation seeks to achieve. The tax payer could, after all, achieve a high level of certainty, but at the price of paying tax".[565]

The taxpayer that achieves a high level of certainty, but at the price of paying tax will not need a tax scheme. The perverse 'certainty' argument, which is dressed up piously as "Preserving the Rights of the Individual" is simply a licence to cheat the public revenue for the tax avoidance industry who cannot sell tax avoidance schemes without the expectation that the Revenue and the courts will accept them as legitimate. As Lord Templeman stated (citing *Ramsay, Burmah* and *Furniss*):

> "It is sometimes alleged that the trio of cases which introduced the judicial approach to tax avoidance schemes in 1982 and 1984 led to uncertainty. It is true that corporations and their advisers were deterred from inventing fresh artificial steps for fear of their being unsuccessful. But there never was any difficulty in identifying steps which had no business purpose save

[564] Mostrous (2012).
[565] *O'Flynn* [74].

> for the avoidance of tax which would otherwise be payable, until the *Westmoreland* case muddied the waters."[566]

Any real uncertainty is the inevitable price of cheating. In the words of Lord Hoffmann in *Carreras Group v The Stamp Commissioner*:

> "Such uncertainty is something which the architects of such schemes have to accept."[567]

There is no objection to the real uncertainty resulting from the constructional approach because it effectively increases the possibility of success of every tax avoidance scheme from zero percent under the proposed cheating or fraud approach to at least fifty percent under the constructional approach which Lord Diplock described aptly as "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant". As he put it:

> "The Court may describe what it is doing in tax appeals as interpretation. So did the priestess of the Delphic oracle."

7.4 RETROSPECTIVE ANTI-AVOIDANCE LEGISLATION

The perverse certainty argument converts cheating the public revenue by tax avoidance into a right to property and requires the justification of every anti-avoidance measure under human rights principles.

This is best illustrated by the objections to retrospective legislation, which is the only legislation that is capable of counteracting a tax avoidance scheme or *two or more interrelated transactions of a kind which had never taken place before the Act it was devised to exploit was passed devised as a result of it*.

In *National & Provincial Building Society v United Kingdom* the ECtHR held that legislation which retrospectively validated certain regulations that imposed a tax liability on building societies in respect of past interest payments did not violate article 1 of Protocol 1 to the ECHR because:

> "Having regard to a contracting state's margin of appreciation in the tax field and to the public interest considerations at stake, it could not be said that

[566] [2001] *L.Q.R.* 575, 557.
[567] [2004] UKPC 16 [16].

> the decisions taken by Parliament to enact these measures with retrospective effect were manifestly without reasonable foundation or failed to strike a fair balance between the demands of the general interest of the community and the protection of the rights of the applicant societies."[568]

In fact, contrary to conventional wisdom, the legality and constitutionality of retrospective legislation are beyond question. According to Fletcher:

> "It is a recognised ingredient of parliamentary sovereignty. No objection can be taken in a court of law to an Act of Parliament on the ground that it is of retrospective operation. ... In the Middle Ages, and before the doctrine of parliamentary sovereignty was recognised in its modern from, Parliament and, earlier still, the King frequently promulgated charters and statutes with retrospective operation. ...
>
> Whatever solution the future may hold, it has to be recognised that retrospective legislation after due and specific warning is regarded as the most effective deterrent against tax avoidance that offends the public conscience, and that it has a long and respectable series of precedents behind it."[569]

There should be no legal or moral objection to the use of retrospective legislation to counteract a tax avoidance scheme or *two or more interrelated transactions of a kind which had never taken place before the Act it was devised to exploit was passed devised as a result of it*. As Neville Chamberlain stated while introducing the retrospective provision in section 14 of Finance Act 1937, "if people persisted in devising these ingenious contrivances for defeating the intentions of the legislature, they must not expect that they would escape retrospective legislation."[570]

It is telling that the apologist and self-serving protests that follow the occasional retrospective anti-avoidance legislation that actually counters specific tax avoidance schemes do not extend to the routine and uncertain retrospective judicial legislation that facilitates tax avoidance under the constructional approach.

Retrospective legislation, like every other legislation, is still inferior to the pre-existing common law of cheating. In the words of the NAO:

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[568] [1997] STC 1466, 1486.
[569] 'Retrospective Fiscal Legislation' [1959] B.T.R. 412, 412.
[570] Hansard, H.C. Debates April 20, 1937–Vol. 322, col. 1610.

> "While the legislative change may be effective in stopping the particular scheme targeted, variants of the scheme may be introduced which get round the conditions in the new legislation."[571]

7.5 THE FALLACY OF PROFIT MAXIMISATION

The recognition that tax avoidance is cheating the public revenue, rather than a right to property, undermines the argument that the supposed duties of directors to maximise profits justifies it.

The Revenue is a stakeholder (on behalf of the public) in every trade, business or enterprise. Monroe concluded that it was "reassuring that the judges showed a sturdy bias towards property and a refined hostility towards taxation"[572] but as he asked in the beginning of the essay:

> "Is not the Inland Revenue a partner in every trade, business or enterprise?"[573]

This means that the Revenue is entitled to the same true representation that corresponds to the economic reality as other stakeholders, and that the failure to comply with this legal and moral obligation of honesty is cheating the public revenue. According to Bergin's apt analysis of Starbucks' scheme:

> "Starbucks has been telling investors the business was profitable, even as it consistently reported losses. … Starbucks has told investors one thing and the taxman another."[574]

The constructional approach to tax avoidance reflects a grave misconception of this notion. Lord Oliver stated:

> "I have never ... made any secret of my dislike of the legitimate business purpose approach. That is principally because I have never been able to understand why, if the making of profits is a legitimate business purpose, the amelioration of the tax burden on those profits is not equally a business purpose."[575]

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[571] NAO, p.23.
[572] *Intolerable Inquisition*, p.63.
[573] Ibid, p.2.
[574] Bergin.
[575] Oliver, p.185.

There is no inconsistency between the making of profits, which is a legitimate business purpose, and the paying of tax, which is equally a legitimate business purpose. The making of a profit is followed by an honest return to investors and should also be followed by an honest return to the Revenue. But according to Begin:

> "You could think of Starbucks' differing versions of its experience in the UK as two different coffees. To its investors, it sells an espresso - strong and vibrant. The UK taxman gets a watered-down Americano."[576]

The misconception of the notion of the Revenue as a stakeholder in every business underpins the idea that tax is an unnecessary cost a business is required to avoid as a matter of law and practice, but which it can volunteer to pay as a matter of morality; rather than a necessary contribution to the public revenue that a business is bound to make as a matter of law, business practice and morality. According to Baker:

> "There is ... a ... truth which is not necessarily accepted by all governments. Tax is a cost. That classic, 20th Century concept - the homo economicus - will always act to reduce costs. Tax goes straight to the bottom line and it is entirely rational behaviour to take all lawful and advisable steps to reduce that cost. This is particularly true, for example, for the managers of widely-owned public companies, one of whose duties is to act to reduce the costs in the company for the benefit of the shareholders."[577]

If "Starbucks ... told investors one thing and the taxman another", it breached the overriding duty of honesty imposed by cheating, which unites the legal and moral obligations to pay tax, and cannot be said to have taken "all lawful and advisable steps to reduce that cost."

Troup's famous statement that "taxation is legalised extortion" reflects this failure to "remember that the Tax Acts are but a part of the general law of the land":

> "Tax avoidance is a normal market reaction. Faced with the opportunity to devote resources to increasing sales or minimising tax bills, business will make a risk/return evaluation ... This judgment is not immoral, it is inevitable in a market economy. The aim of government should not be to adopt a high moral tone but to do its best to ensure that the 'return' from tax planning is as low as possible. ...The popular idea is too often confused with the claim that 'tax avoiders are paying less tax than they should', even though is no objective way of determining how much they 'should' be paying.
>
> Tax law does not codify some Platonic set of tax-raising principles. Taxation is legalised extortion and is valid only to the extent of the law. Tax

[576] Bergin.
[577] Baker.

> avoidance is not paying less tax than you 'should'. Tax avoidance is paying less tax than Parliament would have wanted. Avoidance is where Parliament got it wrong, or didn't foresee all possible combinations of circumstance."[578]

Avoidance is not "where Parliament got it wrong, or didn't foresee all possible combinations of circumstance" but where the enablers devised "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it."[579]

The legal and moral duty of honesty imposed by the general law of cheating and fraud, which determines "the extent of the law", provides the "objective way of determining how much [every taxpayer] 'should' be paying.

7.6 CONCLUSION

This chapter demonstrated that the proposed cheating approach to tax avoidance is an affirmation of the principle of the equality of taxation. In the words of Lord Templeman:

> "If an individual taxpayer employs a device to avoid tax the result is unjust because the Revenue are deprived of money intended by Parliament to be available for the common good. ... I regard tax avoidance schemes ... as no better than attempts to cheat the Revenue."[580]

[578] 'Why the chancellor is missing the point', *Financial Times*, 15 July 1999.
[579] Diplock.
[580] *Fitzwilliam*, pp.534-535.

CHAPTER EIGHT

THE PRIMACY OF THE PUBLIC REVENUE LAW

> **Where there is a breach of trust, a fraud, or an imposition in a subject concerning the public, which, as between subject and subject, would only be actionable by a civil action, yet as that concerns the King and the public, it is indictable. ... I should think the principle so essential to the existence of the country and the constitution, that, without any authority, I may fairly say the constitution would not exist without it, but I think there are authorities that support that principle.**
>
> Lord Mansfield, *R v Bembridge* (1783) 22 State Tr. 1, 156.

8.1 INTRODUCTION

This chapter proposes and expounds the concept of the primacy of the public revenue law to demonstrate that it corresponds to cheating the public revenue and thus underpins the proposed cheating or fraud approach to tax avoidance.

Lord Mansfield's seminal statement of the common law offence of cheating the public revenue reflects the fact that the public revenue (which is "so essential to the existence of the country and the constitution, that ... the constitution would not exist without it") is concerned with the relationship "as concerns ... the King and the public" in public revenue or tax law rather than "as between subject and subject" in private law.

Seligman's 'compulsory revenue', which corresponds to Adam Smith's 'revenue of the people' or taxes, underscores its public (as opposed to private) nature:

> "From the standpoint of the individual all contributions to government are either gratuitous, contractual or compulsory. Every government revenue must fall within one of these three classes. Individuals may make the government a free gift, they may agree or contract to pay, or they may be compelled to pay. ... The second and third methods correspond to the widely adopted classification suggested by Adam Smith. ... That is, the government may in the first place act like a private individual, possessing lands or other revenue-yielding property, and engaging in mercantile, financial or industrial pursuits. ... The government here puts itself in the position of a private person making a contract with another person. Such payments all rest on an agreement between the two contracting parties, in sharp contrast to the payments which the government demands by virtue of the sovereign powers delegated to it."[581]

[581] *Essays in Taxation* (London: Macmillan, 1913), pp.266-267.

Revenues raised from the sale of government assets and the granting of licences (such as the auction for the third generation mobile phone licences that raised £22.47bn for the Exchequer in 2000) are examples of contractual revenue. Subject to any express legislation to the contrary, principles of contract law govern contractual revenues because "[t]he government here puts itself in the position of a private person making a contract with another person."

By contrast, the notion of *the primacy of the public revenue law* advanced in this chapter simply means that the public revenue or tax law governs the relationship between the taxpayer and the Revenue in relation to compulsory revenue or taxes or "the payments which the government demands by virtue of the sovereign powers delegated to it".

In tax avoidance, the primacy of the public revenue law means that cheating the public revenue is concerned with cheating or fraud "as concerns the Revenue and the public" in tax law and not with cheating or fraud or sham "as between subject and subject" in private law. As Lord Steyn stated in *McGuckian*:

> "Neither the individual steps nor the composite transaction were simulated or sham transactions in the sense in which those terms are understood in contract law or trust law (see *Snook v London and West Riding Investments*). On the contrary, tax avoidance was the spur to executing genuine documents and entering into genuine arrangements. But this appeal is concerned with a different question, namely the fiscal effectiveness of the composite tax avoidance scheme."[582]

In other words, to cheat the public revenue "as concerns the Revenue and the public" in tax law by devising and implementing a tax avoidance scheme, transactions that are real "as between subject and subject" in contract or trust law are required. The absence of sham or fraud "as between subject and subject" in private law is, if at all relevant, prima facie evidence of the intent to cheat the public revenue "as concerns the Revenue and the public" in tax law.

On the other hand, *the primacy of the private law* means that the private law relationship of the parties to a tax avoidance scheme "as between subject and subject" overrides their tax law relationship "as concerns the Revenue and the public" for tax purposes. In his article entitled 'Business Purpose, Sham Transactions and the Relation of Private Law to the Law of Taxation', Fuller stated:

[582] [1997] STC 908, 917.

> "Aside from the great differences in legislative technique, the Internal Revenue Code differs from a civil code such as that of Germany or France in that it is not self-contained. ... Instead, the law of federal income, gift and estate taxation largely derives its meaning from definitions and conceptualizations that have developed over many years in the private law. But the dependence of the taxing statute on an existing body of private law definitions and concepts, inevitable though it may be, is an unceasing source of conflicts between taxpayers and the taxing authority. Private law, both Anglo-American and civilian, rests fundamentally on the principle of autonomy of wills. Thus in the law of contracts, it is traditional that the content of an obligation arising from a declaration of will is to be determined explicitly or implicitly by the will of the declarant. Outside the area of those prohibitions and mandates promulgated by the sovereign as commands, it has been thought that the parties were free to give whatever content they chose to any legal transaction consummated by an agreement of wills. ...
>
> A high progressive tax on incomes creates in the taxing sovereign a direct interest in many and various legal transactions between private parties, particularly those transactions in which gain is realized or loss incurred. Moreover, the sovereign's interest is likely to be opposed to the interests of the parties whose manifested wills shape the nature of the transaction. Since the tax consequences of the transaction may depend on the category or classification in which the transaction falls, the parties may seek to frame their act to avail themselves of a private law category which appears advantageous for tax purposes. On the other hand, the taxing authority will desire to reclassify the transaction in order to protect the revenue and to prevent the taxpayer from obtaining a tax advantage not corresponding with what the tax authority regards as the economic reality of the transaction."[583]

Taxes, which Seligman defined as, "the payments which the government demands by virtue of the sovereign powers delegated to it" is clearly *inside* "the area of those prohibitions and mandates promulgated by the sovereign as commands" and thus wholly outside "the principle of autonomy of wills". The primacy of the private law or "the dependence of the taxing statute on an existing body of private law definitions and concepts" is, therefore, not necessary let alone "inevitable". There is no need for an additional, self-contained tax code to give effect to the primacy of the public revenue law because the pre-existing common law of cheating the public revenue, which corresponds to tax fraud in all jurisdictions, provides the requisite overlay upon the tax legislation.

The rest of this chapter demonstrates that the primacy of the public revenue law corresponds to cheating the public revenue and thus underpins the proposed cheating or fraud approach to tax avoidance; and critiques the primacy of the private law that underlies the prevailing constructional approach using the English *Snook* sham

[583] 37 *Tul. L. Rev.* 355. Emphases supplied.

doctrine, the *Duke of Westminster* principle, the *Ramsay* principle, and the American private law sham doctrine and tax sham transaction doctrine.

8.2 CHEATING THE PUBLIC REVENUE

The landmark decision of the Court of Appeal in *Charlton* upheld the primacy of the public revenue law. According to Farquharson LJ:

> "It was the case for the Crown that the accounts presented to the Revenue by the United Kingdom companies were false in that by using Charlton's scheme to transfer part of their profits to the Jersey companies they were not disclosing the full extent of the profits they had made. It was this lack of disclosure which formed the basis of the false representations alleged in the indictment. Each of the Appellants was charged in the relevant counts with cheating the Revenue by '... falsely representing that the apparent purchases (by the United Kingdom company) from (the Jersey company) were bona fide commercial transactions'.
>
> The defence argued that on the evidence the individual purchases by the United Kingdom company were bona fide commercial transactions. ... It is implied in this argument that the sale transactions between the United Kingdom and Jersey companies were genuine and that the accounts of the United Kingdom companies, as submitted to the Revenue, were accurate, that is to say that they were arm's-length transactions and a proper consideration was paid by the United Kingdom companies for the goods represented by each purchase.
>
> The learned Judge rejected the defence submissions, saying: 'I do not accept the proposition ... that sales and purchases do not cease to be real if the objective is to seek the dishonest reduction of tax liability.'... The learned Judge was right to reject the submissions."[584]

In other words, as the objective of a tax avoidance scheme "is to seek the dishonest reduction of tax liability" in tax law "as concerns the Revenue and the public" by executing transactions which are real "as between subject and subject" in private law, they "cease to be real" in tax law "as concerns the Revenue and the public" for tax purposes.

In his article Cunningham, the convicted barrister, reasserted the prevailing argument that the absence of sham "as between subject and subject" in private law overrides the dishonesty or cheating "as concerns the Revenue and the public" in tax law:

> "The above statement of the trial judge, Benson J, cited by his Lordship is startling. He seems to be saying that sales and purchases which otherwise

[584] *Charlton*, pp.507-508. Emphases supplied.

> would be real ceases to be so if the objective is to seek the dishonest reduction of tax liability. The statement is illogical. If the purchases and sales are real they cannot be shams and therefore the reduction of tax liability by use of the interposed companies, by itself, cannot be dishonest. Even if there was an attempt to seek a dishonest reduction in tax liability by charging an exorbitant price for goods, that cannot possibly make the basic transactions unreal."[585]

Rhodes et al rebutted this fallacious argument that underpins every tax avoidance scheme, but without specifying the distinction between tax law and private law:

> "Another line of argument which has been suggested is that if the purchases and sales by the Jersey companies were real then they could not be shams, and therefore the reduction of the UK corporation tax liabilities by the use of interposed offshore companies could not be dishonest. In the *Charlton* case, it is arguable whether the purchases and the sales were real. However, allowing this to be the case, the argument is still missing the fundamental point. Just because individual transactions executed as part of an arrangement are real does not mean that the overall arrangement is either real or legal."[586]

More precisely, just because individual transactions executed as part of a scheme devised to cheat the public revenue are real "as between subject and subject" in private law, that does not mean that the overall arrangement is either real or legal "as concerns the Revenue and the public" in tax law.

Venables' criticism of *Charlton* underscores the reliance of the tax avoidance industry and the tax dogma that legitimises it on the primacy of the private law:

> "In my view, the judgment of the Court of Appeal is a blot on our system of jurisprudence and can only be described as 'unsafe and unsatisfactory'. It makes a fundamental confusion between criminal tax evasion and lawful, albeit possibly ineffective, tax-avoidance. It fails to distinguish between steps which have no commercial purpose or justification, being undertaken purely for tax-avoidance purposes yet which are nonetheless real, and between mere shams, frauds and smokescreens, which have no reality and which are simply intended to deceive. If this judgment is allowed to stand, no man seeking to mitigate or avoid taxation by lawful means, and no professional advising him how to do so, can be sure of preserving his property, his liberty and his reputation.
>
> **Avoidance and evasion**
>
> Most of us are sure we know the difference between criminal evasion and lawful avoidance of tax. ... This fundamental distinction is mirrored in the

[585] Cunningham, pp.330-331
[586] Rhodes.

> concept of a sham. A sham is a fraud, a pretence, something which pretends to be other than it really is. A forged document, for example, is a sham in that it tells a lie about itself. A scheme or arrangement might be highly artificial; it might have no purpose other than tax avoidance, it might or might not be effective to that end, but, provided that transactions involved are intended to be genuine, and not merely a smokescreen for the reality, it is not a sham.
>
> Now it will be readily perceived that the participants in virtually every tax avoidance scheme have not the slightest incentive to produce a sham. The strategies depend for their effectiveness on the steps taken being real. And that is none the less the case if those steps are artificial and are contrived purely for the purpose of tax avoidance. Given that there is no difficulty in taking the artificial steps, there is no point whatsoever in not taking them but merely pretending to take them. Indeed, there is every point in taking them; as otherwise the scheme certainly will not work and will depend for its de facto effectiveness on a criminal fraud which is totally unnecessary and the discovery of which will normally give rise not only to the tax which continues to be due, being in fact collected but the perpetrators being indicted on serious charges.
>
> The learning on the nature and limits of the concept of a sham was firmly established in English law well before *Ramsay*. A classic case, which had nothing to do with tax, was *Snook*. ... As well as introducing the new anti-avoidance rule, *Ramsay* also firmly and authoritatively reasserted the traditional learning on the meaning of a sham."[587]

The underlined paragraph shows that the object of every tax avoidance scheme is to cheat the public revenue "as concerns the Revenue and the public" in tax law by executing transactions which are real "as between subject and subject" in private law.

The primacy of the private law also misconceives the nature of a tax avoidance scheme or *two or more interrelated transactions of a kind which had never taken place before the tax Act it was devised to cheat or defraud was passed devised as a result of it* as the paradigm of "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions."[588] As Lord Templeman stated it *Fitzwilliam*:

> The earliest case in which a tax avoidance scheme appears to have been considered as a whole and held to be ineffective for the purpose of the tax sought to be avoided was *Lupton v FA & AB*. That was a dividend stripping device.
>
> Since the dividend stripping cases there have been several cases in which a tax avoidance scheme has been considered as a whole and in which the device of self cancelling or circulating payments has been held to be

[587] Venables, pp.263-264.
[588] *Fraud Law Reform*.

> ineffective for the purpose of the tax sought to be avoided. These cases are *Black Nominees v Nicol*, *Ramsay, Eilbeck v Rawling, Burmah* and *Moodie v IRC*. The scheme in the present case with regard to the contingent moiety provides another example.
>
> There have been several cases in which a tax avoidance scheme has been considered as a whole and in which the device of dividing one transaction into two or more has been held to be ineffective for the purpose of the tax sought to be avoided. These cases are *Floor v Davis*, *Chinn v Collins*, *Furniss v Dawson* and *Ensign Tankers v Stokes*. The scheme in the present case with regard to the vested moiety provides another example....
>
> All decisions of this House are founded on justice, principle and precedent. If an individual taxpayer employs a device to avoid tax the result is unjust because the Revenue are deprived of money intended by Parliament to be available for the common good. ...
>
> On principle, transactions such as tax avoidance schemes which are intended to operate as a whole must be judged by the results of those transactions considered as a whole, not by the language of each transaction considered separately. ...
>
> In common with my predecessors I regard tax avoidance schemes of the kind invented and implemented in the present case as no better than attempts to cheat the Revenue."[589]

The primacy of the public revenue law or cheating the public revenue means that "transactions such as tax avoidance schemes which are intended to operate as a whole must be judged by the results of those transactions considered as a whole ['as concerns the Revenue and the public' in tax law], not by the language of each transaction considered separately ['as between subject and subject' in private law]."

8.3 THE *SNOOK* SHAM DOCTRINE

Lord Diplock's statement in the hire purchase case of *Snook v London and West Riding*, which Lord Nicholls described in *MacNiven* as "the classic definition"[590] of sham, was concerned with the relationship of the parties "as between subject and subject" in private law. Rejecting Snook's argument, he stated:

> "As regards the contention of the plaintiff that the transactions between himself, Auto Finance and the defendants were a 'sham,' it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the

[589] [1993] STC 502, 534-535.
[590] [2001] UKHL 6 [4].

> appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.
>
> But one thing, I think, is clear in legal principle, morality and the authorities, that for acts or documents to be a 'sham,' with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a 'shammer' affect the rights of a party whom he deceived. There is an express finding in this case that the defendants were not parties to the alleged 'sham.' So this contention fails."[591]

As demonstrated below, if a disappointed taxpayer whose scheme was declared ineffective "as concerns the Revenue and the public" in tax law by the courts contends that the constituent transactions between him and the promoters were a sham "as between subject and subject" in private law and should be set aside in an action in contract or the tort of deceit, the question whether the constituent transactions constitute "*acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create*" will arise. The taxpayer will, therefore, be in the same position as Snook.

By contrast, in relation to the relationship between the taxpayer and the Revenue "as concerns the Revenue and the public" in tax law, the requirement that "*for acts or documents to be a 'sham' ... all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating*" makes the *Snook* sham test a licence to cheat when applied as the ultimate test of legality of tax avoidance schemes under the prevailing primacy of the private law. This is because, as the statements by Lord Steyn and Venables cited above show, the purpose of entering into genuine transactions "as between subject and subject" in private law and thus avoiding "*acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations which the parties intend to create*" is to cheat the public revenue "as concerns the Revenue and the public" in tax law. As Parker J put it in *Hitch v Stone*:

[591] [1967] 2 Q.B. 786, 802. Emphases supplied.

> "In a case involving a complex and artificial tax-avoidance scheme, where the scheme documentation is sloppily executed, where the evidence of the taxpayer and of his legal adviser (the deviser of the scheme) is found to be unreliable, and where their dealings with the Revenue have been less than straightforward, there must be a strong temptation for any tribunal to, in effect, throw up its hands and cry 'Sham!'. But in the instant case - and so long as the *Snook* definition of sham remains the accepted definition - that temptation has, in my judgment, to be resisted."[592]

In other words, provided that the individual transactions that comprise a tax avoidance scheme are not shams "as between subject and subject" in private law, the fact that the scheme cheats the public revenue "as concerns the Revenue and the public" in tax law (and thus makes the professional enablers and the participating taxpayer to cheat or defraud or act dishonestly towards the Revenue because "the evidence of the taxpayer and of his legal adviser (the deviser of the scheme) is found to be unreliable, and ... their dealings with the Revenue have been less than straightforward") does stop the scheme from being "legal" in civil litigation.

By contrast, Farquharson LJ's seminal statement of the overriding legal and moral duty of honesty imposed by the pre-existing common law of cheating in the criminal prosecution in *Charlton*, which corresponds to Lord Mansfield's statement in *Bembridge*, underscores the primacy of the public revenue law:

> "It is a feature, no doubt, of the tax or Revenue law of any country that it must, to a large extent, in its tax-gathering activities, rely on the truthfulness of the taxpayer in indicating the extent of his income or whatever other matter is relevant to the particular statute being considered. It follows also that the Revenue not only have to rely on the taxpayer's good faith, but more especially on the professional advisors they appoint to act for them and, accordingly, when professional advisors are found to have acted dishonestly towards the Revenue, it is almost inevitable, as I think each counsel before us has recognised, that sentences of imprisonment must follow and we adhere to that position."[593]

8.4 THE DUKE OF WESTMINSTER PRINCIPLE

The true *Duke of Westminster* principle is that the reality or legality of transactions "as between subject and subject" in private law is decisive and binding "as concerns the Revenue and the public" in tax law.

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[592] [1999] STC 431, 466.
[593] *Charlton*, p.531.

Each scheme in *Duke of Westminster* comprised the minimum two transactions required to constitute a tax avoidance scheme, in this case a deed of covenant and a letter of explanation.

The Special Commissioners applied the principle that "transactions such as tax avoidance schemes which are intended to operate as a whole must be judged by the results of those transactions considered as a whole, not by the language of each transaction considered separately", which meant the fraudulent nature of the deed of covenant became apparent in the context of the related letter of explanation:

> "We, the Commissioners who heard the appeal, held that, in construing the true effect and substance of the deeds under which payments are made to the Appellant's employees, we were entitled to consider together with these deeds the letters of explanation and form of acknowledgment which were sent to the covenantees."[594]

By contrast, the Court of Appeal and the majority in the House of Lords judged each scheme by the language of the deed considered separately and thus failed to recognise that the fraudulent nature of the deed only becomes apparent in the context of the related letter of explanation. As Lord Wright put it:

> "If the case were one in which it was found as a fact in regard to each of the deeds in question that it was never intended to operate as a legal document between the parties, but was concocted to cover up the payment of salary or wages and to make these payments masquerade as annuities in order to evade Sur-tax, it may well be that the Court would brush aside the semblance and hold that the payments were not what they seemed. But there is no such finding by the Commissioners; indeed no such case was even suggested; on the contrary, it is admitted that the deeds are genuine and carry an obligation according to their tenor, irrespective of whether the various payees are or are not in the Respondent's service at any material date. ...
>
> On the footing that the deed is genuine, I do not see any possibility of going behind what appears on the face of the document, or qualifying its effect by documents dehors the deed and in no way embodied in it, or regarding the payments as other than annual payments, as it is admitted that ex facie they are. **What the legal effect is as between the covenantor and the covenantee must determine for Revenue purposes the character of the payments actually made**. That character is not to my mind changed if the letter of explanation and the letter of acknowledgment can be taken into account. ...

[594] *Westminster*, p.493.

> And once it is admitted that the deed is a genuine document, there is in my opinion no room for the phrase 'in substance'. Or, more correctly, the true nature of the legal obligation and nothing else is 'the substance'."[595]

The statement in bold is the true *Duke of Westminster* principle and an affirmation of the primacy of the private law.

The preceding underlined statement refers to the parole evidence rule which applies in contract law. In *Collins v Blantern* counsel for the defendant argued, and the court agreed, that

> "[T]he general rule that you cannot plead any matter dehors the deed, doth not apply to this case; the true meaning of that rule is, that you cannot alledge any thing inconsistent with and contrary to the deed, but you may alledge matter consistent with the deed".[596]

As the constituent transactions in any scheme are necessarily consistent with each other, this rule has no application. Even in a two-transaction scheme like *Duke of Westminster*, the deed and accompanying letter of explanation were necessarily consistent with each other.

8.5 THE RAMSAY PRINCIPLE

8.5.1 The Scheme

Lord Oliver's summary of the scheme in *Ramsay* (which involved at least fourteen transactions) in *Craven v White* reflects the principle that tax avoidance schemes are "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions":

> "*Ramsay* was concerned with a scheme of a particular but familiar type, that is to say, an artificially contrived concatenation of individual transactions linked together with the purpose of producing an end result entirely different from that which, on the face of it, would have been achieved by each successive link in the preconceived chain if such a link fell to be considered in isolation from its partners."[597]

[595] Ibid, pp.528-529. Emphases supplied.
[596] (1767) 2 Wilson, K. B. 347, 348.
[597] [1988] STC 476, 498.

8.5.2 The Special Commissioners' Decision

The following paragraphs of the marketing letter (Appendix 3) underscore the reliance of the scheme on the primacy of the private law and show that the object of the scheme was to cheat the public revenue:

> "The Scheme is a pure tax avoidance scheme and has no commercial justification insofar as there is no prospect of T making a profit; indeed he is certain to make a loss representing the cost of undertaking the Scheme.
>
> Nevertheless, every transaction in the Scheme will be genuinely carried through, and will in fact be exactly what it purports to be."[598]

As the fraudulent nature 'as concerns the Revenue and the public' in tax law of individual transactions (a) to (o) only becomes apparent in the context of the whole transactions, the fact that "every transaction in the Scheme will be genuinely carried through, and will in fact be exactly what it purports to be" 'as between subject and subject' in private law does not stop the scheme from amounting to cheating "as concerns the Revenue and the public" in tax law.

The Special Commissioners, who were bound by the true *Duke of Westminster* principle on the primacy of the private law, held that the admitted object of the scheme "as concerns the Revenue and the public" was immaterial:

> "The object of the tax avoidance scheme ... was, as the Appellant Company admitted, to manufacture a loss which would reduce a chargeable gain of £187,977 which had accrued to the Appellant Company on the sale of a freehold farm.
>
> We deal first with the Crown's contention that the scheme should be looked at as a whole; that ... when the scheme had been implemented the Appellant Company owned nothing that it did not own before, and so far as that company was concerned the scheme achieved nothing inasmuch as it produced nothing. ... We take the view that it is not open to us to ignore the several steps in the scheme and so treat it as ineffective. The requisite payments were duly made. ... The relevant statutory provisions must accordingly be applied to the several dealings with those assets as though those dealings were independent of one another. We reject the Crown's first contention.
>
> We proceed to consider the matter on the basis that each step must be taken at its face value and to have taken effect as it purported to take effect."[599]

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[598] *Ramsay*, p.111.
[599] *Ramsay*, pp.115-116. Emphases supplied.

The object of the scheme set out in the first paragraph, which was to cheat the public revenue, required "that the scheme should be looked at as a whole" as the Revenue contended. The Special Commissioners, however, ignored the principle that tax schemes are "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions" by maintaining that the transactions should be "taken at its face value and to have taken effect as it purported to take effect" in company law for *tax purposes*.

8.5.3 The Revenue's Case in the House of Lords

When counsel for the Revenue (Mr Millett QC as he then was) pleaded fraud in the House of Lords, he also failed to specify that he was asking their lordships to apply the pre-existing common law of cheating, by failing to use the legal concept of cheating or fraud and by resorting to legal nonsense ('paper transactions') and "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant":

> "The present schemes have a single purpose and effect; to create an allowable loss in the course of a transaction in which neither gain nor loss is made. It is of the essence of each scheme that the taxpayer ends up in the same position from which he has started. The only difference is that at the end of the journey he is out of pocket in respect of the fees payable for the scheme and he has a bundle of documents to present to the Revenue. It cannot have been in Parliament's contemplation that such disposals as are in question here were to give rise to allowable losses.
>
> Diplock L.J. in *Snook*, defined the word 'sham' as follows: 'it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.'
>
> It is conceded that the present schemes are not shams in that narrow sense. They are, however, 'paper transactions' without any objective economic reality. They are incapable of having fiscal consequences."[600]

The fundamental flaw in Millett's pleading, which emasculated the *Ramsay* principle at birth, was the invitation to their lordships to affirm, rather than overrule, the true *Duke of Westminster* principle on the primacy of the private law:

[600] *Ramsay*, pp.175-176.

> "The Crown concede that the subject is to be taxed by Parliament and not by the courts; that he is to be taxed on the basis of what he has done, and not on the basis of what he might have done; and that he is to be taxed in accordance with the legal consequences of his act, and not in accordance with some supposed 'substance of the transaction': *Duke of Westminster*. None of these necessary concessions requires the House to hold that a taxpayer is able to create a tax deduction by entering into schemes such as the present. Considerations of public policy and the manifest intention of Parliament alike require a finding to the contrary. It is the province of the courts to distinguish between those transactions which have reality and substance and those which have none, and between those transactions which are capable of having fiscal consequences and those which are not. As to the cases relied on by the taxpayers in these appeals, *Duke of Westminster* does not derogate from the Crown's argument in the present case."[601]

The concession that the taxpayer "is to be taxed in accordance with the legal consequences of his act, and not in accordance with some supposed 'substance of the transaction'" (which is the primacy of the private law) is inconsistent with the request "to distinguish between those transactions which have reality and substance and those which have none, and between those transactions which are capable of having fiscal consequences and those which are not" (which is the primacy of the public revenue or fiscal law). As Mr Beattie QC, counsel for the taxpayer in *Rawling*, submitted correctly:

> "The Crown are attempting here to overrule the *Duke of Westminster* case in one of its aspects although they contend that they are only distinguishing it. The *Duke of Westminster* case governs every case except the sham transaction in the sense that that word is used by Diplock L.J. in *Snook*."[602]

Leaving aside the question whether the concession as to sham by Millett was made correctly, the argument required to overrule the true *Westminster* principle on the primacy of the private law, expressed in legal concepts, will include the added highlighted expressions:

> It is conceded that the present schemes are not shams in that narrow sense **in which that word was used by Diplock L.J. in *Snook* "as between subject and subject" in private law**. They are, however, **frauds or cheats "as concerns the Revenue and the public" in tax law**. They are incapable of having fiscal consequences. **They are frauds and cheats in tax law**.

[601] Ibid, p.178.
[602] Ibid, p.182.

8.5.4 Lord Wilberforce's Judgment

Lord Wilberforce accepted the Revenue's invitation to reaffirm the true *Westminster* principle on the primacy of the private law:

> "It is for the fact-finding Commissioners to find whether a document, or a transaction, is genuine or a sham. In this context to say that a document or transaction is a 'sham' means that while professing to be one thing, it is in fact something different. To say that a document or transaction is genuine, means that, in law, it is what it professes to be, and it does not mean anything more than that. ...
>
> Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance. This is the well-known principle of *Commissioners of Inland Revenue v Duke of Westminster*. This is a cardinal principle but it must not be overstated or overextended. While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded: to do so is not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded."[603]

To say that provided the transactions (a) to (o) set out in the marketing letter in Appendix 3 were "genuine" 'as between subject and subject' in private law, "the court cannot go behind it to some supposed underlying substance" in tax litigation, which is concerned with the genuineness of transactions "as concerns the Revenue and the public" in tax law, is to reaffirm the primacy of the private law.

"It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence" but this can only be fraud or negligence or honest. Therefore, "if that emerges from a series or combination of transactions, intended to operate as such" as a fraud and an example of "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions", "it is that series or combination which may be regarded."

[603] *Ramsay*, pp.183-185. Emphases supplied.

8.5.5 Lord Fraser's Judgment

Lord Fraser, who delivered the other significant judgment, followed a similar process of reasoning, stating:

> "**Wider question - Was there a disposal in either of these cases?**
>
> The Crown maintain that they are entitled to succeed in both these appeals on the wider ground that in neither case should the disposal of the loss-making asset be considered separately from the scheme of which it formed part. On behalf of the taxpayer in each case reliance was placed on the finding by the Special Commissioners that the various steps in the scheme were not shams. The meaning of the word 'sham' was considered by Diplock LJ in *Snook*. ... Although none of the steps in these cases was a sham in that sense, there still remains the question whether it is right to have regard to each step separately when it was so closely associated with other steps with which it formed part of a single scheme. The argument for the Crown in both appeals was that that question should be answered in the negative and that attention should be directed to the scheme as a whole.
>
> In my opinion the argument of the Crown is well-founded and should be accepted. Each of the appellants purchased a complete pre-arranged scheme, designed to produce a loss which would match the gain previously made and which would be allowable as a deduction for corporation tax (capital gains tax) purposes. In these circumstances the court is entitled and bound to consider the scheme as a whole. The essential feature of both schemes was that, when they were completely carried out, they did not result in any actual loss to the taxpayer. The apparently magic result of creating a tax loss that would not be a real loss was to be brought about by arranging that the scheme included a loss which was allowable for tax purposes and a matching gain which was not chargeable. ...
>
> The taxpayer in both cases bought a complete scheme for which he paid a fee. Thereafter he was not required to produce any more money, although large sums of money were credited and debited to him in the course of the complicated transactions required to carry out the scheme. The money was lent to the taxpayer at the beginning of the scheme, by Thun in the *Rawlings* case and by a finance company, Slater Walker, in the *Ramsay* case, and was repaid to the lender at the end. ...
>
> In *Rawlings* there was not even any need for real money to be involved at all. ... There was apparently no evidence before the Special Commissioners that Thun actually possessed the sum of £543,600 which they lent to the taxpayer to set the scheme in motion, not to mention any further sums that they may have lent to other taxpayers for other similar schemes which may have been operating at the same time, and it might well have been open to the Special Commissioners to find that the loan, and all that followed upon it, was a sham. But they have not done so.

> In *Ramsay* 'real' money in the form of a loan from Slater Walker was used so that a finding of sham in that respect would not have been possible."[604]

The conclusion that a finding of sham in the *Snook* sense was possible in *Rawling* shows that Millett's concession to the contrary was wrong.

In relation to *Ramsay*, it was widely-known that the similar use of non-existent money was a characteristic of Rossminster's schemes. Gillard reported that this triggered the resignations of their in-house lawyer and auditors following the commercial success of the One Year High Income scheme that eventually failed in *Cairns v MacDiarmid*[605]:

> "The lawyer Henry Scrope had joined Roy Tucker & Co in 1973 as the in-house legal adviser on drafting tax-scheme documents. Scrope wrote the instructions to counsel designed to elicit the legal opinions that 'sold' the schemes. Despite its acceptance by prominent tax counsel, he had become concerned about the concept of 'circular money', which was integral to almost every Tucker scheme but might not be considered real money as required by statutes, and by the growing scale of the Rossminster operations, which increased the possibility of something going wrong. By autumn 1974 Scrope had decided to resign. ...
>
> Scrope's exit was followed in January 1975 by that of the Rossminster auditors, Deloitte, who notified Plummer that they no longer wanted to act for the company. ... Accounting for the movement of huge sums of Monopoly money as if it were real posed a dilemma for any auditor required to produce a clean audit certificate attesting that the accounts presented a 'true and fair view of the state of affairs and of the profit for the period', as required by law."[606]

Crucially, Lord Fraser also affirmed the true *Duke of Westminster* principle by effectively denying the fraudulent nature of the scheme:

> "Counsel for the taxpayer naturally pressed upon us the view that if we were to refuse to have regard to the disposals which took place in the course of these schemes, we would be departing from a long line of authorities which required the courts to regard the legal form and nature of transactions that have been carried out. I do not believe that we would be doing any such thing. I am not suggesting that the legal form of any transaction should be disregarded in favour of its supposed substance. Nothing that I have said is in any way inconsistent with the decision in the *Duke of Westminster's* case where there was only one transaction - the grant of an annuity - and there was no question of its having formed part of any larger scheme."[607]

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[604] *Ramsay*, pp.197-198. Emphasis supplied.
[605] 56 TC 556.
[606] *In the Name of Charity*, pp.82-84.
[607] *Ramsay*, p.198.

As demonstrated above, there were two transactions – the grant of an annuity and the accompanying letter of explanation – which formed part of a larger scheme devised to cheat "the Revenue and the public" in tax law.

8.5.6 Lord Hoffmann's Speech in MacNiven

In *MacNiven*, Lord Hoffmann used the failure by counsel for the Revenue and the judges to distinguish what is "genuine" or "real" "as between subject and subject" in private law from what is "genuine" or "real" "as ... concerns the King and the public" in tax law to reassert the primacy of the private law and thus the true *Duke of Westminster* principle:

> "The speeches in *Ramsay* and subsequent cases contain numerous references to the 'real' nature of the transaction and to what happens in 'the real world'. These expressions are illuminating in their context, but you have to be careful about the sense in which they are being used. Otherwise you land in all kinds of unnecessary philosophical difficulties about the nature of reality and, in particular, about how a transaction can be said not to be a 'sham' and yet be 'disregarded' for the purpose of deciding what happened in 'the real world'. The point to hold onto is that something may be real for one purpose but not for another. When people speak of something being a 'real' something, they mean that it falls within some concept which they have in mind, by contrast with something else which might have been thought to do so, but does not.
>
> Thus in saying that the transactions in *Ramsay* were not sham transactions, one is accepting the juristic categorisation of the transactions as individual and discrete and saying that each of them involved no pretence. They were intended to do precisely what they purported to do. They had a legal reality. But in saying that they did not constitute a 'real' disposal giving rise to a 'real' loss, one is rejecting the juristic categorisation as not being necessarily determinative for the purposes of the statutory concepts of 'disposal' and 'loss' as properly interpreted. The contrast here is with a commercial meaning of these concepts. And in saying that the income tax legislation was intended to operate 'in the real world', one is again referring to the commercial context which should influence the construction of the concepts used by Parliament."[608]

The point to hold onto is that two or more interrelated transactions devised to cheat the public revenue may be real "as between subject and subject" in private law but not in tax law "as concerns the Revenue and the public".

[608] *MacNiven* [40]-[41].

"Thus in saying that the transactions in *Ramsay* were not sham transactions, one is accepting the juristic categorisation of the transactions as individual and discrete and saying that each of them involved no pretence" ['as between subject and subject' in private law]. "They were intended to do precisely what they purported to do. They had a legal reality."

"But in saying that they did not constitute a 'real' disposal giving rise to a 'real' loss, one is rejecting the juristic categorisation ['as between subject and subject' in private law] as not being necessarily determinative ['as concerns the Revenue and the public'] for the purposes of" [tax law], which includes the pre-existing common law of cheating.

8.6 THE AMERICAN TAX SHAM TRANSACTION DOCTRINE

Like the *Ramsay* principle, which they inspired, the sham transaction and step transaction doctrines and the business purpose test, are applications of the pre-existing general law of cheating or fraud. As Millett stated in *Ramsay*:

> "The Crown adopt the approach of Templeman L.J. in *Eilbeck* which is given a defensible and logical basis by the American cases. In matters of taxation, it is not normally possible to derive assistance from cases decided in other jurisdictions, since they are likely to turn upon particular provisions of the local tax code. In the United States, however, the Federal Courts have been concerned to formulate general principles of law to enable a distinction to be drawn between 'real' and 'sham' transactions, and they have done so without relying upon the wording of the relevant tax legislation or upon any doctrines which would be rejected as contrary to established principles in the United Kingdom. There can be no doubt that the Federal Courts would dismiss the transactions in the present case as a 'sham'. They would do so on the simple ground that they were without any objective economic reality, being designed from the outset to return all parties within a few days to the position from which they started; see *Gilbert v CIR*[609]; *Knetsch v USA*[610]; *Rubin v USA*[611]; *Goldstein v CIR*[612], and *General Motors Corporation v USA*[613]. The House is invited to adopt the approach of Judge Learned Hand in *Gilbert* where the logical basis on which these cases proceed is explained."[614]

To "formulate general principles of law ... without relying upon the wording of the relevant tax legislation" is to apply the pre-existing common law of cheating or fraud. In

[609] (1957) 248 Fed 2nd 399.
[610] (1960) 364 US 361.
[611] (1962) 304 Fed 2nd 766.
[612] (1966) 364 Fed 2nd 734.
[613] (1978) 41 AFTR 2nd 1132
[614] *Ramsay*, 178-179. Emphases supplied.

the said words of Judge Leaned Hand in *Gilbert* which Lord Wilberforce cited with approval:

> "It is a corollary of the universally accepted canon of interpretation that the literal meaning of the words of a statute is seldom, if ever, the conclusive measure of its scope. Except in rare instances statutes are written in general terms and do not undertake to specify all the occasions they are meant to cover; and their interpretation demands the projection of their expressed purpose upon occasions not present in the minds of those who enacted them. The Income Tax Act imposes liabilities upon taxpayers based upon their financial transactions, and it is of course true that the payment of the tax itself is a financial transaction. If, however, the taxpayer enters into a transaction that does not appreciably affect his beneficial interest except to reduce his tax, the law will disregard it; for we cannot suppose that it was part of the purpose of the Act to provide an escape from the liabilities it sought to impose."[615]

As a matter of law, "a transaction that does not appreciably affect his beneficial interest except to reduce his tax" cheats the public revenue and in the absence of anti-avoidance legislation "the law [that] will disregard it" is the pre-existing common law of cheating which "acts upon the offence, by setting aside the fraudulent transaction" in civil proceedings.

Rubin and *Goldstein*, which Millett cited, and related cases which he did not cite, such as *Lynch v CIR*[616], *Julian v CIR*[617], *Sonnabend v CIR*[618], *Broome v United States*[619], *Becker v CIR*[620], *Lewis v CIR*[621], *Dooley v CIR*[622] and *Bornstein v CIR*[623] involved schemes devised and implemented by one Eli Livingstone. These cases were particularly relevant to the *Ramsay* principle because the schemes provided the blueprint for such Rossminster schemes as the Capital Income Plan in *Plummer* and *Moodie*, the Exempt Debt Capital Loss scheme in *Ramsay* and the One Year High Income Plan in *Cairns v MacDiarmid*[624]*.*

The schemes in all the American cases were held to be shams or cheats or frauds as between the taxpayer and the Commissioner in tax law but this was disguised by "the

[615] 248 Fed. 2nd 299, 411 (1957).
[616] 31 T.C. 990 (1959).
[617] 31 T.C. 998 (1959).
[618] 267 F.2d 319 (1959).
[619] 170 F.Supp. 613 (1959).
[620] 277 F.2d 146 (1960).
[621] 328 F. 2d 634 (1964).
[622] 332 F. 2d. 463 (1964).
[623] 334 F.2d 779 (1964).
[624] [1983] S.T.C. 178.

legal fiction that the Court is only ascertaining and giving effect to what Parliament meant." In *Lynch*, for example, Judge Bruce stated:

> "The only issue is whether petitioner, pursuant to section 23(b), I.R.C. 1939, is entitled to deduct $117,677.11 as interest paid on an indebtedness in 1953. Respondent disallowed petitioner's interest deduction. He contends that the transactions entered into by petitioner were not significant for tax purposes because what was done, apart from the tax motive, was not within the intendment of the statute. He further contends that the transactions should be ignored for tax purposes because they were a sham, or if not a sham, because their characterization lacked in commercial or economic reality. ...
>
> Respondent's determination may be sustained on yet another basis, for it is obvious that the transactions herein involved were nothing but a sham."[625]

In other words, "as concerns the Revenue and the public" in tax law "for tax purposes", "the transactions herein involved were nothing but a sham."

8.7 THE AMERICAN PRIVATE LAW SHAM DOCTRINE

The American private law sham doctrine is concerned with sham or fraud or cheating "as between subject and subject" in private law and thus corresponds to the English *Snook* sham doctrine.

The issue in *Miles v Livingstone*[626] was whether the scheme was a sham as between the disappointed taxpayer and professional enabler. According to Judge Hartigan:

> "Plaintiff-appellant's complaint is in three counts: the first count alleging a scheme or artifice to defraud under federal securities regulations; the second count alleging an action in common-law deceit and the third count alleging a breach of the three contracts. ...
>
> The type of transaction which forms the basis of the present action has been a source of a great deal of litigation. ... Unlike the instant case, the type of transactions usually involved here have been analyzed in the context of a dispute involving the deductibility of interest payments under the federal income tax laws. In such a context, courts have unvaryingly held that the purported interest payments could not be deducted as their underlying events lacked substance. ...
>
> After plaintiff's attempt to deduct the interest which he had prepaid on the 'loans' was disallowed, he initiated the instant action. His central position is

[625] 31 T.C. 990, 990-997.
[626] 301 F.2d 99 (1st Cir. 1962).

> that until the attempted deductions were disallowed, he was unaware that these transactions lacked substance. Relying on the line of cases of which *Goodstein* is an example, he argues that neither a sale of the bonds nor a loan of money ever took place and that the paper shuffling of the defendant was a fraudulent device or artifice as to him."[627]

In other words, Miles's scheme was declared unlawful 'as concerns the Revenue and the public' in tax law for tax purposes but he contended in an action for the tort of deceit that it "was a fraudulent device or artifice as to him" because the constituent transactions between him and Livingstone should be set aside as a sham "as between subject and subject" in private law.

This raised the question whether the transactions constituted "*acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create*" in the words of Lord Diplock in *Snook*.

Miles was, therefore, in the same position as Snook. Because of his common intention with Livingstone to execute genuine transactions "as between subject and subject" in private law in order to cheat the IRS "as concerns the Revenue and the public" in tax law, his case failed because "*for acts or documents to be a 'sham' ... all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating*". As Judge Hartigan put it:

> "[S]o far as the sale aspects of the transactions went, viz., the sale of bonds from Livingstone to Miles, this phase of the transactions was sufficiently viable that Miles could and did claim a capital gain on each of these transactions and duly recorded the gain on his income tax returns. If the sales were valid to this extent it is extremely difficult for us to see how plaintiff can now claim that there was in fact no sale."[628]

[627] Ibid, pp.99-100. Emphases supplied.
[628] Ibid, p.100.

Similar private law sham claims against Livingstone by the disappointed taxpayers in *Grace v Livingstone*[629], *Livingstone v Fatima Charities*[630], *Industrial Research Products v IRC*[631], and *Martin v Livingstone*[632] also failed for the same reason.

8.8 CONCLUSION

This chapter expounded the concept of the primacy of the public revenue law and demonstrated that it corresponds to cheating the public revenue and thus underpins the proposed cheating or fraud approach to tax avoidance.

[629] 195 F. Supp. 933 (1961).
[630] 297 F. 2d. 836 (1962).
[631] 40 TC 578 (1963).
[632] 219 F. Supp. 200 (1963).

CHAPTER NINE

THE MISCHIEF RULE

> **Pro-taxpayer literalism was not an inevitable development in English law. The famous 1584 *Heydon's Case* prevented subjects from avoiding the impact of a statute seizing church property, in much the same way that taxpayers now try to avoid tax. In the 18th century Lord Mansfield did not hesitate to interpret a tax statute to prevent avoidance. Even late 19th century statutory interpretation, though tending towards the literal, was not especially pro-taxpayer. The case cited in *Westminster* to establish the taxpayer's right to rely on the letter of the law was actually an 1869 decision applying the letter of the law to *impose* tax.**
> William Popkin, 'Judicial anti-tax avoidance doctrine in England: a United States perspective' [1991] *B.T.R.* 283, 290, citing *Partington* v *AG* (1869) L.R. 4 H.L., 122.

9.1 INTRODUCTION

This chapter demonstrates that the mischief rule, which "marks the first and indeed only attempt by the judges fully to rationalise that important part of their function which concerns statutory interpretation"[633] and "embodies the necessary legal policy of any democratic state"[634], provides original authoritative judicial support for the proposed cheating or fraud approach to tax avoidance.

As Cohen's statement indicates, the development of the mischief rule by the Barons of the Exchequer in *Heydon's Case*[635] is a seminal recognition of the pre-existing common law of cheating or fraud, which "acts upon the offence, by setting aside the fraudulent transaction"[636] in civil proceedings, as what Lord Hoffmann described in *MacNiven* as "an overlay upon the tax legislation"[637], "an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision"[638], "some paramount provision subject to which everything else must be read"[639] and thus "a broad spectrum antibiotic which killed off all tax avoidance schemes, whatever the tax and whatever the relevant statutory provisions."[640]

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633 Bennion, p.918.
634 Ibid, p.1009.
635 (1584) 3 Coke 7a.
636 Blackstone, p.89.
637 [2001] UKHL 6 at [29].
638 Ibid.
639 Ibid.
640 Ibid [49].

The departure from the mischief rule was established by the 1909 decision of the House of Lords in *Attorney General v Duke of Richmond*[641], which was decided by Lord Loreburn's casting vote in favour of the taxpayer. Citing earlier cases where he decided in favour of the Revenue[642] and insisted on looking at "the substance" of the transaction[643] or finding out what "in reality" was the position[644], Stevens concluded:

> "Loreburn, presiding, no doubt found himself in a quandary. As Speaker of the House of Lords he was at this time both fighting for Lloyd George's budget and presiding over the debates on it. Perhaps he felt that politically it would be unwise to provoke still further the hostility of the Tory peers. ...
>
> Whatever inspired this change of approach in the Lord Chancellor is not certain; but it is clear that his vote on this occasion had a profound impact on the interpretation of tax laws in the United Kingdom. ...
>
> The formalistic approach toward tax legislation that the law lords developed turned English tax law for decades to come into a type of crossword puzzle, with the courts and the legislature playing an often unseemly game of cat and mouse. Politically and economically the semanticism of the English judicial approach to tax problems that developed during these years, although in later years quaintly dressed up as the protection of civil liberties, in fact enabled the extremely wealthy to avoid the undisputed rigors of the English tax system."[645]

The rest of this chapter expounds the development of the mischief rule in *Heydon's Case* under the cheating or fraud approach and the primacy of the public revenue law, and the retreat from it under the *Duke of Richmond* and *Duke of Westminster* principles that substituted the constructional approach and the primacy of the private law.

9.2 THE DEVELOPMENT OF THE MISCHIEF RULE

9.2.1 The Primacy of the Common Law

Plucknett suggested that the abuse of the common law "for the purposes of fraud and dishonesty ... gave a strong impetus to the movement for a written statutory law."[646] In a cautionary tale of the futility of anti-avoidance legislation, he stated:

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[641] [1909] A.C. 466.
[642] *Strong & Woodifield* [1906] AC 448; *De Beers v Howe* [1906] AC 455, 458; *IRC v Maple & Co* [1908] AC 22, 26.
[643] *London & India Docks Co v Attorney-General* [1909] AC 7, 12.
[644] *Blakiston v Cooper* [1909] AC 104, 107.
[645] *Law and Politics: The House of Lords as a Judicial Body, 1800 – 1976* (London: Weidenfeld and Nicolson, 1979), pp.174-176.
[646] *Statutes & their Interpretation in the First Half of the Fourteenth Century* (Cambridge: Cambridge University Press, 1922) p.66.

> "At first, perhaps, it was thought that precise, written, legislation would remove the evil, but the event proved the contrary. No sooner was a statute made, than we find reported in the Year Books numerous ingenious attempts to evade or circumvent the Act. Originally, perhaps the result of legal chicanery, the new written and published statutes themselves rapidly became the cause of further artifice, and the battle of wits between the legislature and the smart litigant has continued until our own day."[647]

In *Omychund v Barker*, therefore, Lord Mansfield reaffirmed the primacy of the common law thus:

> "All occasions do not arise at once; ... a statute very seldom can take in all cases, therefore the common law, *that works itself pure* by rules drawn from the fountain of justice, is for this reason superior to an act of parliament."[648]

9.2.2 The Primacy of the Public Revenue Law

Heydon's Case involved an anti-avoidance legislation enacted to counteract the avoidance of the 1539 Act for the Dissolution of all Monasteries and Abbies. According to Eskridge:

> "A statute adopted by Henry VIII listed specific property transfer devices that would be disregarded if used to avoid the king's seizure of Church property. The statute did not list copyhold interests, which had been used to transfer Church property in the case at hand. ... Because the statute of Henry VIII sought to block evasions of the royal confiscations, the judges extended its ambit to include property interests that had been inadvertently omitted. The judges in *Heydon's Case* followed equitable interpretation to help the legislator accomplish all he was trying to accomplish, but no more than was justified by his original goal." [649]

The fact that the statute is but one part of the law means that any "gap" in the statute is filled by the pre-existing common law of cheating and the question of extending the "ambit" of the statute does not arise. Indeed, contrary to Eskridge's assertion, copyhold had *not* "been inadvertently omitted" by the Act because, like every tax avoidance scheme (or *two or more interrelated transactions of a kind which had never taken place before the tax Act it was devised to cheat or defraud was passed devised as a result of it*), the scheme comprised two copyholds "devised as a result of it". According to the summary in Coke's Report:

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[647] Ibid.
[648] (1744) 1 Atkyns 21, 33.
[649] 'All About Words' (2001) *Columbia Law Review*, 991, pp.1003-1004.

> "The statute 31 H. 8. c. 13. avoids cases of lands whereof any estate for life, &c. was then in being, made by religious persons within a year before; a copyhold was granted by copy for life, and then the religious house made a lease of it to another for 80 years; held that the lease was void, the copyhold estate being an estate for life within the statute."[650]

The transactions were not cheats or frauds or shams "as between subject and subject" in private law but were declared void because their object was to cheat "as concerns the King and the public" in tax law. Referring to *a specific part of the common law,* rather than the overriding common law of cheating, Coke reported:

> "And it was said, that in this case the common law was, that religious and ecclesiastical persons might have made leases for as many years as they pleased, the mischief was that when they perceived their houses would be dissolved, they made long and unreasonable leases: now the stat of 31 H. 8. doth provide the remedy, and principally for such religious and ecclesiastical houses which should be dissolved after the Act (as the said college in our case was) that all leases of any land, whereof any estate or interest for life or years was then in being, should be void; and their reason was, that it was not necessary for them to make a new lease so long as a former had continuance; and therefore the intent of the Act was to avoid doubling of estates, and to have but one single estate in being at a time: for doubling of estates implies in itself deceit, and private respect, to prevent the intention of the Parliament. And if the copyhold estate for two lives, and the lease for eighty years shall stand together, here will be doubling of estates *simul & semel*, which will be against the true meaning of Parliament."[651]

The unravelling of the scheme on the ground of *deceit* confirms that the mischief rule involved the *application of* the pre-existing common law of cheating *which* "acts upon the offence, by setting aside the fraudulent transaction" in civil proceedings. According to Coke:

> "**And it was resolved by them, that for the sure and true interpretation of all statutes in general (be they penal or beneficial, restrictive or enlarging of the common law,) four things are to be discerned and considered:—**
> **1st. What was the common law before the making of the Act.**
> **2nd. What was the mischief and defect for which the common law did not provide.**
> **3rd. What remedy the Parliament hath resolved and appointed to cure the disease of the commonwealth.**
> **And, 4th. The true reason of the remedy; and then the office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions**

[650] Ibid.
[651] Ibid, p.7b. Emphasis supplied.

> **and evasions for continuance of the mischief, and *pro privato commodo*, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bono public*.**"[652]

In order "to suppress subtle inventions and evasions" of the Act, the court necessarily invoked the pre-existing common law of cheating or deceit. In the words of Simpson's directly applicable summary of the *Ramsay* principle:

> "This judge-made move towards regulating the conduct of citizens certainly goes beyond anything expressly demanded by the legislation. To that extent, it clearly involves the recognition that there is, after all, some common law (in the widest sense of that term) of taxation."[653]

9.2.3 The Equality of Taxation

The primacy of the public good ("*pro bono public*") over private advantage (*"pro privato commodo*") shows that the mischief rule gives effect to the equality of taxation. According to Coke:

> "And in this case it was debated at large, in what cases the general words of Acts of Parliament shall extend to copyhold or customary estates, and in what not; and therefore this rule was taken and agreed by the whole Court, that when an Act of Parliament doth alter the service, tenure, interest of the land, or other thing, in prejudice of the lord, or of the custom of the manor, or in prejudice of the tenant, there the general words of such Act of Parliament shall not extend to copyholds: but <u>when an Act of Parliament is generally made for the good of the weal public</u>, and no prejudice can accrue by reason of alteration of any interest, service, tenure, or custom of the manor, there many times copyhold and customary estates are within the general purview of such Acts."[654]

As explained in chapter seven, three hundred years later, Lord Ardmillan based his application of the equality of taxation in *Master Mariner* on strikingly similar proposition:

> "Where there is an Act taxing a particular body, or laying a tax upon a particular article, of course that Act is to be strictly construed, but <u>where there is an Act taxing the whole of Her Majesty's subjects</u>, and the question is, whether it is to be construed so as to sustain the equality of the incidence of the tax, I think there is no presumption in favour of that exemption and against the equality of the incidence of the taxation. It is the next and soundest principle of taxation to be as equal as possible".[655]

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[652] Ibid, pp.7b-8a. Emphasis supplied.
[653] Simpson (2001) p.190.
[654] *Heydon*, p.8a. Emphasis supplied.
[655] (1875) 1 TC 57, 62. Emphasis supplied.

9.3 THE DUKE OF RICHMOND PRINCIPLE

In *Duke of Richmond* the Revenue failed to distinguish the legality of the relevant transactions "as concerns the Revenue and the public" in tax law from their legality "as between subject and subject" in private law, and thus failed to plead fraud to the required procedural standard in civil proceedings and effectively facilitated the substitution of the constructional approach for the pre-existing cheating approach.

The opening two paragraphs of Lord Shaw's speech, which refer to the two minimum transactions required to constitute a scheme and the Act the scheme was devised to cheat show that there was a scheme or *two or more interrelated transactions of a kind which had never taken place before the tax Act it was devised to cheat or defraud was passed devised as a result of it*:

> "My Lords, on October 6, 1897, the late Duke of Richmond granted a bond and disposition in security over his estates after mentioned for 415,000l. in favour of his son the present Duke. On the same date he granted a bond over the same estates for 287,000l. in favour of his grandson, the present Earl of March. The question in the present case is whether, in determining the value of these estates for the purpose of estate duty, allowances should be made for these incumbrances.
>
> The provisions of s. 7, sub-s. 1, of the Finance Act, 1894, applicable to the present case are as follows:
>
> > 'In determining the value of an estate for the purpose of estate duty allowance shall be made … for debts and incumbrances; but an allowance shall not be made—(a) for debts incurred by the deceased or incumbrances created by a disposition made by the deceased unless such debts or incumbrances were incurred or created bona fide for full consideration in money or money's worth wholly for the deceased's own use and benefit and take effect out of his interest.'"[656]

The hallmark of his judgment in favour of the Revenue was, therefore, the recognition that a tax avoidance scheme is the paradigm of "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions."[657] Putting the two transactions he cited above in their wider context, he stated:

> "**I am of opinion that in order to arrive at a just determination upon the elements for consideration presented by this clause it is necessary to consider not merely the transaction of creating incumbrances by itself, but the entire transaction of which they form a part. I think that this**

[656] *Richmond*, pp.483-487. Emphases supplied.
[657] Law Commission.

must be done if mistake is to be avoided. It is for that reason that I give the brief narrative which follows.

Among the Scotch Entail Acts cited in these proceedings the Rutherfurd Act (11 & 12 Vict. c. 36) and the Act of 1875 (38 & 39 Vict. c. 61) are those outstanding. By the former of these Acts, an heir of entail in possession received for the first time in the law of Scotland power to disentail on obtaining the necessary consents of succeeding heirs. By the latter statute, such consents, if not given, might in the case of new entails, of which this is one, namely, entails executed after August 1, 1848, be dispensed with by the Court on payment of the value of the expectancy or interest of the heir or heirs of entail.

The beginning of the series of transactions after mentioned was made on April 12, 1897, when a petition was presented to the Court of Session by the Duke of Richmond, Gordon, and Lennox, the prayer of which was for disentail of what may be comprehensively termed the Gordon Richmond estates lying in six counties in Scotland. The petition necessarily craved for service upon the succeeding heirs of entail, and in the event of any of those whose consent was necessary refusing or failing to give such consents, then for the ascertainment of the value in money of such heirs' expectancy or interest, and the payment of the amount or the giving of proper security therefor over the entailed estates. Upon such payment or security the Court was asked to dispense with consent and to approve of the instrument of disentail tendered in the course of the proceedings. The parties were at one as to the object to be achieved: the consent of the heirs of entail was not given: mortgages were accordingly granted for their interests, and after various steps of procedure the petition was granted.

So far, my Lords, as the proceedings are concerned they appear to have been in proper form. This observation applies not only to the valuation of the interests of those heirs whose consent was necessary, but also to the bonds and dispositions in security granted over the estates and to the instrument of disentail. The procedure is accurately summed up and ratified in the interlocutor of Lord Pearson of October 20, 1897.

As already stated, the finance of the transaction was arranged by security being given over the estates to the next heirs for the ascertained value of their interests, that value being in the case of the Earl of March, now the present Duke, 415,000l., and of Baron Settrington, now the Earl of March, 287,000l., together a sum of 702,000l. As the late Duke of Gordon was at the date of his petition seventy-nine years of age, it is plain that actuarially the value of the succeeding heirs' interest, for which bonds and dispositions in security had to be granted, went a long way towards evacuating the entire value of the entailed estates. As it turned out, this evacuation was completed prior to the Duke's death on September 27, 1903. In the interval between the disentail proceedings and his death instalments of interest became due on the bonds and dispositions in security. These were not, however, paid: from beginning to end of the series of transactions no money passed. At certain dates balances of overdue interest were struck, and further bonds and dispositions in security over the estates were granted to the amount of 88,000l. The result was that, so far as the financial interest of the late Duke of Richmond and Gordon in the Scotch Gordon Richmond entailed estates was concerned, that interest had at the date of his death been reduced to nothing. Indeed, in the estate duty account presented by the solicitors to the

> Inland Revenue it is expressly stated that there is an excess of debts and incumbrances over the value of the heritable property of 47,092l.
>
> So far for finance. But as the statute under construction deals not only with bona fides and full consideration, but provides that the incumbrances are to be created bona fide for full consideration 'in money or money's worth wholly for the deceased's own use and benefit and take effect out of his interest,' it becomes necessary to inquire what became of the Gordon Richmond estates, thus left unentailed but depleted in value in the hands of the late Duke; and, secondly, what became of the sum of over 700,000l., for which, as stated, his Grace granted incumbrances in favour of his son and grandson. With regard to the estates themselves, the late Duke of Richmond, on April 20, 1898, executed a mortis causa deed of entail in favour of the same line of succession as that favoured by the entail of 1872. With regard to the 700,000l., that was settled by an assignation and deed of trust, dated November 11 and 15, 1897, and recorded November 18, 1897. Substantially the result arrived at by these deeds was to put the money represented upon trust for the same line of succession, namely, the old heirs of entail.
>
> **It will be seen, accordingly, that at the end of these transactions the parties affected thereby were, for practical purposes, restored pretty nearly to the identical position which they occupied at the beginning**. **This, I think, was exactly what was sought to be achieved.** Whatever may have happened to others, it is at all events fairly clear that the one man who had not benefited was precisely the petitioner for disentail, the grantor of repeated mortgages, and the re-entailor of the reversion, the late Duke himself. For myself I can see no benefit produced to the late Duke of Richmond and Gordon by this **series of transactions**, and I am unable to affirm that the incumbrances which formed the essential items of the series were, in the language of the statute, 'for the deceased's own use and benefit.' [658]

The facts that "from beginning to end of the series of transactions no money passed" and "that at the end of these transactions the parties affected thereby were, for practical purposes, restored pretty nearly to the identical position which they occupied at the beginning" show that in reality the Duke did not diminish his actual assets and thus did not suffer the actual loss to his personal estate that he was claiming.

Despite the fact that court was engaged in statutory construction, the essence of his judgment, which used 'motive' (which is irrelevant) and 'purpose' or 'object' (which is decisive) synonymously, supports the definition of tax avoidance as cheating by the professional advisers that devise, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using an individual scheme may or may not be complicit:

[658] *Richmond*, pp.483-486. Emphases supplied.

> "What the motive for the transaction was is not denied. Answering the learned judge who tried the case, his Grace speaks with perfect frankness to a conversation with his father. 'You had a conversation with your father before he began this transaction?—Yes. He told you what his motive was?—Yes; his motive, as I think I said yesterday, was to lessen the amount of the death duties if he could.' The interests of all the three parties to the transaction were ably attended to by the same firm of solicitors. They accepted the task of endeavouring to give effect to the motive of the late Duke. In doing so they incurred no risk of prejudicing the interest of his son or grandson. On the contrary the result, if it could be legally accomplished, would benefit them, as, under the judgments appealed against, it has benefited them by a saving in estate duty to the amount of 55,000l.
>
> My Lords, that saving of estate duty (I purposely do not use the term evasion or even avoidance of estate duty) formed the object and purpose of the transaction. It was for this that the incumbrances were created, and not 'for full consideration in money or money's worth wholly for the deceased's own use and benefit' or to 'take effect out of his interest.' The saving was not to take effect till he was dead, and then could be for the benefit only of those who would have the estate duty to pay." [659]

As a matter of law, the purpose of the scheme was to cheat the Revenue of estate duty, whether it is described as "evasion or even avoidance of estate duty" or "to lessen the amount of the death duties".

In his conclusion, he criticised the courts below, which found in favour of the taxpayers, for failing to give effect to the principle that a tax avoidance scheme is archetype of "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions" despite the Revenue's failure to plead fraud:

> "With reference to the judgments in the Courts below, I will only say that they do not appear to me to give effect to the strong and carefully worded language of the statute. When, for instance, Bray J. reasons that 'It is a mistake to assume that to free one's heir from estate duty is necessarily an act done for his benefit,' and that 'it does not necessarily follow that the present Duke will reap the whole benefit if he escapes the payment of estate duty,' the point of the provision appears to have been missed, namely, that escape is not permissible unless the incumbrance was created inter alia 'wholly for the use and benefit,' not of the present Duke, but of the late Duke, the grantor of the deed. And with reference to the decision of the learned judges in the Court of Appeal I think (1.) **that it was too confined to the one item of the transaction as a purchase of a reversion without taking into account the fact appearing from other parts of the transaction that the reversion was purposely reduced to a shadow**, and (2.) that too much stress was laid upon argument, possible but not put forward, as to fraud. **The deeds make no attempt at concealment, but disclose quite openly the interrelation of the facts, deeds, and transactions which go to make up the scheme**. **To view these, so interrelated, as if they were in isolation,**

[659] *Richmond*, p.486. Emphases supplied.

> **would be for me—and I speak of course only for myself—to shut out the light, to lose their true meaning, and to produce a risk of failure to get down to the reality and substance of the case**. I think that the creation of these incumbrances was not for the use and benefit of the late Duke of Richmond and Gordon, but was simply part of a plan for saving death duties to his heirs. I do not think that the scheme was in this case accomplished without a contravention of the letter as well as a very plain violation of the spirit of the statute." [660]

As the exposition of the fraudulent nature of a tax avoidance scheme in chapter two shows, "a very plain violation of the spirit of the statute" is fraud upon a tax statute and cheating the public revenue.

"The deeds make no attempt at concealment, but disclose quite openly the interrelation of the facts, deeds, and transactions which go to make up the scheme" because, as expounded in chapter seven, in order to cheat the public revenue "as concerns the Revenue and the public" in tax law, "deeds, and transactions" that are genuine "as between subject and subject" in private law are required.

Despite the constraints of statutory construction and the Revenue's failure to plead fraud "as concerns the Revenue and the public" in tax law, Lord Collins, who also confused 'motive' with 'purpose', also effectively held that the scheme cheated the public revenue by "Looking … at the transaction as a whole:

> "I accept unreservedly the conclusions of fact found by Bray J., and adopted by the Court of Appeal, and I do not at all question the right of an owner of property so to dispose of it, if he can, as to keep it outside the meshes of a taxing statute. But the real question here is whether he has succeeded in doing so. In my opinion he has not. It is common ground and expressly found by the learned judge that 'it was the intention of the late Duke to bar the entail and to make himself owner in fee simple of the Gordon Richmond estates subject to the incumbrances, including the bonds, but that the motive which mainly actuated him in taking the steps which he did for that purpose was that he would thereby diminish his estate and lessen the estate duty payable on his death.' Can an incumbrance created mainly from such a motive be fairly said to be 'incurred or created wholly for the deceased's own use and benefit,' and not in whole or in part for that of his successor? I think not. …
>
> But even if the grammatical construction put on the section by the Courts below be adopted, **I am far from satisfied that 'full consideration in money or money's worth' was received by the deceased in return for the incumbrances. In fact, if it had been, it might have defeated the main purpose of the transaction, which involved a diminution in the value of the estate to be left in the hands of the settlor at the close of**

[660] *Richmond*, pp.486-487. Emphases supplied.

> **the transaction**. In fact, the machinery put in operation by the elaborate processes adopted would have failed in its main object if it had left the estate which it was contemplated would pass on the death of the settlor of the same value at the close of the proceedings as it would have been had no settlement been made. It was through the means of allowable deductions only that the intended diminution of the taxable value of the estate could be brought about, and to the extent of such deductions the consideration was less than full. **Looking, as we are entitled to do, at the transaction as a whole**, there is no doubt that the interests of Lord March and his son in the estate which the late Duke was to buy up were carefully assessed at the sum for which the incumbrances were created, but the proper equivalent in return for the incumbrances to such an amount would have been an estate equivalent to the sum total of those interests and unencumbered by a charge for the purchase-money. But it was part of the arrangement that the purchase-money was to be secured on the estate not paid, and therefore the consideration intended to be given, and actually given, was less than full by the value of the incumbrances, and thus furnished ground for claiming the deduction which has been allowed.
>
> There is no evidence that the dominion acquired over the fee was really desired with a view to altering the succession, or had any special value for that reason. **In point of fact, the property was at once resettled as nearly as possible on the old lines. I cannot think that a claim thus manufactured can be held good**. For these reasons, I think, the appeal should be allowed."[661]

If "[i]n point of fact, the property was at once resettled as nearly as possible on the old lines" then the Duke did not diminish his actual assets; and if it was not established "that 'full consideration in money or money's worth' was received by the deceased in return for the incumbrances", then he did not suffer the actual loss to his personal estate that he was claiming.

Like the judges below, however, the majority refused to recognise that tax schemes are "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions" because of the Revenue's failure to plead fraud "as concerns the Revenue and the public" in tax law.

In his speech in the House of Lords, which underscores the departure from the equality of taxation, Lord Macnaghten stated:

> "The question involved in this appeal has at last been brought within a very narrow compass. In the case as originally presented on behalf of the Crown there were charges and insinuations of bad faith which ought never to have been made. Those charges and insinuations were disproved at the hearing, and they have been abandoned or dropped, somewhat grudgingly I think, and with some appearance of reluctance. However, they are out of the way

[661] Ibid, pp.480-482. Emphasis supplied.

now, and the only question remaining is a question of construction, a question perhaps of some difficulty, arising as it does on one of the least intelligible sections in an Act of Parliament not remarkable for perspicuity.

In 1897, three years after the passing of the Finance Act, 1894, the late Duke of Richmond was minded to acquire in fee simple certain estates in Scotland known as the Gordon Richmond estates, of which he was then institute of entail in possession. There is no doubt about the motive which influenced him. He was advised by the solicitor of the family, a gentleman of the highest standing (and advised, I suppose, rightly), that if the entail were subsisting at the time of his death the principal value of the entailed estates would be aggregated with the rest of the property passing on his death so as to form one estate, but that it was competent for him under the law of Scotland, with the consent of the next two heirs of entail, his eldest son, then Earl of March, who is the present Duke, and his grandson, Lord Settrington, or failing their consent on paying or securing to the satisfaction of the Court the ascertained value of their respective interests, to acquire the estates in fee simple. He was further advised (but the soundness of this advice is questioned in these proceedings) that if he acquired the fee simple, then, although the principal value of the Gordon Richmond estates would still fall to be aggregated with the rest of his property, the value of the estate subject to duty would be diminished by the sums paid or secured as purchase-money or compensation for the interests of his son and grandson.

The Duke acted on the advice of his solicitor, conceiving, rightly or wrongly, that he was not under any obligation, legal or moral, to keep his property in a form peculiarly and unnecessarily obnoxious to an impost which I am afraid many people still think unequal and unfair. Everything was done in an open and straightforward manner, without subterfuge or concealment of any kind or any attempt to make the transaction appear other than what it was in reality. The sanction of the Court was applied for on the footing that Lord March and Lord Settrington failed to consent. The procedure was regular and proper throughout. The interests of the next two heirs of entail were valued under the direction of the Court, and the amount of the valuation in each case was secured on the fee simple of the Gordon Richmond estates to the satisfaction of the Court.

On the death of the late Duke, which occurred in 1903, his executor, the present Duke, who succeeded under the late Duke's will or trust disposition, claimed an allowance in respect of the sums secured in his favour and in favour of his son on the fee simple of the Gordon Richmond estates. The Commissioners of Inland Revenue rejected the claim. An information was brought by the Attorney-General to enforce their view. Bray J. dismissed the information with costs, and the Court of Appeal sustained his decision. I think the judgment of the Court of Appeal is right."[662]

The fact that the transactions that constituted the scheme were implemented "three years after the passing of the Finance Act, 1894" makes them "transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which

[662] Ibid, pp.470-471. Emphases supplied.

they had never thought at all"[663] and "transactions … of a kind which had never taken place before the Act was passed … devised as a result of it" [664], and underscores "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant"[665] involved in said "question of construction".

Again, in order to cheat the public revenue "as concerns the Revenue and the public" in tax law, it is necessary that "[e]verything was done in an open and straightforward manner, without subterfuge or concealment of any kind or any attempt to make the transaction appear other than what it was in reality" in private law "as between subject and subject". In order to identify the cheating or fraud "as concerns the Revenue and the public" in tax law, therefore, it is necessary to recognise that tax schemes are "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions."

Lord Atkinson, who also confused 'motive' with 'purpose' or 'object', however, also refused to do so because of the Revenue's failure to plead fraud:

> "[I]n this case, the facts of which have already been stated with sufficient fullness, **fraud is not relied upon by the Crown**. It is on the contrary admitted that the transactions ... were real and genuine as opposed to colourable transactions. If so, the incumbrances on these estates created by the late Duke were ... created bona fide within the meaning of s. 7. It is admitted that the motive which prompted the late Duke to enter into these transactions was to relieve from the payment of estate duty those estates which upon his death would pass to another or to others. That motive does not, however, vitiate the transactions. ...
>
> I further think that the case must be determined solely with regard to the legal rights and interest which the respective parties had acquired in October, 1897, the date of execution of the impeached securities. What they did afterwards, how they chose to dispose of those legal interests or to exercise those legal rights, is ... irrelevant. It might have been legitimate to inquire into these matters subsequent, if the transactions which were concluded on that day had been impeached as unreal, colourable, or sham transactions; but they have been admitted to be real and genuine in their character, and, if so, all the subsequent dealing with the estate and the interest created in it lie outside the field of inquiry, even though by their operation they practically restore the status quo ante. ...
>
> Were they created bona fide? They cannot, for the reasons already given, be held ... to have been created mala fide, simply because they constituted

[663] Diplock.
[664] Diplock.
[665] Diplock.

> one step in proceedings designed to provide a means of escape from the payment of estate duties."[666]

As explained above, "fraud [was] not relied upon by the Crown" because of the failure to argue that while the constituent transactions could not be "impeached as unreal, colourable, or sham transactions" in private law 'as between subject and subject', they could be "impeached as unreal, colourable, or sham transactions" 'as concerns the Revenue and the public' in tax law or as *not* "created bona fide within the meaning of s. 7" because they were devised to cheat the public revenue or "designed to provide a means of escape from the payment of estate duties."

Lord Loreburn decided the case in this one-paragraph judgment that concluded with an effective repudiation of the mischief rule:

> "I have had the advantage of reading in print the opinions of my noble and learned friends Lord Macnaghten and Lord Atkinson, and I agree with the conclusion at which they have arrived. It is not necessary to decide finally whether the words 'wholly for the deceased's own use and benefit' are to be read with the word 'created' in s. 7, sub-s. 1 (a), of the Act of 1894, or relate only to the 'consideration.' If the latter, then no doubt the consideration for the incumbrance was received wholly for the late Duke. If the former, I think the incumbrance was created wholly for the late Duke's use and benefit, in the sense that this was the direct and immediate purpose. And this suffices where the other conditions of the section are satisfied. I see no other arguable point in the case. **It is not my province either to censure or to commend the transaction itself. It was within the law and without dishonesty. If this case has disclosed a way by which settled property may largely escape the estate duty, that is an affair for the Legislature to consider, in which Courts of law have no concern**."[667]

In principle the assertion that the scheme "was within the law and without dishonesty" affirmed the overriding duty of honesty imposed by the pre-existing common law of cheating. In practice, however, it is misleading on two grounds. First, he was concerned with dishonesty "as between subject and subject" in private law rather than "as concerns the Revenue and the public" in tax law. Secondly, as Lord Shaw's reference to "argument, possible but not put forward, as to fraud" and Lord Atkinson's statement that "fraud is not relied upon by the Crown" show, fraud or dishonesty was not pleaded by the Revenue or considered by the courts. By concluding that the scheme "was within the law and without dishonesty" when dishonesty was not in issue or in evidence,

[666] Ibid, pp.475-476. Emphases supplied.
[667] *Richmond*, pp.469-470. Emphasis supplied.

therefore, Loreburn went beyond the procedural safeguard that: "It is not open to the court to infer dishonesty from facts which have not been pleaded."[668]

Most significantly, the notion that "*the office of all the Judges ... always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and pro privato commodo, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, pro bono public*" under the mischief rule was now "*an affair for the Legislature to consider, in which Courts of law have no concern*" under the *Duke of Richmond* principle induced the vicious cycle of tax avoidance, tax complexity and tax uncertainty that continues to this day. In the words of Lord Diplock:

> "The history of tax legislation is thus the history of an attempt to deal specifically with the liability to tax of every kind of financial transaction which people enter into. And it is a history of failure. ... [I]n the face of human ingenuity in devising new variants of transactions, this aim is impossible of achievement. It is worse. It is self-defeating."[669]

9.4. LORD CLYDE'S CHARTER FOR TAX CHEATS

9.4.1. Background

Like Lord Loreburn, Lord Clyde was also a leading politician. By the time he appeared in the High Court for the taxpayers in *Duke of Richmond* in 1907, he had served as Solicitor General for Scotland and stood unsuccessfully as a Tory Parliamentary candidate. His evidence resulted in Lord Macnaghten's claim that the Revenue's "charges and insinuations were disproved at the hearing". As Bray J put it:

> "The first witness called was Mr. Clyde, an advocate of the Scottish Bar, holding the rank of King's Counsel and Solicitor-General in the time of the last Government. His evidence was given with admirable lucidity, and helped to remove many of the difficulties I felt in dealing with a question so largely dependent upon Scotch law. His evidence was not really disputed by the Attorney-General, and I have accepted it as accurate in every respect."[670]

By the time Lord Clyde presided over the taxpayers' appeal in the First Division of the Court of Session as Lord President in *Ayrshire Pullman* in 1929, he had served as an

[668] Gibson, LJ, *Wimpey* [31].
[669] Diplock, p.8.
[670] *AG v Duke of Richmond* [1907] 2 K.B. 923, 933.

MP and as the Lord Justice General. His son (James Clyde), who would later also become Lord Advocate and Lord Justice General, appeared as one of the two counsel for the taxpayers.

9.4.2. Lord Clyde's Judgment

Like Lord Loreburn's judgement in *Richmond*, Lord Clyde's famous speech in *Ayrshire* shows that references to honesty in civil proceedings are to the private law and does not extend to the overriding common law duty of honesty imposed by the pre-existing common law of cheating the public revenue:

> "This is an appeal against assessments to Income Tax ... imposed in respect of the profits of a business ... made upon, and in the name of, the firm ... and on a Mr Ritchie who, according to the contentions of the Revenue both before the Commissioners and before this Court, is the sole owner of that business and, therefore, solely entitled to the profits upon which the assessments were made. The appeal is taken against these assessments upon the ground that the business in question ... was not during the years in question a business which belonged to Mr Ritchie but, on the contrary, was a business carried on by a partnership under a written contract of co-partnery. ...
>
> There is no doubt at all that there was a contract of co-partnery under which this business was carried on, and there is no doubt that that contract of co-partnery managed its business with regard to its books and with regard to its balance sheets and the like, exactly as any other contract of co-partnery manages its affairs, but *it is true that it has certain salient and striking features of its own*.
>
> To begin with, it was a contract of co-partnery between Mr Ritchie and five of his children, two of whom at the date of the contract of co-partnery itself were actually minors. It provides that the capital of the Company is to be provided by a loan of £1,600 from Mr Ritchie, and that upon that loan he is to get 5 per cent interest. Furthermore, he has no share in the profits, although he is the exclusive manager of the concern. The profits are to go in equal shares to his children, and his children, who earn these profits and to whom they are allotted from year to year, are not to draw any part of those profits until the capital debt of £1,600 due to Mr. Ritchie is paid off. I do not know that there is anything else in the contract of co-partnery which differs from the ordinary style of such documents, but these are indeed peculiarities and they show, as plainly as words can show, that <u>the object of this contract of co-partnery was</u> to enable the children of Mr. Ritchie to acquire the substantial interests in this business as time went on - at any rate, if they chose - and incidentally to secure repayment of Mr. Ritchie's capital advance of £1,600, and, I think one may reasonably add, <u>to create a state of legal relations between the family and this business which would render the position of the family, as entitled to its profits, favourable in relation to the Inland Revenue both with regard to Income Tax to some extent, certainly with regard to Super-tax, and still more clearly with regard to Death Duties.</u>

> *So far as my point of view is concerned, the agreement is neither better nor worse for that reason.*
>
> **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 taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue**."[671]

The paragraph in bold is described in this thesis as Lord Clyde's charter for tax cheats. Because of the two minors, it is debatable whether the contract was real "as between subject and subject" in contract law. More significantly, the underlined expression, which is a legal nonsense for cheating the public revenue of Super-tax and Death Duties, shows that the object of the contract was to cheat "as concerns the Revenue and the public" in tax law. Under the primacy of the private law, however, "the agreement is neither better nor worse for that reason."

9.4.3. Lord Morison's Dissenting Judgement

In his lesser-known dissenting speech, Lord Morison rejected the primacy of the private law thus:

> "It was contended that the terms of the contract of co-partnery are such as to render the assessments ineffectual. I am quite unable to assent to this view. ... Nor am I able to find anything in the contract of co-partnery which affects the assessments. The terms of this document may be of value in ascertaining the rights of the partners inter se. It makes Mr. Ritchie the trustee for the members of his family in holding and dividing among them the profits of the business for the years in question. He had the sole control of these profits. In my opinion this has no bearing on the assessment and recovery of Income Tax from the trading profits of the business. That matter is, in my opinion, regulated solely by the terms of the statute. I think it only leads to confusion to mix up partnership arrangements with the roles of the statute."[672]

Regrettably, however, he referred to the charging provision of the statute rather than the civil fraud penalty provision.

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[671] *Ayrshire*, pp.763-764. Emphases supplied.
[672] Ibid, p.767. Emphases supplied.

9.4.4. The Cheating or Fraud Approach

The courts could have discharged "*the office of all the Judges ... always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and pro privato commodo, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, pro bono public*" as established by the mischief rule by applying section 30 of the Income Tax Act 1918 which effectively codified the pre-existing common law of cheating and fraud thus:

> "**Penalty for fraudulent claims.**
>
> (1) A person who in making a claim for or obtaining any exemption, abatement, or relief hereinbefore described, or in obtaining any certificate as aforesaid—
> (a) is guilty of any fraud or contrivance; or
> (b) fraudulently conceals or untruly declares any income or any sum which he has charged against or deducted from, or was entitled to charge against or to deduct from another person; or
> (c) fraudulently makes a second claim for the same cause,
> shall forfeit the sum of twenty pounds and treble the tax chargeable in respect of all the sources of his income and as if such claim had not been allowed.
>
> (2) A person who knowingly and wilfully aids or abets any person in committing an offence under this section shall forfeit the sum of fifty pounds."

If the Revenue did "take every advantage which [was] open to it under the taxing statutes", as Lord Clyde suggested, it would have applied section 30. The issue would have been whether the participating taxpayer was "guilty of any fraud or contrivance" or "fraudulently conceal[ed] or untruly declare[d] any income or any sum"; and whether his professional enablers were "guilty of any fraud or contrivance" by "knowingly and wilfully aid[ing] or abet[ing]" him.

Furthermore, as the tax statutes are but one part of the law, the rule of law required the Revenue "to take every advantage which [was] open to it under the" common law by bringing a criminal prosecution for cheating. Indeed, when the same issue under the same legislation came before Andrews L.J. in the Northern Ireland case of *R v 'J'*, he made precisely the same point:

> "The ... reason for my opinion is founded on the express words in section 224 of the Income Tax Act, 1918, which provides that the provisions of that

> Act 'shall not affect any criminal proceedings for any felony or misdemeanour.' Therefore, no enactment which provides for the imposition of treble charge or for power to have the matter considered at petty sessions, in any way interferes with the common law rights of the King.[673]

Contrary to the common belief derived from Lord Clyde's statement that the taxpayer acted "so far as he honestly can", therefore, the fact is that the Revenue failed to enforce the relevant statutory and common law duties of honesty. Furthermore, by effectively concluding that the taxpayer acted "so far as he honestly" could, when dishonesty was not in issue or in evidence, Lord Clyde went beyond the procedural safeguard that: "It is not open to the court to infer dishonesty from facts which have not been pleaded."[674]

9.5. THE DUKE OF WESTMINSTER PRINCIPLE

9.5.1. Lord Atkin's Failure to Identity the Cheating

The real difference between Lord Atkin and the majority was that, like the Commissioners and Finlay J, he recognised that tax schemes are "cases where the fraudulent nature of a transaction only becomes apparent in the context of several other transactions" by judging the deeds and the letters of acknowledgment together.

Like the majority, however, he failed to identify the fraud "as concerns the Revenue and the public" in tax law by agreeing that the case turned on the construction of the transactions "as between subject and subject" in contract law:

> "It is agreed between the parties that the question in this case is whether the payments were for remuneration of services or not; if the former the Respondent is chargeable, otherwise not. It is unnecessary, therefore, to trouble your Lordships with the various relevant Sections and Rules of the Income Tax Act, 1918, and subsequent Finance Acts. It is sufficient to say that your Lordships were satisfied that the admission was correct. It was not, I think, denied, at any rate it is incontrovertible, that the deeds were brought into existence as a device by which the Respondent might avoid some of the burden of Sur-tax. 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."[675]

[673] [1933] N.I. 73, 78.
[674] Gibson, LJ, *Wimpey* [31].
[675] Ibid, p.511. Emphasis supplied.

In law, “a device by which the Respondent might avoid some of the burden of Sur-tax” amounts to cheating “so far as they affect tax.” While “the subject ... has the legal right so to dispose of his capital and income as to attract upon himself the least amount of tax” nobody has the right to cheat the public revenue.

9.5.2. Lord Tomlin’s Charter for Tax Cheats

The so-called doctrine of the primacy of “form over substance” is more accurately described as the primacy of the form and substance of the legal position “as between subject and subject” in private law over the form and substance of the legal position “as concerns the Revenue and the public” in tax law. As Lord Tomlin put it in his famous speech:

> “Apart ... from the question of contract with which I have dealt it is said that in Revenue cases there is a doctrine that the Court may ignore the legal position and regard what is called ‘the substance of the matter’ and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages and that, therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled and the supposed doctrine given its quietus the better it will be for all concerned, for the doctrine seems to involve substituting ‘the uncertain and crooked cord of discretion’ for ‘the golden and straight mete wand of the law’ (4 Inst. 41).
>
> **Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow tax-payers may be of his ingenuity, he cannot be compelled to pay an increased tax.**
>
> 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.... So here the substance is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles, and having regard to what I have already said, the conclusion must be that each annuitant is entitled to an annuity which, as between himself and the payer, is liable to deduction of Income Tax by the payer and which the payer is entitled to treat as a deduction from his total income for Sur-tax purposes.
>
> There may, of course, be cases where documents are not bona fide nor intended to be acted upon but are only used as a cloak to conceal a different transaction. No such case is made or even suggested here. The

> deeds of covenant are admittedly bona fide, and have been given their proper legal operation. They cannot be ignored or treated as operating in some different way because as a result less duty is payable than would have been the case if some other arrangement - called for the purpose of the Appellants' argument 'the substance' - had been made."[676]

The underlined sentences confirm that the true *Duke of Westminster* principle is that the reality or legality of transactions "as between subject and subject" in private law is decisive and binding "as concerns the Revenue and the public" in tax law as explained in chapter eight. The paragraph in bold is more accurately described as the false *Duke of Westminster* principle.

9.5.3. The Cheating or Fraud Approach

As *Duke of Westminster* was also decided in the context of the Income Tax Act 1918, the courts could have discharged "*the office of all the Judges ... always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and pro privato commodo, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, pro bono public*" as established by the mischief rule by applying section 30.

The application of section 30 would have shown that the Duke "untruly declare[d]", rather than "fraudulently conceal[ed]", his tax liability under section 30(1)(b) but this was still be a "fraud or contrivance" under section 30(1)(a). The Duke's advisers "knowingly and wilfully aid[ed] or abet[ed] [him]" in the words of section 30(2). As Gammie put it:

> "[T]he Duke of Westminster could not deduct for tax purposes the wages that he paid his private household, so his advisers came up with a tremendous wheeze: reduce the servants' wages and pay them a tax deductible annuity instead. The Duke agreed by deed to make payments over a specified period and his employees acknowledged that so long as they remained in his employment they would forego an equivalent amount of their wage. ...
>
> Now it is obvious that in this case there was no concealment: the Duke told the Inland Revenue everything about his payments. Nor was there any 'lie': the Duke did not claim that the payments reimbursed non-existent expenses. But was there an element of misrepresentation? He claimed that the payments were annuities but the Commissioners concluded that they were really payments for work done. Misrepresentation may seem a rather harsh characterisation; it was instead, perhaps, a case of 'pull the other leg,

[676] Ibid, pp.520-521. Emphases supplied.

> it's got bells on'. Or as Lord Templeman said in *Ensign Tankers v Stokes*, 'gardeners do not work for Dukes on half-wages'."[677]

As explained in chapter four, misrepresentation, which encompasses implied concealment, is a lie. There was a lie because "the Duke told the Inland Revenue everything about his payments" but concealed or misrepresented his true tax liability by using "a tremendous wheeze" which "his advisers came up with".

Under the fraud approach, therefore, the payments could have been declared void in tax law and thus not deductible in arriving at the Duke's liability for surtax. The Duke could have "forfeit[ed] the sum of twenty pounds and treble the tax chargeable in respect of all the sources of his income and as if such claim had not been allowed" under section 30(1) while his advisers "who knowingly and wilfully aid[ed] or abet[ed]" him could have "forfeit[ed] the sum of fifty pounds" under section 30(2).

The Revenue also failed to exercise the power preserved by section 224 to bring "criminal proceedings for any felony or misdemeanour." The Duke's success, therefore, owed more to the Revenue's inactivity than "his ingenuity".

9.6. CONCLUSION

This chapter demonstrated that the mischief rule provides authoritative judicial support for the proposed cheating or fraud approach to tax avoidance and contradicts Lord Hoffmann's claim that "the courts have no constitutional authority to impose such an overlay upon the tax legislation and ... have not attempted to do so."[678]

It also demonstrated how the application of the proposed cheating or fraud approach would have prevented the emergence of the *Duke of Richmond* and the *Duke of Westminster* principles, and Lord Clyde's and Lord Tomlin's charters for tax cheats. Gammie's statement analysed in the Introduction underscores the enduring influence of those misleading statements:

> "I have an enduring memory of attending a meeting as a newly-qualified solicitor nearly forty years ago at the office of a firm that specialized in devising and implementing tax schemes. On that occasion it was the office of Emson & Dudley rather than that of Rossminster or Bradman organizations. ...

[677] Gammie, 'Moral taxation, immoral avoidance - what role for the law?' [2013] *B.T.R.* 577, 578.
[678] *MacNiven* [29].

The meeting rooms were adorned with framed quotations from famous cases designed to provide assurance to potential clients that the business in which the firm was engaged was a legitimate one. Two quotations stood out —

> 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 taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.
>
> Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow tax-payers may be of his ingenuity, he cannot be compelled to pay an increased tax."[679]

[679] Simpson (ed) p.211.

CHAPTER TEN

THE RAMSAY PRINCIPLE

> **I think the turning-point in tax cases was caused by the realisation by the judges that the narrow semantic approach led inevitably to tax avoidance. The courts were faced with lots of cases about tax avoidance schemes, which they alone had caused. Doctors have a word for it: iatrogenic, or doctor-induced, disease; my Greek is not up to it, but there should be a word for the judge induced disease of tax avoidance, for that is what it was. The only way out of hearing an eternal diet of artificial tax avoidance cases was for the judiciary to invent a principle, a principle so strong that it could overrule a previous House of Lords decision on the same facts. *Ramsay* and then *Furniss v Dawson*, by applying an extraneous principle to the interpretation of tax legislation, came as something of a shock.**
> John A. Jones, 'Tax Law: Rules or Principles?' (1996) *Fiscal Studies*, 63, 71-72.

10.1. INTRODUCTION

This chapter shows that the *Ramsay* principle provides a modern authoritative judicial support for the proposed cheating or fraud approach to tax avoidance.

As Avery Jones's statement indicates, like the mischief rule, the development of the *Ramsay* principle that reached its high-water mark in *Furniss v Dawson* by the House of Lords is a seminal reaffirmation of the pre-existing common law of cheating or fraud, which "acts upon the offence, by setting aside the fraudulent transaction"[680] in civil proceedings, as what Lord Hoffmann described variously in *MacNiven* as "an overlay upon the tax legislation"[681], "an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision"[682], "some paramount provision subject to which everything else must be read"[683] and thus "a broad spectrum antibiotic which killed off all tax avoidance schemes, whatever the tax and whatever the relevant statutory provisions."[684]

The departure from the *Ramsay* principle, which started in *Craven v White* and involved the denial that the courts were "applying an extraneous principle to the interpretation of tax legislation" was completed in *MacNiven.* As Lord Hoffmann put it:

> "In choosing the constructional approach rather than the *Furniss v Dawson* formula, the House had to rewrite history in a way which struck some people as a little disingenuous. We said that the formula was not a

[680] Blackstone, p.89.
[681] *MacNiven* [29].
[682] Ibid.
[683] Ibid.
[684] Ibid [49].

> freestanding principle but rather the effect of construing a taxing provision in a particular way. ...
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> The sleight of hand which covered this retreat to constitutional propriety did not deceive Lord Templeman, who wrote a brilliant article for the *Law Quarterly Review*[685] accusing the House of Lords of having deserted the true faith and opened the door to tax avoidance. ... Lord Templeman said, correctly, that *MacNiven* satisfied the *Furniss v Dawson* formula and was therefore in his opinion wrongly decided. ...
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> The primacy of the construction of the particular taxing provision and the illegitimacy of rules of general application has been reaffirmed by the recent decision of the House in *BMBF v Mawson.* 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, perhaps the interpretation of utterances of any kind."[686]

Mayes v HMRC disproved the supposed "constitutional propriety" and "primacy of the construction of the particular taxing provision" and proved the constitutional propriety and primacy of rules of general application. Upholding the "SHIPS 2" scheme, Proudman J, with whom the Court of Appeal agreed, stated:

> "I sympathise with the instinctive reaction that such an obvious scheme ought not to succeed. However, I cannot extract from the legislation any underlying or overriding purpose enabling me to conclude that parts of the scheme may be ignored. To do so would ... revert to an acceptance of the type of submission that was roundly rejected in *MacNiven*. I am bound by the ratio of the decision in *MacNiven* and in my judgment it points only one way on the facts of this case."[687]

The rest of this chapter expounds the development of the *Ramsay* principle in *Ramsay*, the arrested development of the principle in *Craven* and *McGuckian*, and the retreat from the principle in *MacNiven*, *BMBF*, *Mayes* and the GAAR.

10.2. THE DEVELOPMENT OF THE *RAMSAY* PRINCIPLE

10.2.1. Lord Wilberforce's Judgment

10.2.1.1 *Application of the Pre-Existing Common Law of Cheating*

685 (2001) 117 LQR 575.
686 'Tax avoidance' [2005] *B.T.R.* 197, 202.
687 [2010] STC 1 at [45].

In *Plummer* Lord Wilberforce effectively reaffirmed the *Duke of Richmond* principle ("If this case has disclosed a way by which settled property may largely escape the estate duty, that is an affair for the Legislature to consider, in which Courts of law have no concern"[688]) by upholding Rossminster's Capital Income Plan and concluding:

> "One final point: the familiar argument was used that Parliament can never have intended to exempt from the taxing provisions an arrangement solely designed to obtain fiscal advantages. But this is not the question, nor is a canon of interpretation of this kind an admissible, or indeed a workable canon. The question is whether a certain series of transactions in a certain legal form do or do not fall within the taxing words. If they do not, and if Parliament dislikes the consequence, it can change the law".[689]

In *Ramsay* eighteen months later, however, he rejected the *Duke of Richmond* principle and accepted the exact argument he rejected in *Plummer* by effectively affirming the mischief rule ("the office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and *pro privato commodo*, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bono public*") while disallowing the similar Rossminster's Capital Loss Scheme thus:

> "Before I come to examination of the particular schemes in these cases, there is one argument of a general character which needs serious consideration. For the taxpayers it was said that to accept the Crown's wide contention involved a rejection of accepted and established canons, and that, if so general an attack upon schemes for tax avoidance as the Crown suggest is to be validated, that is a matter for Parliament. The function of the courts is to apply strictly and correctly the legislation which Parliament has enacted: if the taxpayer escapes the charge, it is for Parliament, if it disapproves of the result, to close the gap. General principles against tax avoidance are, it was claimed, for Parliament to lay down. ... I have full respect for the principles which have been stated but I do not consider that they should exclude the approach for which the Crown contends. That does not introduce a new principle: it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation. While the techniques of tax avoidance progress are technically improved, the courts are not obliged to stand still. Such immobility must result either in loss of tax, to the prejudice of other taxpayers, or to Parliamentary congestion or (most likely) to both**.** To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process. In each case the facts must be established, and a legal analysis made: legislation cannot be required or even be desirable

[688] *Richmond*, p.470.
[689] *Plummer*, p.801.

> to enable the courts to arrive at a conclusion which corresponds with the parties' own intentions.
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> The capital gains tax was created to operate in the real world, not that of make-belief. As I said in *Aberdeen Construction v CIR*[690], it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function.
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> We were referred, on this point, to a number of cases in the United States of America in which the courts have denied efficacy to schemes or transactions designed only to avoid tax and lacking otherwise in economic or commercial reality. ... It is probable that the U.S. courts do not draw the line precisely where we with our different system, allowing less legislative power to the courts than they claim to exercise, would draw it, but the decisions do at least confirm me in the belief that it would be an excess of judicial abstinence to withdraw from the field now before us."[691]

This reaffirms that the *Ramsay* principle and the American sham transaction doctrine are applications of the pre-existing law of cheating or fraud, which is the antidote to tax avoidance ("loss of tax, to the prejudice of other taxpayers") and tax complexity ("Parliamentary congestion"). Lord Wilberforce's substitution of 'fiscal nullity' and other legal nonsenses for fraud and cheating fortifies this proposition:

> "The first of these appeals is an appeal by W. T. Ramsay Ltd., a farming company. In its accounting period ending 31 May 1973 it made a 'chargeable gain' for purposes of corporation tax by a sale-leaseback transaction. This gain it desired to counteract, so as to avoid the tax, by establishing an allowable loss. The method chosen was to purchase from a company specialising in such matters a ready-made scheme. The general nature of this was to create out of a neutral situation two assets one of which would decrease in value for the benefit of the other. The decreasing asset would be sold, so as to create the desired loss; the increasing asset would be sold, yielding a gain which it was hoped would be exempt from tax.
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> In the courts below, attention was concentrated upon the question whether the gain just referred to was in truth exempt from tax or not. The Court of Appeal, reversing the decision of Goulding J., decided that it was not. In this House, the Crown, while supporting this decision of the Court of Appeal, mounted a fundamental attack upon the whole of the scheme acquired and used by the appellant. It contended that it should simply be disregarded as artificial and fiscally ineffective.

[690] [1978] AC 885.
[691] *Ramsay*, pp.186-188. Emphases supplied.

Immediately after this appeal there was heard another taxpayer's appeal - *Eilbeck v Rawling*. This involved a scheme of a different character altogether, but one also designed to create a loss allowable for purposes of capital gains tax, together with a non-taxable gain, by a scheme acquired for this purpose. Similarly, this case was decided, against the taxpayer, in the Court of Appeal upon consideration of a particular aspect of the scheme: and similarly, the Crown in this House advanced a fundamental argument against the scheme as a whole. ...

I will first state the general features of the schemes which are relevant to the wider argument. In each case we have a taxpayer who has realised an ascertained and quantified gain: in *Ramsay* £187,977, in *Rawling* £355,094. He is then advised to consult specialists willing to provide, for a fee, a preconceived and ready-made plan designed to produce an equivalent allowable loss. The taxpayer merely has to state the figure involved i.e. the amount of the gain he desires to counteract, and the necessary particulars are inserted into the scheme.

The scheme consists, as do others which have come to the notice of the courts, of a number of steps to be carried out, documents to be executed, payments to be made, according to a timetable, in each case rapid (see the attractive description by Buckley L.J. in *Rawling*). In each case two assets appear, like particles in a gas chamber with opposite charges, one of which is used to create the loss, the other of which gives rise to an equivalent gain which prevents the taxpayer from supporting any real loss, and which gain is intended not to be taxable. Like the particles, these assets have a very short life. Having served their purpose they cancel each other out and disappear. At the end of the series of operations, the taxpayer's financial position is precisely as it was at the beginning, except that he has paid a fee, and certain expenses, to the promoter of the scheme.

There are other significant features which are normally found in schemes of this character. First, it is the clear and stated intention that once started each scheme shall proceed through the various steps to the end - they are not intended to be arrested half-way. This intention may be expressed either as a firm contractual obligation (it was so in *Rawling*) or as in *Ramsay* as an expectation without contractual force. Secondly, although sums of money, sometimes considerable, are supposed to be involved in individual transactions, the taxpayer does not have to put his hand in his pocket. The money is provided by means of a loan from a finance house which is firmly secured by a charge on any asset the taxpayer may appear to have, and which is automatically repaid at the end of the operation. In some cases one may doubt whether, in any real sense, any money existed at all. It seems very doubtful whether any real money was involved in *Rawling*: but facts as to this matter are for the Commissioners to find. I will assume that in some sense money did pass as expressed in respect of each transaction in each of the instant cases. Finally, in each of the present cases it is candidly, if inevitably, admitted that the whole and only purpose of each scheme was the avoidance of tax.

In these circumstances, your Lordships are invited to take, with regard to schemes of the character I have described, what may appear to be a new

> approach. We are asked, in fact, to treat them as fiscally, a nullity, not producing either a gain or a loss."[692]

This shows that even where fraud is pleaded and proved, the relevant schemes can still be described conveniently as 'legal' and the tax dogma can still remain intact if the court does not use the legal concepts of fraud, cheating and dishonesty. To adopt the words of Venables:

> "I am particularly concerned with the problems which arise when the courts are less than candid in explaining what they are doing and why they are doing it and, to cover their tracks, resort to legal fictions which are apt to confuse all but the inner initiates."[693]

10.2.1.2. *Unnecessary Reference to the Statutes*

The corollary of the principle that "fraud unravels all", is that "to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law" is to determine whether they are fraudulent or honest; and if they are fraudulent they are unravelled and it cannot be required or even be desirable "to relate them to existing legislation."

Lord Wilberforce's references to the legislation ("to relate them to existing legislation" and "... not such a loss (or gain) as the legislation is dealing with") were in response to Millett's formulation:

> "It cannot have been in Parliament's contemplation that such disposals as are in question here were to give rise to allowable losses."[694]

10.2.2. Lord Fraser's Judgment

As demonstrated in chapter eight, Lord Fraser also followed a similar process of reasoning by dealing with classic statutory construction and "the wider question" separately.[695]

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[692] *Ramsay*, pp.183-184. Emphases supplied.
[693] Venables (1997) pp.25-26.
[694] *Ramsay*, pp.175-176.
[695] *Ramsay*, pp.197-198.

If the answer to "the wider question" was that there was no "disposal in either of these cases"[696] then there was cheating in law. Like Lord Wilberforce, however, Lord Fraser responded to Millett's contention by referring to the statutes in his conclusion:

> "Accordingly I would refuse both appeals on the additional ground that the relevant asset in each case was not disposed of in the sense required by the statutes."[697]

10.3. THE ARRESTED DEVELOPMENT OF THE *RAMSAY* PRINCIPLE

10.3.1. Lord Goff's Misinterpretation of *Ramsay*

In *Craven v White*, Lord Goff relied on the unnecessary references by Lord Wilberforce and Lord Fraser to the legislation to deny that the *Ramsay* principle involved the application of the pre-existing common law of cheating which embodies the legal and moral duty of honesty, stating:

> "These appeals raise in an acute form the question of the true scope of what has come to be known as the *Ramsay* principle.
>
> It would be naive in the extreme to imagine that that principle is not concerned with the outlawing of unacceptable tax avoidance. It plainly is. But it would be equally mistaken to regard the principle as in any sense a moral principle, or having any foundation in morality. It plainly is not. ...
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> Any idea that the principle in *Ramsay* is a moral principle, or that it is designed to catch any step taken to avoid tax, is, in my opinion, destroyed by the recognition of the *Ramsay* principle as a principle of statutory construction. Indeed the principle cannot be independent of the statute, for the obvious reason that your Lordships have no power to amend the statute. That it is essentially a principle arising from the construction of the statute appears from a number of passages in the speeches in the cases. For example, in *Ramsay* itself Lord Wilberforce stated that it was within the judicial function to conclude that there was not such a loss (or gain) as the legislature was dealing with; see also an earlier passage in his speech in that case. In the same case, Lord Fraser stated that he was prepared to dismiss the appeals on the ground that the relevant asset was not disposed of in the sense required by the statute. ... But that being so, it follows that tax avoidance schemes are only unacceptable for present purposes if, on a true construction of the statute, they are held to be so."[698]

[696] P.196.
[697] P.199.
[698] *Craven*, pp.510-511. Emphasis supplied.

To say that a tax avoidance scheme, which amounts to cheating and fraud by design under the common law, is unravelled *in toto* and thus outside the scope of the terms of the statute it was devised to cheat and defraud *ab initio* is not "to amend the statute". It is to preserve the integrity of the statute and uphold Parliamentary sovereignty and the rule of law.

10.3.2. Lord Steyn's Judgment in *McGuckian*

In *McGuckian*, however, Lord Steyn cited Lord Goff and the cases he misinterpreted and concluded:

> "The new *Ramsay* principle was not invented on a juristic basis independent of statute. That would have been indefensible since a court has no power to amend a tax statute. The principle was developed as a matter of statutory construction. That was made clear by Lord Wilberforce in the *Ramsay* case and is also made clear in subsequent decisions in this line of authority (see the review in the dissenting speech of Lord Goff in *Craven*)."[699]

By maintaining that "[t]he new *Ramsay* principle was not invented on a juristic basis independent of statute", therefore, their lordships effectively reverted to the *Duke of Richmond* principle which Lord Wilberforce reasserted in *Plummer*.

10.4. THE RETREAT FROM THE *RAMSAY* PRINCIPLE

10.4.1. Lord Hoffmann's Judgment in *MacNiven*

In *MacNiven*, Lord Hoffmann relied on *McGuckian* to reject the Revenue's contention that falls within the ambit of the mischief rule and indeed the *Ramsay* principle:

> "Everyone agrees that *Ramsay* is a principle of construction. The House of Lords said so in *McGuckian*. But what is that principle? Mr McCall formulated it as follows in his printed case:
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> 'When a Court is asked
> (i) to apply a statutory provision on which a taxpayer relies for the sake of establishing some tax advantage
> (ii) in circumstances where the transaction which is said to give rise to the tax advantage is, or forms part of, some pre-ordained, circular, self-cancelling transaction

[699] *McGuckian*, p.916.

(iii) which transaction though accepted as perfectly genuine (i.e. not impeached as a sham) was undertaken for no commercial purpose other than the obtaining of the tax advantage in question

then (unless there is something in the statutory provisions concerned to indicate that this rule should not be applied) there is a rule of construction that the condition laid down in the statute for the obtaining of the tax advantage has not been satisfied.'

I am bound to say that this does not look to me like a principle of construction at all. There is ultimately only one principle of construction, namely to ascertain what Parliament meant by using the language of the statute. All other 'principles of construction' can be no more than guides which past judges have put forward, some more helpful or insightful than others, to assist in the task of interpretation. But Mr McCall's formulation looks like an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision, save for the possibility of rebuttal by language which can be brought within his final parenthesis. This cannot be called a principle of construction except in the sense of some paramount provision subject to which everything else must be read, like s 2(2) of the European Communities Act 1972. But the courts have no constitutional authority to impose such an overlay upon the tax legislation and, as I hope to demonstrate, they have not attempted to do so."[700]

Lord Hoffmann failed "to demonstrate" that "the courts have no constitutional authority to impose such an overlay upon the tax legislation and ... have not attempted to do so", not least because that was what the Barons of the Exchequer did in *Heydon's Case* when they developed the mischief rule and what the House of Lords did when they developed the Ramsay principle in *Ramsay*.

As demonstrated throughout, what Lord Hoffmann hailed as the "only one principle of construction" in 2001 was demolished by Lord Diplock in 1965 thus:

"Whenever the Court decides that kind of dispute it legislates about taxation. It makes a law taxing all gains of the same kind or all documents of the same kind. Do not let us deceive ourselves with the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant. Anyone who has decided tax appeals knows that most of them concern transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all. Some of the transactions are of a kind which had never taken place before the Act was passed: they were devised as a result of it. The Court may describe what it is doing in tax appeals as interpretation. So did the priestess of the Delphic oracle."[701]

[700] [2001] UKHL 6 [28]-[29]. Emphases supplied.
[701] Diplock, p.6.

Lord Hoffmann's exposition shows that to purport "to ascertain what Parliament meant by using the language of the statute" is "deceive ourselves with the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant":

> "[I]t has occasionally been said that the boundary of the *Ramsay* principle can be defined by asking whether the taxpayer's actions constituted (acceptable) tax mitigation or (unacceptable) tax avoidance. In *IRC v Willoughby* Lord Nolan described the concept of tax avoidance as 'elusive'. In that case, the House had to grapple with what it meant, or at any rate what its 'hallmark' was, because the statute expressly provided that certain provisions should not apply if the taxpayer could show that he had not acted with 'the purpose of avoiding liability to taxation'. The same question arises on the interpretation of the anti-avoidance provisions to which Lord Cooke referred in *IRC v McGuckian*. But when the statutory provisions do not contain words like 'avoidance' or 'mitigation', I do not think that it helps to introduce them. The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory language to the facts of the case. It is not a test for deciding whether it applies or not. If I may be allowed to repeat what I said in *Norglen v Reeds*[702]:
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> > 'If the question is whether a given transaction is such as to attract a statutory benefit, such as a grant or assistance like legal aid, or a statutory burden, such as income tax, I do not think that it promotes clarity of thought to use terms like stratagem or device. The question is simply whether upon its true construction, the statute applies to the transaction. Tax avoidance schemes are perhaps the best example. They either work (*Duke of Westminster*) or they do not (*Furniss*.) If they do not work, the reason, as Lord Steyn pointed out in *McGuckian*, is simply that upon the true construction of the statute, the transaction which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes.'"[703]

Whatever its merits in other cases, "such as a grant or assistance like legal aid, or a statutory burden, such as income tax" where no scheme or "stratagem or device" is involved, "[t]he question ... whether upon its true construction, the statute applies to the transaction" is completely without merit in cases of tax avoidance schemes or "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it."

"The fact that steps taken for the avoidance of tax are acceptable or unacceptable" or more precisely amount to cheating or fraud as a matter of law is *not* "the conclusion at

[702] [1999] 2 AC 1, 13-14
[703] [2001] UKHL 6 [62]. Emphases supplied.

which one arrives by applying the statutory language to the facts of the case." The corollary of the principle that "fraud unravels all" is that it *is* "a test for deciding whether it applies or not." To say that a tax avoidance scheme that amounts to cheating or fraud under the general law is unravelled *in toto* and thus outside the scope of the terms of the statute it was devised to cheat or defraud *ab initio* does not mean "that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes". It simply affirms "the principle that the courts would not lend their assistance to the achievement of an unlawful purpose"[704] which was put to Lord Hoffmann in *Norglen*.

The cases Lord Hoffmann cited in support of the notion that "[t]ax avoidance schemes ... either work (*Duke of Westminster*) or they do not (*Furniss*)" underscores its reliance upon "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant." In *Westminster* the Special Commissioners, with whom Finlay J and Lord Atkin agreed, held that the scheme did not "work" but the Court of Appeal and the majority in the House of Lords held that it "worked". In *Furniss* the Special Commissioners, Vinelott J and the Court of Appeal held that the scheme "worked" but the House of Lords held unanimously that it did not "work". In the words of Lord Diplock:

> "The Court may describe what it is doing in tax appeals as interpretation. So did the priestess of the Delphic oracle."[705]

10.4.2. *BMBF v Mawson*

The joint opinion of the House of Lords in *BMBF* endorsing the "new approach" was delivered by Lord Nicholls thus:

> "The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found. As Lord Nicholls said in *MacNiven*:

[704] *Norglen*, p.13.
[705] Diplock.

> ‘The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case.’[706]”[707]

Again, the “interpretation of the particular statutory provision and its application to the facts of the case” cannot work in the context of “transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it”.

10.4.3. *HMRC v Mayes*

As explained above, *Mayes* proved this. The Court of Appeal, which was also bound by *MacNiven* and *BMBF*, agreed with Proudman J and refused to grant the Revenue permission to appeal.

Toulson LJ similarly expressed his “reluctant concurrence in a result which instinctively seems wrong, because it bears no relation to commercial reality and results in a windfall which Parliament cannot have foreseen or intended.”[708] In a clear abdication of the mischief rule (*“the office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and pro privato commodo, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, pro bono public”*[709]), he concluded:

> “Unattractive as the result is for other taxpayers and the rest of society, I agree with Proudman J. and Mummery L.J. that the Court cannot lawfully hold, as a matter of proper construction of the statute, that because the sole purpose of steps 3 and 4 was to avoid tax by the creation of a corresponding deficiency unrelated to any underlying commercial loss, those events are therefore to be treated as if they had not occurred.”[710]

Thomas LJ similarly embraced the *Duke of Richmond* principle (“*If this case has disclosed a way by which settled property may largely escape the estate duty, that is an affair for the Legislature to consider, in which Courts of law have no concern*”[711]) in his equally one-paragraph judgment:

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[706] *MacNive*n [8].
[707] [2004] UKHL 51 [32].
[708] Ibid, p.316.
[709] *Richmond*, p.470.
[710] *Heydon*, p.8a.
[711] *Richmond*, p.470.

> ‘I agree with the judgment of Mummery LJ which sets out with great clarity why the appeal and cross appeal have to be dismissed. However, for the reasons given by Toulson LJ, my concurrence is reluctant. The higher-rate taxpayers with large earnings or significant investment income who have taken advantage of the scheme have received benefits that cannot possibly have been intended and which must be paid for by other taxpayers. It must be for Parliament to consider the wider implications of the decision as it relates to the way in which revenue legislation is structured and drafted.’[712]

10.5. THE GAAR

In the wake of public and Parliamentary disquiet over tax avoidance and the tax avoidance industry, the Government commissioned Aaronson in 2010 “to lead a study programme to establish whether a General Anti Avoidance Rule (GAAR) could be framed that would be effective in the UK tax system and, if so, how the provisions of the GAAR might be framed.”[713]

Aaronson cited the failure of the “new approach” in *Mayes* as the reason for the introduction of a GAAR in the UK:

> “There is no doubt that the combination of purposive interpretation, specific anti-avoidance rules and DOTAS substantially reduces the scope for tax avoidance. Accordingly, the UK context is very different from that which applied in other common law jurisdictions, such as Australia and Canada, when GAARs were first introduced there. ...
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> Regrettably, however, it is clear that purposive interpretation, specific anti-avoidance rules and DOTAS are not capable of dealing with some of the most egregious tax avoidance schemes. Such schemes focus on prescriptive tax rules which are not susceptible to contextual interpretation. A recent example is the ‘SHIPS 2’ scheme, which gave UK taxpayers a seven step route to creating an artificial tax loss which could be used to set off against their other tax liabilities. In the High Court Proudman J sympathised ‘with the instinctive reaction that such an obvious scheme ought not to succeed’. However given the prescriptive nature of the statutory rules in question she was unable to find a purposive interpretation sufficient to defeat it. ...
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> I agree with Thomas LJ that it would be appropriate for Parliament to consider the implications of that decision. SHIPS 2 shows the inadequacy of the existing means of combating highly artificial tax avoidance schemes. It, and other schemes like it, provide the answer to the question ‘does the UK need a GAAR?’. The answer is that it does.”[714]

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[712] *Mayes*, p.315.
[713] HMRC (2010) p.2.
[714] Aaronson, pp.19-20.

Aaronson misrepresented the reason Proudman J stated for her inability to find a purposive interpretation sufficient to defeat the scheme:

> "I am bound by the ratio of the decision in *MacNiven* and in my judgment it points only one way on the facts of this case."

The GAAR Study Group, which included Lord Hoffmann, therefore, failed to tackle "the ratio of the decision in *MacNiven*". Consequently, as demonstrated in chapter two, the resultant GAAR in Part 5 of Finance Act 2013 falls short of both the pre-existing common law of cheating and the *Ramsay* principle.

In 2005 Freedman, who was also a member of the Study Group, compared the application of the "broad spectrum general anti avoidance rule" in section 245 of Canada's Income Tax Act[715] (which was introduced in 1987 in response to the rejection of the business purpose test by the Supreme Court in *Stubart*) by the Supreme Court in *Canada Trustco*[716] and *Mathew*[717] to the application of the *Ramsay* principle by the House of Lords in *BMBF* and *Scottish Provident*[718] and concluded:

> "What is curious is that, despite the existence of a statutory general anti-avoidance rule (GAAR) in Canada, the most recent judgments of the Supreme Court are, arguably, rather more conservative than the latest tax-avoidance decisions of the House of Lords in the United Kingdom, where there is no GAAR. One might have expected that the GAAR would give a legislative signal to judges to be bold, but it seems to have had the opposite effect of making them all the more careful to protect the taxpayer. In the United Kingdom, certainly, some will see this as a vindication of the policy of relying upon judicial creativity."[719]

10.6. CONCLUSION

This chapter demonstrated that the *Ramsay* principle provides a modern authoritative judicial support for the proposed pre-existing common law of cheating or fraud approach to tax avoidance. In the words of Lord Scarman in *Furniss*:

> "The limits within which this principle is to operate remain to be probed and determined judicially. Difficult though the task may be for judges, it is one which is beyond the power of the blunt instrument of legislation. Whatever a statute may provide, it has to be interpreted and applied by the courts:

[715] RSC 1985, c. 1 (5th Supp.), as amended.
[716] 2005 SCC 54.
[717] 2005 SCC 55.
[718] [2004] UKHL 52.
[719] Freedman (2005) p.1039.

and ultimately it will prove to be in this area of judge-made law that our elusive journey's end will be found."[720]

[720] *Craven*, p.156.

CHAPTER ELEVEN

THE HISTORY OF TAX EVASION, TAX AVOIDANCE AND TAX MITIGATION

> **The terms 'tax avoidance' and 'tax evasion' have been created by the legal and accountancy professions as convenient generic terms to distinguish what is legal from what is illegal, and the fact that they have also been adopted by the courts should not blind us to what they actually are.**
> Rhodes et al, Regina v Charlton, Cunningham, Kitchen and Wheeler' (1999) *JMLC*, 197, 203.

11.1. INTRODUCTION

This chapter expounds the origins and developments of the concepts of tax evasion, tax avoidance and tax mitigation.

It uses the landmark cases analysed in chapters nine and ten to prove the proposition advanced in the Introduction that "the terms 'tax avoidance' and 'tax evasion' have been created by the legal and accountancy professions as convenient generic terms" or legal nonsenses to disguise the fraudulent nature of "the judge induced disease of 'tax avoidance'"[721] and the resultant tax avoidance industry.

It demonstrates that the dogma that "tax evasion is illegal but tax avoidance is legal" (or that "the terms 'tax avoidance' and 'tax evasion' … distinguish what is legal from what is illegal") originated in the metamorphoses of cheating the public revenue by the use of a tax scheme (or *two or more interrelated transactions of a kind which had never taken place before the tax Act it was devised to cheat or defraud was passed devised as a result of it*), which corresponds to cheating "by means of *some artful device*, contrary to the plain rules of common honesty"[722], cheating by fraudulent misrepresentation and fraud by false representation under section 2 of the Fraud Act (as opposed to cheating "accompanied with no manner of artful contrivance, but wholly depends on ***a bare naked lie"***[723], cheating by fraudulent concealment and fraud by failing to disclose information under section 3 of the Fraud Act) from tax evasion to tax avoidance by the division of tax avoidance into unacceptable tax avoidance and acceptable tax avoidance or tax mitigation. It also shows how the dogma is sustained by the invention of new legal nonsenses, such as 'aggressive tax planning', 'abuse'

[721] Avery Jones.
[722] Hawkins.
[723] Hawkins.

and ‘Base Erosion and Profits Shifting (BEPS)’, which similarly serve to legitimise “the judge induced disease of ‘tax avoidance’” and the resultant tax avoidance industry.

11.2. TAX EVASION

11.2.1. Statutes

As demonstrated in chapter one, a fraud on an Act (or *transactions of a kind which had never taken place before the Act it was devised to cheat or defraud was passed devised as a result of it*) was described as ‘evasion’ in the statutes against fraud. According to Bennion:

> “Sometimes Parliament inserts special provisions in an Act for the purpose of countering evasion of its requirements. ... The presence or absence of such provisions does not affect the general duty of the courts to counter evasion.”[724]

A statute against fraud enacted by Edward III in 1366 shows that HMRC’s supposed distinction between ‘evasion’, ‘avoidance’ and ‘legal interpretation’ is a distinction with no difference:

> “And every man ... shall keep and observe the aforesaid ordinances and statutes ... without addition, or fraud, by covin, evasion, art or contrivance, ‘ou par interpretation des paroles’ (or by interpretation of the words).”[725]

11.2.2. Case Law

As “[t]he presence or absence of such provisions does not affect the general duty of the courts to counter evasion”, the courts similarly used ‘evasion’ to describe a fraud on an Act. According to Bennion:

> “The courts have frequently held that a construction is to be preferred that prevents evasion of the intention evinced by Parliament to provide an effective remedy for the mischief against which the enactment is directed. When deliberately embarked on, such evasion is judicially described as a fraud on the Act.”[726]

[724] *Bennion*, p.1014.
[725] 10 Edw. III, stat 3 (1366). Emphases supplied.
[726] *Bennion*, p.1010.

In *Heydon's Case*, therefore, the Barons of the Exchequer voided the scheme that comprised two copyhold estates on the grounds that "doubling of estates implies in itself deceit, and private respect, to prevent the intention of the Parliament"[727], and held that:

> "[F]or the sure and true interpretation of all statutes ... the office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and *pro privato commodo*, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bono public*."[728]

Lord Mansfield's effective application of the pre-existing common law of cheating and the primacy of the public revenue law in *Magistrates and Town Council of the City of Glasgow v Messrs Murdoch, Warren & Co*[729] involved an appeal from the Court of Session in Edinburgh heard in the House of Lords in 1783. According to Ferrier:

> "For many years the City of Glasgow had enjoyed the right to levy a duty of two pence Scots ... on 'every pint of ale or beer brewed, inbrought, vended, tapped or sold within the said city and suburbs.' The city experienced a problem in collecting the duty, particularly in the case of breweries located outside its boundaries. There was difficulty in tracing the movement of beer into Glasgow. Accordingly, when an Act [28 Geo. II, c. 29] was passed renewing the duty, the opportunity was taken to insert an anti-avoidance provision, making it unlawful after May 1, 1755 for 'any brewer or seller of beer or ale' outside Glasgow 'to import or sell any beer ... into or in the said city ... unless he or she do previously give notice to the magistrates.'
>
> The respondents owned a brewery at Anderston, just outside Glasgow. For some time they did not dispute their liability to the duty. Then they opened up an export trade to Ireland and the West Indies. They asked for an exemption in respect of these sales and the magistrates agreed to allow them a draw-back on the duty. They then asked for exemption for sales made outside the city. When this was refused, they gave notice that they would not sell any more to Glasgow. They made a contract with a Mr Munro in which he agreed to purchase all the beer previously supplied to the city and then advertised that they have discontinued furnishing ales to customers in Glasgow, but indicated that they would be dealt with on the premises. The customers came out to Anderston and were supplied by Munro. It may be assumed that Munro proved a somewhat elusive person. Nothing daunted, the magistrates brought the matter to court by suing the brewery in the Court of Session for the payment of the duties. They alleged that the contract with Munro was a mere device to evade the Act, the object of it being to get free of the charge of duty as brewers. The defence was

[727] *Heydon*, p.8a.
[728] Ibid, p.7b. Emphasis supplied.
[729] (1783) 2 Paton 615; *House of Lords Journal*, May 9.

> that 'since July 1, 1780, they had not imported into, or sold ale in the city, and therefore were not liable.'"[730]

The essence of the appellants' contention was that the object of the scheme was to cheat the public revenue and that the principle that "fraud unravels all" applied:

> "[T]he only reason and motive of the agreement with Munro was to escape the duty, and to deprive the revenue of the city of the impost which they were entitled to exact from them as brewers, within the intent and meaning of the Act. Such being the obvious character of the transaction, law will not lend its sanction to support such a device."[731]

Lord Mansfield agreed that the scheme was a fraud upon a tax Act or a cheat or fraud in tax law, stating:

> "The agreement with Munro was a device to elude the meaning of the statute 28 Geo II; and therefore I move your Lordships to reverse the judgment below."[732]

As in *Heydon's Case*, there was no question of the agreement being a fraud or a sham "as between subject and subject" in private law. The basis of the decision must, therefore, be the pre-existing common law of cheating "as concerns the Revenue and the public" rather than "the Act of the 28 Geo II". According to their lordships:

> "It is declared, that the respondents selling beer and ale to Munro upon the express condition of his selling the whole in the town of Glasgow, and making discounts and allowances to him accordingly, is a manifest evasion of the Act of the 28 Geo II and ought to be considered as a selling within the town of Glasgow by the respondents themselves."[733]

Cases of Appellants relating to the Duties on Houses, Windows, or Lights, with the Opinion of the Judge thereon reported this 1757 case of evasion that exemplifies cheating "by means of *some artful device*, contrary to the plain rules of common honesty":

> "The Appellant is by the Assessors of the Parish charged Two Shillings for his House; by the Surveyor he is charged with ten Windows; he saith he hath but nine windows, having fixed between two of the Windows a Piece

[730] 'The Meaning of the Statute: Mansfield on Tax Avoidance' [1981] *B.T.R.*, 303-304. Emphasis supplied.
[731] 2 Paton 615.
[732] Ibid.
[733] House of Lords Journal. Emphasis supplied.

> of Glass about four inches in Breadth, and eleven inches in Length. We are of Opinion, That this is a manifest Evasion of the Act."[734]

The rate of the tax on windows in houses that applied in England and Wales from 1696 to 1851 increased sharply from two shillings for less than ten windows to six shillings for ten to twenty windows.[735] By this "artful device" and "contrary to the plain rules of common honesty", therefore, the taxpayer with ten windows cheated the public revenue by obtaining the same tax advantage obtained by a taxpayer that blocked one window in order to reduce his tax from six to two shillings, but without actually suffering the loss of light and other basic amenities suffered by that taxpayer.

11.3. TAX AVOIDANCE

11.3.1. Rejection of 'Evasion'

By the late nineteenth century, the appeal judges started rejecting the concept of 'evasion' to "enable the extremely wealthy to avoid the undisputed rigors of the English tax system."[736]

In the 1898 case of *Attorney-General v Beech*, where the Court of Appeal approved a complex scheme devised to evade estate duty, Chitty LJ deployed this disingenuous analogy:

> "Much was said upon opening the door to evasion. Would these be cases of evasion? Certainly not. Indeed, the whole argument on evasion of the Act is fallacious. The case either falls within the Act or it does not. If it does not, there is no such thing as an evasion. If a tax is imposed on using a crest or coat-of-arms and a man who has previously used them ceases to use them in order to be free from the tax, there is no evasion of the Act in any sense of the term legitimately used."[737]

"If a tax is imposed on using a crest or coat-of-arms and a man who has previously used them ceases to use them in order to be free from the tax" no scheme is required. *Beech*, however, turned on a scheme or *two or more interrelated transactions of a kind*

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[734] Adams, 'The Early History of Surveyors of Taxes', *The Quarterly Report of the Association of Her Majesty's Inspector of Taxes*, July 1956, p.297.
[735] Dowell, *A History of Taxation and Taxes in England from the Earliest times to the year 1885* (London: Longmans, 1888) Volume 3, p.168.
[736] Stevens, p.176.
[737] [1898] 2 Q.B. 147, 157.

which had never taken place before the tax Act it was devised to cheat or defraud was passed devised as a result of it. As Smith L.J. put it:

> "By deed bearing date December 21, 1886, Eliza Beech, who had a life interest in certain trust funds, over which she had a power of appointment, appointed the funds, subject to her life interest therein, to the remainderman, her son Howard Beech. In the year 1894 Eliza Beech was desirous of surrendering her life interest in the trust funds for the benefit of her son Howard Beech, and by deed bearing date December 18, 1894, she surrendered her life interest in these funds 'to the end and intent that such life interest might merge in the interest in remainder of her son Howard Beech'. ... Upon the surrender of this life interest to Howard Beech he became absolute owner of these funds. Eliza Beech died upon August 27, 1896. These are the facts."[738]

In the 1889 case of *CIR v Angus*, where the Court of Appeal upheld a scheme devised to evade stamp duty by rejecting the concept of 'evasion', Lord Esher effectively repudiated the mischief rule ("the office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and *pro privato commodo*, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bono public*") thus:

> "If a vendor can convey the property sold to the purchaser without the execution of any instrument, he can convey it without paying any stamp duty under s. 70. The subject may have the good fortune to escape the stamp duty, if he can get a conveyance of property sold to him without the execution of any instrument. But it is said that if the appeal be decided against the Commissioners purchasers will rest satisfied with an agreement of which specific performance would be decreed, and will not go on to execute a conveyance, and so the Crown will lose the stamp duty, and it is rather suggested that this would be cheating the Crown and committing a fraud. The Crown, however, must make out its right to the duty, and if there be a means of evading the stamp duty, so much the better for those who can evade it. It is no fraud upon the Crown, it is a thing which they are perfectly entitled to do."[739]

11.3.2. Invention of the Evasion-Avoidance Dichotomy

The cases that established the dogma that "tax evasion is illegal but tax avoidance is legal" involved statutes that referred to 'evade', which forced the courts to distinguish,

[738] Ibid, p.149-150.
[739] (1889) 23 Q.B.D. 579, 589-593.

rather than dismiss 'evasion', in order to "enable the extremely wealthy to avoid the undisputed rigors of the English tax system."

Lindley LJ's statement in *Yorkshire Railway Wagon v Maclure*, which involved a fraud on the Railway Regulation Act 1844, shows that the wider distinction between 'evading an Act' and 'avoiding an Act', which was adopted in tax cases, rested upon the primacy of the private law:

> "It is said to be an evasion of the Act of Parliament really to borrow the money. There is always an ambiguity about the expression 'evading an Act of Parliament.' In one sense you cannot evade an Act of Parliament; that is to say, the Court is bound so to construe every Act of Parliament as to take care that that which is really prohibited may be held void. On the other hand, you may avoid doing that which is prohibited by the Act of Parliament and you may do something else equally advantageous to you which is not prohibited by the Act of Parliament. It appears to me that the transaction falls under the last of these two classes, it is a transaction as useful for the Railway Company as the other, but it is a real transaction, and is not struck at by the Act of Parliament at all."[740]

The two decisions of the House of Lords (sitting as the Privy Council) that established the supposed distinction between 'unacceptable tax evasion' and 'acceptable tax avoidance' - *Simms v Registrar of Probates*[741] and *Bullivant and Others v Attorney-General for Victoria*[742] - similarly turned on the fact that the relevant transactions, which were devised to cheat the public revenue "as that concerns the Crown and the public" in tax law, were real and not shams or frauds or colourable "as between subject and subject" in private law. As Lord Hobhouse put it in *Simms*:

> "The whole question is whether the transaction was colourable or real."[743]

The question before the Supreme Court of South Australia in *Simms* was whether a deed was executed by the deceased "with intent to evade payment of duty" under section 27 of the South Australian Succession Duties Act, 1893. A majority (Bundey J and Boucaut J) held that it was. Way C.J., who disagreed, effectively confirmed that 'evade' referred to cheating "by means of *some artful device*, contrary to the plain rules of common honesty" despite his focus on legality in private law:

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[740] (1882) 21 Ch D 309, 318. Emphases supplied.
[741] [1900] A.C. 323.
[742] [1901] A.C. 196.
[743] *Simms*, p.324.

> "I am thus driven to the conclusion that the word 'evade' in s. 27 means to avoid by some direct means, by some device or stratagem. Without attempting, what is probably impracticable, to give an exhaustive definition of the phrase 'with intent to evade the payment of duty hereunder,' I am of opinion that the phrase would cover some arrangement, trust or other device, whether concealed, or apparent on the face of the non-testamentary disposition by which what is really a part of the estate of the deceased is made to appear to belong to somebody else in order to escape payment of duty."[744]

The House of Lords agreed with Way C.J. Citing *Yorkshire Railway*, Lord Hobhouse used the specious evasion-avoidance dichotomy applied in that case to relieve what he considered to be "great harshness":

> "Bundey J. lays it down in this case that to impose succession duty the Court must find fraud; and Boucaut J. says that s. 27 says substantially that an attempt to evade duty is a fraud. ...
>
> It does not appear to their Lordships that an examination of the decisions in which the word 'evade' has been the subject of comment leads to any tangible result. Everybody agrees that the word is capable of being used in two senses: one which suggests underhand dealing, and another which means nothing more than the intentional avoidance of something disagreeable. Beyond this, nothing is to be found having much bearing on the construction of the word, which depends entirely upon its use in the Colonial Acts. ...
>
> But where there are two meanings each adequately satisfying the language, and great harshness is produced by one of them, that has legitimate influence in inclining the mind to the other."[745]

In *Bullivant*, where the House of Lords reversed the decision of the Court of Appeal that the fraud exception to legal professional privilege applied to compel the disclosure of legal advice because the relevant transactions were executed "with intent to evade the payment of duty" under section 115 of the Administration and Probate Act, Lord Halsbury stated:

> "If, for the purpose of evading the payment of duty to which the man was liable, he entered into some secret and covinous arrangement whereby, although he should still retain the property during his lifetime, nevertheless colourable deeds should be executed which would shew that the property was not liable to duty, that would undoubtedly be a fraud, and I should think there would be no doubt that a person who was engaged in such a transaction could be compelled either to produce the correspondence or to state the conversation shewing how that alleged fraud was intended to be carried out. But there is no such allegation. ...

[744] Ibid, p.331. Emphasis supplied.
[745] Ibid, pp.329-335. Emphases supplied.

> [I]n the parallel, but not exactly similar, case in the Privy Council where the word 'evade' was used, the Privy Council held (I myself was a party to that judgment) ... that it was no fraud for a man to make a voluntary conveyance of his estates, not having say secret trust, and not having any arrangement whereby the deed could say one thing and the voluntary arrangement mean another; that the fact that he did intend to make a gift during his lifetime was no offence and no breach of the Act of Parliament, and nothing that could be considered tainted with the character of fraud: *Simms*."[746]

In other words, by failing to distinguish cheating "as concerns the Crown and the public" in tax law from cheating "as between subject and subject" in private law, the courts substituted "unacceptable evasion of a Tax Act" for cheating by fraudulent concealment or "accompanied with no manner of artful contrivance, but wholly depends on *a bare naked lie*" and "acceptable avoidance of a Tax Act" for cheating by fraudulent misrepresentation or "deceitful practices, in defrauding or endeavouring to defraud another of his known right by means of *some artful device*".

11.3.3. Basis of the Tax Avoidance Industry

In *Simms*, counsel for the taxpayer and the courts based the supposed distinction between unacceptable tax evasion and acceptable tax avoidance upon the temporal question whether the tax liability had been incurred or not. Relying on the primacy of the private law, Counsel contended, and the Board agreed, that:

> "The deed ... was unimpeached. No evidence was given or producible to shew that it was not a bonâ fide operative deed according to its terms. There was no evidence or allegation that there was any secret or other engagement, trust, or arrangement not in accordance with or contradicting its terms. The registrar had not made out a primâ facie case or any case for relief under s. 27, sub-s. 2, of the Act. If W. K. Simms, the covenantor, had died within three months of executing the deed, duty would have been payable. As he lived for more than three months afterwards, it was not payable. If one of his motives for executing it was to avoid liability to duty, that was within his rights. He had a right to avoid liability, but not to incur liability and then evade discharging it. No duty was ever payable in respect of the deed in the events which had happened, and, therefore, there was no payment which could be or was evaded."[747]

In *Bullivant*, where the House of Lords used this distinction to reverse the decision of the Court of Appeal that the fraud exception to LPP applied, Lord Lindley stated:

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[746] *Bullivant*, pp.201-202.
[747] [1900] A.C. 323, 325.

> "[T]here are two ways of construing the word 'evade': one is, that a person may go to a solicitor and ask him how to keep out of an Act of Parliament - how to do something which does not bring him within the scope of it. That is evading in one sense, but there is nothing illegal in it. The other is, when he goes to his solicitor and says, 'Tell me how to escape from the consequences of the Act of Parliament, although I am brought within it.' That is an act of quite a different character. ...
>
> [I]t appears to me that the Court of Appeal have overlooked the fact that the word 'evade' has the double meaning to which I have referred. They seem to have assumed that what was done here must have been a conspiracy to do something forbidden by the Act and to avoid the consequences of illegal conduct."[748]

Gammie's historical overview analysed in the Introduction shows that tax avoidance as presently understood is clearly a conspiracy to do an act of precisely the same character as tax evasion of old.

In fact, the history of the tax avoidance industry boils down to the inevitable development of classic tax avoidance, which relied upon the notion that a taxpayer "*had a right to avoid liability, but not to incur liability and then evade discharging it*", into marketed tax avoidance which rests upon the revised proposition that any taxpayer that can afford the cost of a scheme *has a right to incur liability and then evade discharging it*. According to Lord Millett:

> "The classic form of tax avoidance consists in the deliberate fashioning of a transaction into which the taxpayer proposes to enter so that it does not attract the tax which it would do if it were entered into in the normal and straightforward manner. Thus, capital gains tax is chargeable only where there is a 'disposal.' If a vendor can transfer an asset to a purchaser and receive the purchase price, not by a single transaction, but as the result of a series of separate and independent transactions, none of which constitutes a 'disposal,' then according to the classic view no charge arises.
>
> In the early 1970s, however, a new form of tax avoidance appeared on the scene, prompted by the large profits which had been made in the property boom of 1972-73, and given added encouragement by the advent of a Labour government in February 1974. In these cases, it was too late to resort to traditional forms of avoidance. By the time the taxpayer consulted his advisers, the transaction had already been carried out: the gain had been made; the charge to tax had been incurred. It was too late to refashion the transaction and avoid the charge. All that could be done was to create an artificial loss which could be set off against the liability. ...
>
> Tax avoidance had become big business. Schemes were devised and commercially marketed by specialist companies whose principal or only activity consisted in the sale and operation of such schemes. In return the

[748] [1901] A.C. 196, 207.

> taxpayer paid a fee, usually calculated as a proportion of the tax he hoped to save, and payable at the outset. Schemes tended to be very complicated, and to require the participation of numerous parties and the circulation of substantial sums of money. In return for a fee, the scheme-vendor provided not only the scheme, but the necessary funds and the participation of other parties, usually his own associated companies. The taxpayer had merely to state the figure involved, i.e. the amount of the gain he desired to counteract. From that the fee was calculated, and all the necessary particulars were inserted in the scheme. The taxpayer paid the fee, and received in return a timetable and a bundle of documents. All he had to do was to sign the documents and take the various steps described in the timetable. This would enable him to claim to have entered into a bewildering series of complicated transactions; but these all cancelled each other out. ...
>
> In any jurisdiction less sophisticated than ours, such schemes would simply be laughed out of court. Transparently artificial, they are merely 'paper transactions,' intended to be self-cancelling. But according to the classic approach allegedly based on *Duke of Westminster*, each step in the scheme had to be examined separately. ... Until *Ramsay*, it was generally accepted that this was the correct approach".[749]

Indeed, the counter-argument by counsel for the taxpayer-company in *Ramsay* was the exact opposite of the successful arguments and dicta in *Simms* and *Bullivant* ("*He had a right to avoid liability, but not to incur liability and then evade discharging it"*):

> "In the courts below the present proceedings were decided on a narrow issue. But in their printed case before this House, there is an attempt by the Crown to change entirely the approach of the courts towards tax avoidance schemes. … <u>The short question is that the Appellant Company having realised a very substantial chargeable gain (that is capital gain) and being faced with paying corporation tax on that gain contemplated making an allowable loss in the same accounting period</u>. The allowable loss to be created was in the region of £170,000."[750]

11.3.4. Emasculation of the Tax Dogma

The development of the *Ramsay* principle against the background of the evasion-avoidance dichotomy meant that a scheme it caught amounted to unacceptable tax evasion.

[749] A New Approach to Tax Avoidance Schemes" (1982) 98 *L.Q.R.* 209, 210-214. Emphasis supplied.
[750] *Ramsay*, pp.168-169. Emphasis supplied.

Of the fifteen speeches that established the principle in *Ramsay*, *Burmah* and *Furniss*, however, only Lord Scarman's prescient statement of the primacy of the pre-existing common law of cheating in *Furniss* acknowledged this inconvenient truth:

> "I would allow the appeals for the reasons given by ... Lord Brightman. I add a few observations only because I am aware, and the legal profession (and others) must understand, that the law in this area is in an early stage of development. Speeches in your Lordships' House and judgments in the appellate courts of the United Kingdom are concerned more to chart a way forward between principles accepted and not to be rejected than to attempt anything so ambitious as to determine finally the limit beyond which the safe channel of acceptable tax avoidance shelves into the dangerous shallows of unacceptable tax evasion.
>
> The law will develop from case to case. Lord Wilberforce in *Ramsay* referred to 'the emerging principle' of the law. What has been established with certainty by the House in *Ramsay* is that the determination of what does, and what does not, constitute unacceptable tax evasion is a subject suited to development by judicial process. The best chart that we have for the way forward appears to me, with great respect to all engaged on the map-making process, to be the words of Lord Diplock, in *Burmah*, which Lord Brightman quotes in his speech. These words leave space in the law for the principle enunciated by Lord Tomlin in *Duke of Westminster* that every man is entitled if he can to order his affairs so as to diminish the burden of tax. The limits within which this principle is to operate remain to be probed and determined judicially. Difficult though the task may be for judges, it is one which is beyond the power of the blunt instrument of legislation. Whatever a statute may provide, it has to be interpreted and applied by the courts: and ultimately it will prove to be in this area of judge-made law that our elusive journey's end will be found."[751]

This judicial confirmation that tax avoidance schemes caught by the *Ramsay* principle constituted unlawful unacceptable tax evasion meant that "the legal profession (and others)" in the tax avoidance industry could no longer use the dogma that "tax avoidance is legal and tax evasion is illegal" to sell tax schemes and to legitimise their fraudulent enterprise.

11.3.5. Revival of the Tax Dogma

The retreat from the *Ramsay* principle, which started with the rejection of the Revenue's argument in *Craven*, therefore, involved the revival of the tax dogma by the unanimous rejection of Lord Scarman's clarification.

[751] *Furniss*, p.156.

In his majority speech, Lord Oliver relied on Lord Brightman's description of the scheme in *Furniss* as "honest" to reassert the tax dogma by rejecting "evasion" and the Revenue's argument:

> "[T]here appears to be introduced in the speech of Lord Scarman at least, a moral dimension by which the court is to identify what he described as 'unacceptable tax evasion'. On the face of it this might be taken to suggest that the long accepted distinction between tax avoidance and tax evasion is to be elided and that the fiscal effect of a transaction is no longer to be judged, as in *Ramsay* and *Burmah*, by the criterion of what the taxpayer has actually done, but by whether what he has done is 'acceptable'. It may be doubted whether this was indeed what Lord Scarman intended to suggest, but if it was, he was, I think, alone in expressing this view. Indeed Lord Brightman, who delivered the leading speech from which the ratio of the decision is to be deduced, expressly affirmed:
>
> > 'The scheme before your Lordships is a simple and honest scheme which merely seeks to defer payment of tax until the taxpayer has received into his hands the gain which he has made.'"[752]

As demonstrated in chapter two, the corollary of the proposition that a tax avoidance scheme is a cheat by design is that the apologist notion of an "honest" tax avoidance scheme is a contradiction in terms.

In his minority speech, however, Lord Goff also relied on Lord Brightman's description of the scheme in *Furniss* as "honest" to reassert the tax dogma by rejecting "evasion" and, crucially, by substituting "unacceptable avoidance" (which is supposedly different from both "unacceptable tax evasion" and "acceptable tax avoidance"):

> "These appeals raise in an acute form the question of the true scope of what has come to be known as the *Ramsay* principle.
>
> It would be naive in the extreme to imagine that that principle is not concerned with the outlawing of unacceptable tax avoidance. It plainly is. But it would be equally mistaken to regard the principle as in any sense a moral principle, or having any foundation in morality. It plainly is not. We can see this clearly from Lord Brightman's description of the scheme in *Furniss* as an honest scheme; and I would likewise so describe the schemes in the present three appeals. What the courts have established, however, is that certain tax avoidance schemes, although not shams in the sense of not being what they purport to be, are nevertheless unacceptable because they embrace transactions which are not 'real' disposals or do not generate 'real' losses (or gains) and so are held not to attract certain fiscal consequences which would normally be attached to disposals or losses (or gains) under the relevant statute. It is these unacceptable tax avoidance schemes which Lord Scarman described as 'tax evasion' - a label which is

[752] *Craven*, p.501-502. Emphasis supplied.

> perhaps better kept for those transactions which are traditionally so described because they are illegal."[753]

To paraphrase, "[w]hat the courts have established ... is that certain tax avoidance schemes, although not shams ["as between subject and subject"] in the sense of not being what they purport to be, are nevertheless unacceptable ["as concerns the Revenue and the public"] because they embrace transactions which are not 'real' disposals or do not generate 'real' losses (or gains) and so are held not to attract certain fiscal consequences which would normally be attached to disposals or losses (or gains) under the relevant statute [because they amount to cheating the public revenue]." "It is these unacceptable tax avoidance schemes which Lord Scarman described as 'tax evasion' – a label which is [now used to describe cheating "by means of *some artful device*, contrary to the plain rules of common honesty"] because they are illegal."

11.4. TAX MITIGATION

11.4.1. Reinvention of the Tax Dogma

The retreat from the *Ramsay* principle was completed, and the tax avoidance industry secured, by the substitution of the conveniently vague evasion-avoidance-mitigation trichotomy (which divides avoidance into "unacceptable avoidance" that is supposedly different from unacceptable evasion, and "acceptable avoidance" that is also called mitigation) for the evasion-avoidance dichotomy rendered inconvenient by the *Ramsay* principle. According to Bennion's restatement of the tax dogma in his cryptic summary of the developments explained above:

> "The large amounts of money at stake in the tax field have led to some confusion over nomenclature. Earlier it was clearly established that escaping a statutory obligation was termed 'evasion' when it constituted a breach of the obligation (and was therefore unlawful) and 'avoidance' when it meant that the obligation was never incurred because the case narrowly missed fitting the statute (and was therefore lawful). This is a convenient distinction, which still generally obtains. In the tax field however the term avoidance is now equivocal. This is because the huge sums at stake in a vast number of cases have led to the emergence of what is sometimes called the tax avoidance industry. Professional experts devise elaborate schemes designed to allow taxpayers to escape tax in cases where Parliament intended tax to be charged. When this happens on a large scale in relation to a particular charging enactment it may lead to counter measures in the form of an equally elaborate anti-avoidance provision

[753] Ibid, p.510. Emphasis supplied.

> inserted in a Finance Act. The experts then seek to devise ways around the provision, and so the chase goes on. In these circumstances, the term 'avoidance' has come to be used in two senses in the tax field. What may be called unacceptable tax avoidance, while not unlawful, is countered by the application of the *Ramsay* principle. The rest, that is 'acceptable' avoidance, is now sometimes called tax mitigation."[754]

As demonstrated throughout, the fallacy that "unacceptable tax avoidance [is] not unlawful" is required to legitimise tax avoidance and the tax avoidance industry.

11.4.2. Invention of the Evasion-Avoidance-Mitigation Trichotomy

Like the evasion-avoidance dichotomy, the evasion-avoidance-mitigation trichotomy was developed in *Challenge* by the Privy Council and in the context of an antipodean legislation. Entitled "Agreements purporting to alter incidence of tax to be void", the GAAR in section 99 of New Zealand's Income Tax of 1976 provided, so far as material:

> "(2) Every arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes if and to the extent that, directly or indirectly, its purpose or effect is tax avoidance.
>
> (3) Where an arrangement is void in accordance with subsection (2) of this section, the assessable income and the non-assessable income of any person affected by that arrangement shall be adjusted in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that person from or under that arrangement."

Subsection (2) shows that the legislation was concerned with cheating or fraud "as against the Commissioner for income tax purposes" in tax law as opposed to cheating or fraud or sham "as between subject and subject" in private law.

Subsection (3) confirms that the legislation is a statute against fraud which "acts upon the offence, by setting aside the fraudulent transaction."

Like his subsequent extra-judicial statement analysed in the Introduction, Lord Templeman's original statement in *Challenge*, which was a firm and authoritative rejection of the perverse 'certainty' argument, is consistent with the definitions of tax evasion, tax avoidance and tax mitigation proposed in this thesis, and confirms the substitution of 'tax evasion' for cheating by fraudulent concealment or "accompanied

[754] *Bennion*, pp.1017-1018.

with no manner of artful contrivance, but wholly depends on *a bare naked lie*" or fraud by failing to disclose information under section 3 of the Fraud Act and the substitution of 'tax avoidance' for cheating by fraudulent misrepresentation or "deceitful practices, in defrauding or endeavouring to defraud another of his known right by means of *some artful device*, contrary to the plain rules of common honesty" or fraud by false representation under section 2 of the Fraud Act:

> "Challenge advanced the threat that if their chosen method of tax avoidance is not rendered effective by the courts, any commercial transaction or family arrangement will be fraught with uncertain, capricious or harsh fiscal consequences and will be vulnerable to action by the commissioner under s 99. It was suggested before the Board that a seven-year covenant or a settlement of capital might be void against the commissioner under s 99 as an arrangement entered into for two or more purposes or effects one of which would be tax avoidance, namely a reduction in the tax payable by the covenantor or the settlor. Indeed the Solicitor-General on behalf of the commissioner seemed inclined to agree. In the judgments in the courts of New Zealand there are references to other disturbing suggestions, for example that the purchase of life insurance in order to qualify for tax exemption would incur the wrath of the commissioner under s 99. Barker J speculated that 'a company carrying on business to obtain export incentives could find its business threatened by the use of section 99 by the commissioner'. The frequent argument by the tax avoider that he seeks to protect the interests of a taxpayer who does not indulge in tax avoidance requires serious but sceptical consideration.
>
> **There are however discernible distinctions between a transaction which is a sham, a transaction which effects the evasion of tax, a transaction which mitigates tax and a transaction which avoids tax**.
>
> **In the present case Barker J pointed out that the transaction was not a sham. It was not so constructed as to create a false impression in the eyes of the tax authority.** The appearance created by the documentation was precisely the reality. In other words Challenge purchased the shares of Perth; Challenge did not pretend to purchase the shares of Perth. The question is whether that purchase was also an arrangement under s 99.
>
> **Tax evasion** also can be dismissed. Evasion **occurs when the commissioner is not informed of all the facts relevant to an assessment of tax**. Innocent evasion may lead to a reassessment. Fraudulent evasion may lead to a criminal prosecution as well as reassessment. In the present case Challenge fulfilled their duty to inform the commissioner of all the relevant facts.
>
> The material distinction in the present case is between tax mitigation and tax avoidance. A taxpayer has always been free to mitigate his liability to tax. In the oft quoted words of Lord Tomlin in *Duke of Westminster* 'Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be'. In that case however the distinction between tax mitigation and tax avoidance was neither considered nor implied. …

> Section 99 does not apply to **tax mitigation where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability**.
>
> Section 99 does apply to tax avoidance. **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**."[755]

"**Tax evasion** … occurs when the commissioner is not informed of all the facts relevant to an assessment of tax" because it is **cheating the public revenue by a taxpayer who deliberately fails to make a return of the relevant tax liability or by a taxpayer who deliberately makes a false return of the relevant tax liability without using a tax scheme.**

Tax avoidance is cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using an individual scheme may or may not be complicit. According to Lord Templeman's sole focus on the taxpayer:

> "**In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax**.
>
> In *IRC v Duke of Westminster*, the Duke avoided tax by reducing his assessable income without reducing his income by the method of substituting an annuity for a wage payable to his gardener. So long as the gardener continued to work, the Duke gained a tax advantage over other taxpayers who paid wages to their working gardeners.
>
> In *Black Nominees Ltd v Nicol*[756] an actress sought to avoid income tax by reducing her assessable income without reducing her income. She converted her earnings into instalments of capital by a number of transactions each designed to take advantage of some specific exemption or relief provision of the taxing statute. She attempted to obtain a tax advantage over other actresses and other taxpayers who paid tax on their earnings.

[755] [1986] STC 548, 554-555. Emphases supplied.
[756] [1975] STC 372.

> In *Chinn v Collins*[757] the trustees and beneficiaries under a settlement attempted to avoid capital gains tax payable on the distribution of trust property. By a number of transactions each designed to take advantage of some specific exemption or relief provision of the taxing statute, the beneficiary entitled to trust shares was converted into a purchaser of the shares without involving him in the expenditure of a purchase price. The beneficiary attempted to obtain a tax advantage over other beneficiaries who paid capital gains tax when they became entitled to trust property.
>
> In *Ramsay v IRC* and *Eilbeck v Rawling*[758] the taxpayers attempted to avoid capital gains tax by making a deductible loss matched by a non-chargeable gain and setting off the loss against a pre-existing chargeable gain. In reality the taxpayer did not make any loss. The taxpayer attempted to obtain a tax advantage over other taxpayers who paid capital gains tax on chargeable gains.
>
> In *IRC v Burmah Oil*[759] the House of Lords refused to accept that the taxpayer 'had achieved the magic result of creating a tax loss that was not a real loss'.
>
> In New Zealand section 99 would apply to all the cited English cases of income tax avoidance. Section 99 also applies where, as in this case, the taxpayer alleges that he has achieved the magic result of creating a tax loss by purchasing the tax loss of another taxpayer. …
>
> **Whatever the circumstances or complications, if a taxpayer asserts a reduction in assessable income, or if a taxpayer seeks tax relief without suffering the expenditure which qualifies for such relief, then tax avoidance is involved and the commissioner is entitled and bound by section 99 to adjust the assessable income of the taxpayer so as to eliminate the tax advantage sought to be obtained**."[760]

The statement that "Challenge fulfilled their duty to inform the commissioner of all the relevant facts" shows that, as explained in chapter four, the equation of **tax evasion** to cheating by fraudulent concealment results from the sole focus on the taxpayer and the failure to consider the role of the professional advisers involved in "devising and implementing the arrangement" in **tax avoidance**.

As in *Charlton*, **the professional advisers** cheated by "devising and implementing the arrangement" by which Challenge sought "to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax." **Challenge (or more precisely the directors of Challenge)** fulfilled

[757] [1981] STC 1.
[758] [1981] STC 174.
[759] [1982] STC 30, 39 (Lord Fraser).
[760] [1986] STC 548, 554-556. Emphases supplied.

their duty to inform the commissioner of all the relevant facts relating to the disclosed scheme or arrangement devised and implemented by their professional advisers, but they concealed or misrepresented the company's tax liability because "by the arrangement [they sought] to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax." Whether the directors of Challenge involved concealed or misrepresented the company's tax liability fraudulently or negligently or innocently depended on their knowledge, abilities and circumstances, but the effect of the principle that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable" for fraud or negligence if the advice proves to be wrong is that they were more likely to have acted honestly than negligently or fraudulently. According to Lord Templeman:

> "In the present case the taxpayer subsidiaries seek to reduce their assessable income by a loss of $5.8 million which was sustained by Perth and suffered by Merbank and was not sustained by the taxpayer subsidiaries or suffered by the taxpayer. It is true that the taxpayer expended $10,000 in purchasing the shares in Perth but this purchase price is not deductible against the taxpayer's assessable income. Apart from the risk of losing $10,000, the Challenge group never risked anything, never lost anything and never spent anything but now claim to deduct a loss of $5.8 million. The taxpayer has practised tax avoidance to which section 99 applies. Challenge have not practised tax mitigation because the Challenge group never suffered the loss of $5.8m which would entitle them to a reduction in their tax liability of $2.85m. The tax advantage stems from the arrangement with Merbank and not from any loss sustained by Challenge or the Challenge group.
>
> It was argued that if this appeal by the commissioner succeeds, a purchase of shares in a company which becomes part of a specified group will always be void under section 99. But a purchase of shares will only be void in so far as it leads to tax avoidance and not tax mitigation."[761]

Tax mitigation is making a true and honest return by a taxpayer without using a tax scheme. As Lord Templeman elaborated:

> "**Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability**.
>
> Thus when a taxpayer executes a covenant and makes a payment under the covenant he reduces his income. If the covenant exceeds six years and satisfies certain other conditions the reduction in income reduces the

[761] *Challenge*, p.555.

> assessable income of the taxpayer. The tax advantage results from the payment under the covenant.
>
> When a taxpayer makes a settlement, he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income.
>
> Where a taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitled the taxpayer to reduction of tax liability. The tax advantage results from the expenditure on the premium.
>
> A taxpayer may incur expense on export business or incur capital or other expenditure which by statute entitles the taxpayer to a reduction of his tax liability. The tax advantages result from the expenditure for which Parliament grants specific tax relief."[762]

In relation to **sham**, none of the transactions that comprised the scheme was a sham or "so constructed as to create a false impression in the eyes of the tax authority" "as between subject and subject" in private law, but the scheme, considered as a whole, was a fraud "as against the Commissioner for income tax purposes" in the words of subsection (2) in tax law. As demonstrated in chapter eight, in order to pepetrate a fraud "as against the Commissioner for income tax purposes" in tax law, it was crucial that "[t]he appearance created by the documentation was precisely the reality" "as between subject and subject" in private law.

11.4.3. Importation of the Evasion-Avoidance-Mitigation Trichotomy

The earliest cases in which a tax avoidance scheme was described judicially as cheating the public revenue and held to be ineffective for the purpose of the tax sought to be avoided involved dividend stripping. In *Harrison* v *Griffiths* Lord Denning described it as "a way of getting money out of the Revenue authorities"[763] by "prospectors digging for wealth in the subterranean passages of the Revenue, searching for tax repayments."[764] In *Lupton* v *F.A. & A.B.* Lord Donovan said:

> "If I am asked what it is, I would reply that it is the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons."[765]

[762] *Challenge*, pp.554-555.
[763] [1962] 1 All ER 909, 915.
[764] Ibid, p.915.
[765] [1972] AC 634, 657.

In *Ensign Tankers*, which involved section 41 of the Finance Act 1971 that did not refer to 'avoidance', therefore, Lord Templeman and Lord Goff imported the evasion-avoidance mitigation trichotomy into English law, using Lord Donovan's "the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons" to distinguish avoidance from mitigation.

The enabling professional advisers, described by Lord Templeman as "Guinness Mahon, a merchant bank specialising in the manufacture of tax avoidance schemes"[766], cheated the public revenue by devising, marketing, implementing and otherwise facilitating the use of a tax avoidance scheme by which the taxpayer-company cheated the public revenue by claiming a first-year allowance of $14,000,000 for an expenditure of only $3,250,000. As Lord Templeman put it:

> "This appeal is concerned with a tax avoidance scheme, a single composite transaction whereunder the tax advantage claimed by the taxpayer is inconsistent with the true effect in law of the transaction. In the present case the taxpayer claims for itself and its partners capital allowances for expenditure of $14,000,000 although the partners were never liable to spend more than $3,250,000 of their own money. ...
>
> The tax avoidance scheme introduced by Guinness Mahon to the taxpayer company presented the taxpayer company (in words adopted from those of Lord Donovan in *Lupton*) with an opportunity to claim from the revenue the benefit of a large sum which the taxpayer company had never disbursed. Though s 41 of the 1971 Act required a taxpayer to expend $14,000,000 in order to qualify for the first-year allowance of that amount, the scheme was embraced because it was thought to obtain that allowance for an expenditure of only $3,250,000.The Scheme, again in the words of Lord Donovan was the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons."[767]

Four years after he substituted 'unacceptable tax avoidance' in *Craven* for Lord Scarman's 'unacceptable tax evasion' (apparently because the latter was "a label which is perhaps better kept for those transactions which are traditionally so described because they are illegal"), Lord Goff effectively described it as cheating the public revenue:

> "Like ... Lord Templeman, I approach this case on the basis that there is a fundamental difference between tax mitigation and unacceptable tax avoidance. Examples of the former ... are cases in which the taxpayer takes advantage of the law to plan his affairs so as to minimise the incidence of

[766] [1992] STC 226, 229.
[767] Ibid, pp.229-244.

> tax. Unacceptable tax avoidance typically involves the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it may be, which otherwise would never have existed. These structures are designed to achieve an adventitious tax benefit for the taxpayer, and in truth are no more than raids on the public funds at the expense of the general body of taxpayers, and as such are unacceptable. ... The question in the present case is into which of these two categories the transaction under consideration falls."[768]

The true question in law remains into which of the three categories of the fraud-negligence-honesty trichotomy the transaction under consideration, or more precisely the conduct of the professional enablers and the participating taxpayer, falls, which shows that it is cheating the public revenue or "a raid on the Treasury" or "raids on the public funds". By asking "into which of these two categories [of legal nonsense – tax avoidance and tax mitigation] the transaction under consideration falls", therefore, the Courts continue to obscure the fraudulent nature of "the judge induced disease of 'tax avoidance'".

11.4.4. Lord Nolan's Avoidance-Mitigation Distinction

IRC v Willoughby[769] involved section 741 of ICTA 1988 which provided an exemption from the charging provisions for the transfer of assets abroad as follows:

> "Sections 739 and 740 shall not apply if the individual shows in writing or otherwise to the satisfaction of the Board either –
>
> (a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected; or
>
> (b) that the transfer and any associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation."

In accepting the submissions of counsel for the Revenue, Lord Nolan endorsed the speeches of Lord Templeman and Lord Goff in *Ensign* and reflected their description of tax avoidance as cheating the public revenue, but focused solely on the taxpayer and thus missed the significance of tax avoidance schemes and their professional enablers which distinguish tax avoidance from tax mitigation:

[768] Ibid, pp.244-245. Emphasis supplied.
[769] [1997] STC 995.

> "In order to understand the line thus drawn, submitted Mr. Henderson, it was essential to understand what was meant by 'tax avoidance' for the purposes of section 741. Tax avoidance was to be distinguished from tax mitigation. **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 hall mark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option**. Where the tax payer's chosen course is seen upon examination to involve tax avoidance (as opposed to tax mitigation), it follows that tax avoidance must be at least one of the taxpayer's purposes in adopting that course, whether or not the taxpayer has formed the subjective motive of avoiding tax.
>
> My Lords, I am content for my part to adopt these propositions as a generally helpful approach to the elusive concept of 'tax avoidance', the more so since they owe much to the speeches of Lord Templeman and Lord Goff in *Ensign Tankers v Stokes*. One of the traditional functions of the tax system is to promote socially desirable objectives by providing a favourable tax regime for those who pursue them. Individuals who make provision for their retirement or for greater financial security are a familiar example of those who have received such fiscal encouragement in various forms over the years. This, no doubt, is why the holders of qualifying policies, even those issued by non-resident companies, were granted exemption from tax on the benefits received. In a broad colloquial sense tax avoidance might be said to have been one of the main purposes of those who took out such policies, because plainly freedom from tax was one of the main attractions. But it would be absurd in the context of section 741 to describe as tax avoidance the acceptance of an offer of freedom from tax which Parliament has deliberately made. **Tax avoidance within the meaning of section 741 is a course of action designed to conflict with or defeat the evident intention of Parliament**."[770]

The distinction between 'object' or 'purpose' (which is decisive) from 'motive' (which is irrelevant) is fundamental. In the words of Lord Millett:

> "In fact, the use of the word 'motive' in this context is inaccurate, and is best avoided. 'Motive' must be distinguished from 'purpose.' 'Motive' is the reason why; 'purpose' is the aim, or object, or end in view. Both words must be distinguished from 'effect,' which is the result achieved, or actual consequence."[771]

The decisive 'object' or 'purpose' in tax avoidance is, however, that of the professional enablers that devise, market, implement and otherwise facilitate the use of the tax avoidance scheme or *two or more interrelated transactions of a kind which had never*

[770] Ibid, pp.1002-1003. Emphasis supplied.
[771] 'Artificial tax avoidance: the English and American approach' [1986] B.T.R. 327, 330.

taken place before the tax Act they were devised to cheat or defraud was passed devised as a result of it or "*a course of action designed to conflict with or defeat the evident intention of Parliament*" rather than the participating taxpayer that use it. In the words of Lord Templeman:

> "The object of a tax avoidance scheme is to enable the taxpayer to enjoy a taxable event without paying the tax."[772]

Tax mitigation, where "the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option", does not require a scheme or "*a course of action designed to conflict with or defeat the evident intention of Parliament*" and thus does not involve cheating or fraud or dishonesty. The taxpayer may require professional advice to ensure that he properly "takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option", but he will not require a scheme.

The business of the tax avoidance industry, which distinguishes it from the legitimate role of tax professionals, is the devising, marketing, implementing, and otherwise facilitating the use of tax schemes by which "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." If the taxpayer "genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option", a scheme becomes pointless and the tax avoidance industry becomes redundant.

Applying the test of "how an honest person would behave" advanced by Lord Nicholls in *Brunei*, an honest person involved in tax mitigation "takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option" but a dishonest person involved in tax avoidance "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."

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[772] 'Tax and the Taxpayer' [2001] *L.Q.R.* 575, 576.

As explained in the Introduction, the red herrings that are usually introduced into the debate on tax avoidance, such as ISAs, premium bonds and pension contributions, are cases of tax mitigation distinguishable by the fact that "the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option." In the words of Lord Templeman in *Ensign Tankers*:

> "There is nothing magical about tax mitigation whereby a taxpayer suffers a loss or incurs expenditure in fact as well as in appearance."[773]

11.5 REJECTION OF THE EVASION-AVOIDANCE-MITIGATION TRICHOTOMY

Lord Oliver delivered the only dissenting judgment in *Challenge* where Lord Templeman invented the evasion-avoidance-mitigation trichotomy. In his article where he acknowledged his participation in "emasculating *Furniss*"[774] in *Craven* (where he also rejected Lord Scarman's description of failed schemes as 'unacceptable tax evasion'), he stated:

> "What, it seems to me, the Courts have succeeded in doing is to trespass into the legislation field by creating, almost arbitrarily, two categories of tax avoidance; permissible tax avoidance and impermissible tax avoidance. And they have done it without at the same time establishing any reliable criteria for distinguishing between the two. Pre-ordination is no sort of criterion because no commercial transaction is undertaken without a measure of pre-ordination. 'Business purpose' is no sort of criterion, because the saving of money from tax mitigation in order to have it available for a business must itself be a 'business purpose'. So the citizen and the Courts themselves are left without any readily intelligible reference points."[775]

As explained in chapter seven, the rejection of the Revenue's argument and the business purpose test in *Craven* "because the saving of money from tax mitigation in order to have it available for a business must itself be a 'business purpose'" misconceives the fact that paying tax is a business purpose and that the Revenue is a stakeholder (on behalf of the public) in every business.

[773] [1992] STC 226, 240.
[774] Oliver, p.185.
[775] Ibid, p.186.

As demonstrated in chapter ten, Lord Hoffmann explicitly rejected the concepts of 'tax avoidance' and 'tax mitigation' in his reaffirmation of the constructional approach in *MacNiven* the way his predecessors rejected 'tax evasion' a century earlier, stating:

> "**Tax mitigation and tax avoidance.**
>
> My Lords, it has occasionally been said that the boundary of the *Ramsay* principle can be defined by asking whether the taxpayer's actions constituted (acceptable) tax mitigation or (unacceptable) tax avoidance. In *IRC v Willoughby* Lord Nolan described the concept of tax avoidance as 'elusive'. In that case, the House had to grapple with what it meant, or at any rate what its 'hallmark' was, because the statute expressly provided that certain provisions should not apply if the taxpayer could show that he had not acted with 'the purpose of avoiding liability to taxation'. The same question arises on the interpretation of the anti-avoidance provisions to which Lord Cooke referred in *IRC v McGuckian*. But when the statutory provisions do not contain words like 'avoidance' or 'mitigation', I do not think that it helps to introduce them. The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory language to the facts of the case. It is not a test for deciding whether it applies or not."[776]

"The fact that steps taken for the avoidance of tax are acceptable or unacceptable" or more precisely amount to cheating or fraud as a matter of law is *not* "the conclusion at which one arrives [or can arrive] by applying the statutory language to the facts of the case." The corollary of the principle that "fraud unravels all" and the rule of law is that it *is* "a test for deciding whether it applies or not."

Writing in 2007, Freedman provided this damning indictment of the judicial approach to tax avoidance:

> "The development of the UK case law over the last 25 years has not been impressive. It has failed to produce a clear framework for dealing with tax avoidance cases, with the result that an increasing amount of specific anti-avoidance legislation is necessary, coupled with extensive disclosure requirements, which have to be followed up regularly by yet more specific provisions. Distinctions have been introduced into the cases only to be found to be unsustainable. Attempts have been made to distinguish tax avoidance from tax mitigation, but subsequently rejected as unhelpful."[777]

In these circumstances, as revelations in the courts and increasingly in the media and elsewhere illuminate the fraudulent nature of tax avoidance and undermine the dogma

[776] [2001] UKHL 6 [62].
[777] Freedman (2007) pp. 53-54.

that it is legal and the tax avoidance industry it underpins, more virulent terms are easily invented to fortify them.

11.6. AGGRESSIVE TAX PLANNING

The foreword to the OECD's *Study into the Role of Tax Intermediaries*[778] published on January 11, 2008, which formalised 'aggressive tax planning', highlights the role of captive national and international tax authorities in this sleight of hand:

> "This report has been prepared by a Study Team comprised of HMRC in the United Kingdom and the OECD Secretariat. During the course of the study, the team included a number of people on short-term attachments from several major law and accounting firms. ... There was extensive consultation with the private sector. Meetings were held with the 'Big Six' and other accounting firms and with major law firms, and also with business groups including the Business and Industry Advisory Committee (BIAC). Staff of HMRC and the OECD made numerous presentations on the project at conferences organised by the private sector."[779]

What the *Study into the Role of Tax Intermediaries* described as 'aggressive tax planning' are cases of cheating the public revenue by tax intermediaries, including "the 'Big Six' and other accounting firms and … major law firms", but the *Study into the Role of Tax Intermediaries* focused solely on taxpayers thus:

> "The following two areas of concern were identified:
>
> - **Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences.** Revenue bodies' concerns relate to the risk that tax legislation can be misused to achieve results which were not foreseen by the legislators. This is exacerbated by the often lengthy period between the time schemes are created and sold and the time revenue bodies discover them and remedial legislation is enacted.
>
> - **Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law.** Revenue bodies' concerns relate to the risk that taxpayers will not disclose their view on the uncertainty or risk taken in relation to grey areas of law (sometimes, revenue bodies would not even agree that the law is in doubt).
>
> In this report, these two areas of concern are referred to as 'aggressive tax planning'."[780]

[778] OECD (2008) p.3.
[779] ibid.
[780] Ibid, pp.10-11.

Tesco Stores v Guardian News & Media[781], which involved proceedings for libel and for malicious falsehood that arose from the publication in *The Guardian* newspaper of two articles in February 2009 alleging that Tesco had set up an offshore tax avoidance scheme to avoid some £1 billion of corporation tax, demonstrated the value of legal nonsenses like 'aggressive tax planning' to "the 'Big Six' and other accounting firms and … major law firms, and … business groups including the Business and Industry Advisory Committee (BIAC)." Seeking to draw a distinction between different types and different levels of tax avoidance, counsel for Tesco submitted:

> "It is now more usual to divide 'tax avoidance' into aggressive and non-aggressive tax planning behaviour. The claimant would readily put itself into the second category, but not the first."[782]

Judge Eady remarked that he was "grappling with the notion of passive tax avoidance"[783]

11.7. BASE EROSION AND PROFIT SHIFTING (BEPS)

The concept emerged from the OECD's 2013 study commissioned by the G-20 – *Addressing Base Erosion and Profit Shifting.*[784]

The *BEPS - Frequently Asked Questions* asserted that *some* BEPS are illegal but then proceeded on the basis that *all* BEPS are legal:

> "**119. What is BEPS?**
>
> Base erosion and profit shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.
>
> **120. Are BEPS strategies illegal?**
>
> Although some schemes used are illegal, most are not. Largely they just take advantage of current rules that are still grounded in a bricks and mortar economic environment rather than today's environment of global players

[781] [2009] *E.M.L.R.* 5.
[782] Brooks (2013) 122.
[783] Ibid.
[784] OECD (2013).

which is characterised by the increasing importance of intangibles and risk management.

121. What causes BEPS?

Corporate tax is levied at a domestic level. When activities cross border, the interaction of domestic tax systems means that an item of income can be taxed by more than one jurisdiction, thus resulting in double taxation. The interaction can also leave gaps, which result in income not being taxed anywhere. BEPS strategies take advantage of these gaps between tax systems in order to achieve double non-taxation.

122. Why should we be worried about BEPS if it is legal?

First, because it distorts competition: businesses that operate cross-border may profit from BEPS opportunities, giving them a competitive advantage over enterprises that operate at the domestic level. Second, it may lead to inefficient allocation of resources by distorting investment decisions towards activities that have lower pre-tax rates of return, but higher after-tax returns. Finally, it is an issue of fairness: when taxpayers (including ordinary individuals) see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

123. Is public outcry about the tax affairs of corporate giants the driving force behind the OECD's work on BEPS?

The OECD has been providing solutions to tackle aggressive tax planning for years. The debate over BEPS has now reached the highest political levels in many OECD and non-OECD countries. The OECD does not see BEPS as a problem created by one or more specific companies. Apart from some cases of egregious abuses, the issue lies with the tax rules themselves. Business cannot be faulted for using the rules that governments have put in place. It is therefore governments' responsibility to revise the rules or introduce new rules."[785]

As stated in the Introduction, the opening paragraph of the Inland Revenue's Statement of Evidence in *Charlton* corresponds to the OECD's definition of BEPS (at **119**) and shows that every offshore or multinational corporate tax avoidance amounts to "*tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid*":

"The prosecution case is that each of the defendants participated in one or more of a series of similar schemes to cheat the public revenue. The purpose and effect of each scheme was the same. The apparent taxable profits of a United Kingdom business would be reduced below their true

[785] OECD, *BEPS - Frequently Asked Questions* (117, 118 & 119). http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm#background.

level. An untaxed fund would accumulate in an offshore company for the use of the directors/proprietors of the United Kingdom business."[786]

On the face of it, the acknowledgement that "some schemes used are illegal" (at **120**) might be taken to suggest the abandonment of the mantra that "tax avoidance is legal", which the OECD has long defended in the same way as the national tax authorities that constitute it, such as HMRC. One would, therefore, expect to see some guidance for distinguishing those schemes which "are illegal" and those which "are not". But the Q&A reverts quickly to the mantra by explaining (at **122**) why we should be "worried about BEPS if it is legal". In effect, in order to disguise the fundamentally flawed presumption that *all* BEPS are legal, the BEPS Project resorted to vague notions of fairness and inefficiency that are not based in law.

123 indicates that BEPS is a type of "aggressive tax planning" and that some BEPS schemes are "cases of egregious abuses". Again, there is no guidance for distinguishing these cases from those where "the issue lies with the tax rules themselves." It is telling that the apologia in the last two sentences of **123** is the same formulation used by multinational corporations whose tax avoidance has been exposed recently.

The entire BEPS Project is based on the fallacy that BEPS is legal. Like *Charlton*, therefore, the criminal investigations of the BEPS schemes used by Google and Apple in France and Italy respectively underscore the fundamental flaw in the Project.

11.8. ABUSE

The General Anti-Abuse Rule (GAAR) in Part 5 of Finance Act 2013 is effectively based on the nonsensical notions of 'aggressive' and 'passive' tax avoidance.

In his recommendation, which was accepted by the Government, Aaronson substituted 'responsible tax planning' for 'acceptable tax avoidance' and 'abusive arrangements' for 'unacceptable tax avoidance':

> "I have concluded that introducing a broad spectrum general anti avoidance rule would *not* be beneficial for the UK tax system. ... However, introducing a moderate rule which does not apply to responsible tax planning, and is

[786] Masters, pp 388-389. Emphasis supplied.

> instead targeted at abusive arrangements, would be beneficial for the UK tax system."[787]

This sleight of hand did not deceive the Association of Revenue and Customs (ARC) – "a body of professional civil servants, administering and ensuring compliance with UK tax law"[788] – who stated:

> "ARC believes the proposal, and the concept of 'responsible' tax planning, may widen perceptions of what is responsible tax planning and so make it harder to tackle avoidance. ... A narrow GAAR may otherwise serve to legitimise what is currently held to be avoidance. In other words, under the guise of tackling avoidance, it may actually facilitate it."[789]

Aaronson's "overarching principle" strengthens the suspicion that "under the guise of tackling avoidance, it may actually facilitate it":

> "I have concluded that a GAAR which is appropriate for the UK must be driven by an overarching principle. This is that it should target those highly abusive contrived and artificial schemes which are widely regarded as intolerable, but that it should not affect the large centre ground of responsible tax planning.
>
> Critically, I consider that this overarching principle must be supported by the simple proposition that where there can be reasonable doubt as to which side of the line any particular arrangement falls on, then that doubt is to be resolved in favour of the taxpayer so that the arrangement is treated as coming within the unaffected centre ground."[790]

Aaronson did not define 'abuse' or 'abusive arrangements' but described it variously as 'highly abusive contrived and artificial schemes'[791], 'highly artificial tax avoidance schemes'[792], 'the most egregious tax avoidance schemes'[793] and 'highly aggressive schemes'[794].

It was against this background that, while announcing the GAAR on March 21, 2012, the Chancellor of the Exchequer famously declared:

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[787] Aaronson, pp.3-4.
[788] ARC, p.1.
[789] ARC, p.1.
[790] Aaronson, p.28.
[791] Aaronson, p.28.
[792] Ibid, p.41.
[793] Ibid, p.20.
[794] Ibid, p.23.

> "I regard tax evasion and, indeed, aggressive tax avoidance, as morally repugnant".[795]

11.9. TAX DODGING

In the Revenue Bar Association's debate on the subject "This House believes that tax avoidance should be punished" on September 28, 2016 Aaronson contended:

> "These fine distinctions between tax avoidance and tax evasion; they don't matter a toss. They're tax dodging."

As a matter of law and fact, 'tax dodging', like the classic tax avoidance, the more exotic 'unacceptable tax avoidance', 'aggressive tax avoidance', 'aggressive tax planning', 'abuse', 'Base Erosion and Profit Shifting', 'Risk-Mining the Public Exchequer'[796], 'risks to the UK Government's tax take'[797], and judicial expressions like "a way of getting money out of the Revenue authorities"[798], "digging for wealth in the subterranean passages of the Revenue, searching for tax repayments"[799], "the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons"[800], "raids on the public funds at the expense of the general body of taxpayers"[801] and "attempts to cheat the Revenue"[802], is cheating the public revenue. In the words of the then Financial Secretary to the Exchequer which echoes Lord Simon's in *Latilla*:

> "Such devices lead to a greater share of the overall tax burden falling on the remainder of taxpayers. One person's successful tax dodge is another person's higher tax bill. If left unchecked, this creates unfairness for the many while the few get away with paying much reduced tax bills, ultimately bringing the system into disrepute among those who find themselves shouldering the increased burden."[803]

11.10. CONCLUSION

This chapter demonstrated that the concepts of tax evasion, tax avoidance and tax mitigation were invented, and serve, to disguise the fraudulent nature of "the judge

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[795] Rhodes.
[796] Quentin, 'Risk-Mining the Public Exchequer', August 2014.
[797] Part of the title of a joint CIOT/IFS debate held in London on April 26, 2016.
[798] Denning, *Griffiths*, p.915.
[799] Ibid, p.918.
[800] Donovan, *Lupton*, p.657.
[801] Goff, *Ensign*, p.244.
[802] Templeman, *Fitzwilliam*, p.535.
[803] Primarolo, 'Playing with fire', *Tax Journal*, September 22, 1997, p.2.

induced disease of ‘tax avoidance’” and to legitimise the resultant fraudulent multi-billion pound tax avoidance industry.

PART FOUR

CONCLUSIONS

CONCLUSIONS

THE NATURE AND MEANING OF TAX AVOIDANCE AND TAX EVASION IN LAW, AND WHY IT MATTERS

> **Cheating clearly cannot be dismissed as a quaint antiquity of the criminal law, nor should it be ignored by professional tax advisers. In one of the most recent cases, those convicted (and imprisoned) included accountants and a barrister. Yet there has been very little academic consideration of the offence and its precise ambit; a fact which is true of most tax frauds.**
> David Ormerod, 'Cheating the Public Revenue' (1998) *Crim. L.R.* 627, citing *R v Charlton and others* [1995] 67 TC 500.

I. THE EXISTING BODY OF KNOWLEDGE

The fundamental thesis that tax avoidance is cheating the public revenue by the professional enablers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the participating taxpayer using an individual scheme may or may not be complicit is a fundamental departure from the existing body of knowledge, which continues to rest upon the dogma that "tax avoidance is legal and tax evasion is illegal".

This is attributable to the fact that, more than twenty years after Ormerod's article, there is still "very little academic consideration of the offence and its precise ambit; a fact which is true of most tax frauds." Most significantly, despite the authorities in the criminal and civil law like *Charlton* and *Fitzwilliam* that held that the relevant schemes amounted to cheating the public revenue, there is **no** published consideration of the resultant fundamental question whether tax avoidance is cheating the public revenue as a matter of law.

This fundamental gap in the existing body of knowledge is of fundamental constitutional, legal and administrative significance because if the meaning of "the elusive concept of 'tax avoidance'"[804] in law is cheating, the antidote to "the judge induced disease of 'tax avoidance'"[805] must be cheating. In the words of Lord Hughes in *Ivey*:

> "There will be a difference in standard of proof as between civil and criminal proceedings, but that does not affect the meaning of cheating."[806]

[804] Nolan.
[805] Avery Jones.
[806] *Ivey* [38].

In *Ivey*, where the appellant professional gambler described himself as an "advantage player", Lord Hughes concluded:

> "The judge accepted that he was genuinely convinced that what he did was not cheating. But the question which matters is not whether Mr Ivey thought of it as cheating but whether in fact and in law it was. ... To label an activity 'advantage play', as Mr Ivey and others did, is of no help at all. It asks, rather than answers, the question whether it is legitimate or cheating."[807]

The thesis demonstrated that the question which matters in tax avoidance is similarly not whether commentators, taxpayers, professional advisers, Revenue officials and indeed judges think of it as cheating but whether in fact and in law it is. *Charlton* showed that to label an activity 'tax avoidance' is to ask, rather than answer, the question whether it is legitimate or cheating. In the words of Rhodes et al:

> "*Charlton* tells us clearly that sitting on top of a set of artificial arrangements waving a flag saying 'tax avoidance scheme' will not necessarily provide either the taxpayer or his professional advisers with immunity from prosecution."[808]

Charlton, which was heard by the Court of Appeal in 1995, however, remains what Ormerod described in 1998 "one of the most recent cases" of tax avoidance prosecution in the UK because of the immunity from prosecution enjoyed by the tax avoidance industry from the Revenue.

The rest of this concluding chapter reinforces the proposed definitions of tax evasion, tax avoidance and tax mitigation in law and explains the corollaries of the fraudulent and criminal nature and meaning of tax avoidance in law.

II. THE NATURE AND MEANING OF TAX EVASION AND TAX AVOIDANCE IN LAW

II.I. Legal Nonsense

It is important to remember that 'tax evasion' and 'tax avoidance are not legal concepts but legal nonsenses which Cohen defined as "peculiar concepts which are not defined either in terms of empirical fact or in terms of ethics but which are used to answer

[807] Ibid [27]&[47].
[808] Rhodes, p.203.

empirical and ethical questions alike, and thus bar the way to intelligent investigation of social fact and social policy." As Baker stated in his article:

> "The fundamental thesis behind this paper is that key terms like 'tax avoidance', 'tax evasion' and 'tax mitigation' – which are some of the most important basic building blocks for discourse about domestic and international taxation – are not sufficiently clearly understood or defined, and that is wrong."[809]

Baker's proposal demonstrates how the equation of tax evasion (a legal nonsense) to tax fraud (a legal concept) restates the dogma "tax avoidance is legal and tax evasion is illegal" by substituting tax fraud for tax evasion under the classic evasion-avoidance-mitigation trichotomy:

> "The purpose of this short article has been to suggest a possible – and, hopefully, relatively simple – approach to these terms based upon a spectrum of conduct and boundaries to be drawn between tax fraud, tax avoidance and tax mitigation."[810]

As "'tax avoidance', 'tax evasion' and 'tax mitigation' ... are not sufficiently clearly understood or defined" because they are legal nonsenses rather than legal concepts, the correct approach in law should be "based upon a spectrum of conduct and boundaries to be drawn between tax fraud" and the related legal concepts of negligence and honesty. Legal nonsenses, such as tax avoidance and tax mitigation, do not exist upon the same "spectrum of conduct" as the legal concept of tax fraud.

In fact, the subsequent invention of 'aggressive tax planning' and 'BEPS' by the OECD shows that, unlike legal concepts, the categories of legal nonsense are not closed; and underscores the flaw in "a spectrum of conduct and boundaries to be drawn between tax fraud, tax avoidance and tax mitigation."

II.II. Cheating, Fraud and Dishonesty

As demonstrated throughout, Hardy J's classic definition of "what in law is cheating the Public Revenue" shows that it boils down to dishonesty:

> "The common law offence of cheating the Public Revenue does not necessarily require a false representation either by words or conduct. Cheating can include **any form of fraudulent [or] dishonest conduct by the defendant to prejudice, or take the risk of prejudicing, the**

[809] Baker, p.1.
[810] Ibid, p.14.

> **Revenue's right to the tax in question** knowing that he has no right to do so."[811]

The seminal statement of dishonesty by Lord Hughes in *Ivey*, therefore, shows that cheating the public revenue means the same thing in both the criminal and civil law:

> "Dishonesty is by no means confined to the criminal law. Civil actions may also frequently raise the question whether an action was honest or dishonest. ... There can be no logical or principled basis for the meaning of dishonesty (as distinct from the standards of proof by which it must be established) to differ according to whether it arises in a civil action or a criminal prosecution."[812]

The tort of deceit is an example of civil actions that raise the question whether an action was honest or dishonest. Lord Herschell's classic statement in *Derry v Peek*, which outlines the boundaries of the fraud-negligence-honesty trichotomy, embodies a generally applicable definition of fraud:

> "First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, **fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false**."[813]

II.III. Tax Evasion

Tax evasion is cheating the public revenue by a taxpayer who deliberately fails to make a return of the relevant tax liability or by a taxpayer who deliberately makes a false return of the relevant tax liability without using a tax scheme.

Tax evasion is, therefore, distinguished from tax avoidance by the absence of a tax scheme.

In terms of Hardy J's definition of cheating, the hallmark of tax evasion is that <u>the taxpayer</u> cheats the public revenue or "prejudice[s], or take[s] the risk of prejudicing, the Revenue's right to the tax in question *knowing that he has no right to do so*" by deliberately failing to make a return of the relevant tax liability or by making a deliberately false return of the relevant tax liability without using a tax scheme.

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[811] *Less*. Emphases supplied.
[812] [2017] UKSC 67 [62]-[63].
[813] (1889) 14 App. Cas. 337, 374.

In *R v Mavji*, the taxpayer cheated the public revenue by deliberately failing to make returns of VAT liability. According to Davies J:

> "This appellant was in circumstances in which he had a statutory duty to make value added tax returns and to pay over to the Crown the value added tax due. He dishonestly failed to do either. Accordingly, he was guilty of cheating HM The Queen and the public revenue."[814]

In *R v Hudson* the taxpayer cheated the public revenue by deliberately making a false return of income tax liability without using a tax scheme. Goddard CJ stated:

> "We think that the offence here consisted of sending in documents to the inspector of taxes which were false and fraudulent to the appellant's knowledge ... for the purpose of avoiding the payment of tax. That is defrauding the Crown and defrauding the public."[815]

In terms of Lord Herschell's definition of fraud, the hallmark of *tax evasion* is that <u>the taxpayer</u> cheats or defrauds the public revenue or makes "a false representation ... knowingly, or without belief in its truth, or recklessly, careless whether it be true or false" by deliberately failing to make a return of the relevant tax liability or by making a deliberately false return of the relevant tax liability without using a tax scheme.

Baker's application of Lord Herschell's definition shows that his proposal substitutes tax fraud for tax evasion as stated above:

> "Tax fraud – as a criminal matter – must involve intentional behaviour or actual knowledge of the wrongdoing. In some countries that is not necessarily the case. There should be an internationally accepted approach. Tax fraud must involve intentional behaviour or actual knowledge. The classic situations will be deliberately failing to put an item into a tax return or deliberately claiming a deduction to which a person knows he is not entitled. ...
>
> Tax fraud must surely involve a degree of knowledge; in particular, it must involve the absence of an honest belief that a person is not liable to the particular tax. If a taxpayer cannot show that he has an honest belief that he is not liable to the tax, that seems prima facie to fall within the scope of tax fraud.
>
> Tax fraud should not extend to negligent conduct and - though this is perhaps debatable - it should not include reckless conduct (e.g. submitting

[814] *Mavji*, pp.1391-1392.
[815] [1956] 2 QB 252, 261-262.

> a tax return with reckless disregard for the accurate position). That may be a matter dealt with by administrative fines, but should not be regarded as tax fraud."[816]

Tax fraud is "a criminal matter" in criminal proceedings where the criminal law "acts upon the offender, and inflicts a penalty" and "a civil matter" in civil proceedings where the civil law "acts upon the offence, by setting aside the fraudulent transaction."

Lord Herschell's definition shows that tax fraud includes "reckless conduct." Administrative fines may be imposed, and the level may vary, depending on whether "a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false", but this does not affect its nature and meaning in law as tax fraud. As Baker, himself, put it:

> "In some countries there are different degrees of tax fraud. In Switzerland, for example, there is a distinction between tax evasion and tax fraud. It is doubtful if these distinctions are very helpful. A State may want to have different levels of penalty dependent upon the degree of culpability, but simplicity suggests that the essence should be a single offence of tax fraud".[817]

II.IV. Tax Avoidance

Tax avoidance is cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes (or "the professional enablers") in which the taxpayer using an individual scheme (or "the participating taxpayer") may or may not be complicit.

In chapter two, Hardy J's and Hawkins's classic definitions of the common law offence of cheating were merged to define tax avoidance schemes as **deceitful practices to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question by means of some artful device, contrary to the plain rules of common honesty** in order to reflect the fundamental principle that cheating and fraud are 'conduct' crimes committed by prejudicing the Revenue's right to the tax in question (rather than 'result' crimes that require proof of actual loss to the Revenue).

[816] Baker, pp.6-8.
[817] Baker, pp.8-9.

As demonstrated in chapter two, the corollary of that principle is that a tax avoidance scheme falls within Hardy J's definition ("**any form of fraudulent [or] dishonest conduct by the defendant to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so**") when it is devised. This means that marketing or implementing or concealing or otherwise facilitating the use of the scheme after it is devised, is a distinct and separate *actus reus*.

In terms of Hardy J's definition, therefore, the hallmark of tax avoidance is that each of <u>the professional advisers</u> involved in devising or marketing or implementing or otherwise facilitating the use of a tax scheme cheats the public revenue or "prejudice[s], or take[s] the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so."

In *R v Charlton* where the professional enablers, but not the participating taxpayers, were prosecuted, Farquharson LJ stated:

> "On 1 August 1994 these Appellants were convicted at Nottingham Crown Court on an indictment containing 14 counts of cheating the public revenue. ... Kitchen and Wheeler are qualified accountants. Charlton has practised for many years as an accountant, as a partner in a firm called Charltons, but was not professionally qualified. Cunningham is a barrister practising at the Revenue Bar, with chambers in Lincoln's Inn. He also works in Glasgow in the same field as well as having an association with a firm of lawyers in Madrid. Another defendant, Lawlor, pleaded guilty to four counts of the indictment. He, too, was a qualified accountant working at the relevant time for Charltons. In imposing a suspended sentence of imprisonment upon him the Judge said that '... the whole Charltons empire was riddled with dishonesty'. The firm had offices in Derby, Birmingham, Manchester and Jersey.
>
> The case for the prosecution was that Charlton had **devised** a dishonest, tax-avoidance scheme for the benefit of some of the firm's clients and that the Appellants were involved with the **implementation** of the schemes or the **concealment** from the Revenue of the existence of the fraud."[818]

As demonstrated in the previous chapters, particularly in the Introduction and in chapter five, *Charlton* proved that the dogma that "tax evasion is illegal but tax avoidance is legal" rests for its support upon a fundamental misunderstanding of the fact that in all jurisdictions "it is entirely within the discretion of the tax authorities whether they take the procedural course of bringing a criminal tax-fraud case or imposing only civil tax-

[818] *Charlton*, pp.504-505.

fraud penalties or simply establishing tax liability without fines or penalties, applying doctrines such as substance over form"[819], the *Ramsay* principle in English law, the sham transaction doctrine in American law and the abuse doctrine in European Union law. According to Rhodes et al:

> "It is a commonly held belief among professional advisers that tax avoidance is legal and tax evasion is illegal. Tax avoidance schemes may fail but the taxpayers and their advisers have, until now, been secure in the knowledge that the worst that can happen is the receipt of a large bill for tax and interest. ...
>
> Amongst professional tax advisers, alarm and concern have been expressed at the approach of the Revenue and the conduct of the case. It has been argued that there is a general move to 'blur' the 'very clear' distinction between legal tax avoidance and illegal evasion. However, it might well be suggested that the distinction is not and has never been as clear as many professional advisers (and their clients) would like to believe. Where avoidance arrangements are wholly artificial and have no substance then clearly it is and always has been open to the Revenue and the courts to consider whether they are in fact 'devices to cheat the public revenue'.
>
> What perhaps has confused the issue is the Revenue's highly selective policy on prosecutions. Although the Revenue are a law enforcement agency, their principal purpose is to collect taxes. Accordingly, historically, they have only been interested in invoking the criminal law where they consider that they will be successful and the case will generate publicity which will serve as a warning to other taxpayers or professional advisers. Should this attitude change, and should the Revenue seek to act as a law enforcement agency on the lines adopted so successfully many years ago by the US Internal Revenue Service, then many more taxpayers and their professional advisers may find that they are at risk.
>
> Moreover, the terms 'tax avoidance' and 'tax evasion' have been created by the legal and accountancy professions as convenient generic terms to distinguish what is legal from what is illegal, and the fact that they have also been adopted by the courts should not blind us to what they actually are."[820]

As demonstrated in previous chapters, the terms 'tax avoidance' and 'tax evasion' are legal nonsenses created by the legal and accountancy professions as convenient generic terms to disguise the fraudulent nature of tax avoidance.

As a matter of law, tax evasion is clearly distinguishable from tax avoidance as cheating cheating by a taxpayer who deliberately fails to make a return of the relevant tax liability or by a taxpayer who deliberately makes a false return of the relevant tax liability without using a tax scheme.

[819] Wisselink, p.203.
[820] Rhodes, pp.203-206. Emphases supplied.

By contrast, in *Charlton* the prosecution of the participating taxpayers was not required to establish the criminal offence. This is because using a tax avoidance scheme by **the participating taxpayer** is a fundamentally distinct and separate *actus reus* or "prejudice, or ... risk of prejudicing, the Revenue's right to the tax in question" from devising, marketing, implementing and otherwise facilitating the use of a tax scheme by the professional enablers.

The corollary of the principle that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable"[821] for negligence, let alone fraud, if the advice proves to be wrong is that the participating taxpayer using a tax avoidance scheme "to prejudice, or take the risk of prejudicing, the Revenue's right to the tax in question" is *not* likely to do so "knowing that he has no right to do so."

In *Charlton*, Farquharson LJ applied the principle that cheating is a conduct crime which means "that the actual result of the loss does not need to be proved"[822] and which underscores the proposition that a tax avoidance scheme is a cheat and a fraud by design thus:

> "Furthermore, it was urged upon us that, unusually perhaps in a fraud of this scale, **there was no loss to the public purse**, in the sense that apart from one company the tax that was due, as a result of this defrauding of the Revenue, has now all been repaid as well as penalties and interest."[823]

In terms of Lord Hershell's statement in *Derry*, the hallmark of *tax avoidance* is that <u>the professional enablers</u> cheat or defraud the public revenue or make "a false representation ... knowingly, or without belief in its truth, or recklessly, careless whether it be true or false" by devising, marketing, implementing and otherwise facilitating the use of a tax avoidance scheme.

The Law Commission's definition, which informed the offence of fraud by false representation in section 2 of the Fraud Act 2006, shows that fraudulent misrepresentation is wide enough to encompass devising, marketing, implementing and otherwise facilitating the use of a tax avoidance scheme:

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[821] [2012] UKFTT 314 at [21]. Emphasis supplied.
[822] Stuart-Smith LJ, *Hunt*, p.827.
[823] *Charlton*, p.532. Emphasis supplied.

> "The concept of fraudulent misrepresentation is well established in both the civil and criminal law. It may be defined as an assertion of a proposition which is untrue or misleading, either in the knowledge that it is untrue or misleading or being aware of the possibility that it might be. The assertion may be express, implicit in written or spoken words, or implicit in non-verbal conduct. The proposition asserted may be one of fact or of law. It may be as to the current intentions, or other state of mind, of the defendant or any other person."[824]

By facilitating the use of a tax avoidance scheme, the professional enablers enable the participating taxpayer to make "a false representation" in a return submitted to the Revenue. The principle that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable" for negligence or fraud if the advice proves to be wrong makes it unlikely that "a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false."

Any legal opinion used to sell the scheme serves to provide the honest belief Lord Herschell referred to thus:

> "To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth."[825]

As demonstrated in chapter three, the proper focus on the conduct of the professional advisers based on the proposition that a tax avoidance scheme is a cheat and a fraud by design will show that it is completely irrelevant for the purposes of the nature and meaning in law of tax avoidance that the taxpayer using the scheme put his cards on the table so that there is no intention on his part to mislead.

As demonstrated in chapter two, a defining feature of a tax avoidance scheme is the creation by the professional enablers of a mismatch between the true or economic position that exists for other purposes and the false or fiscal position that is presented to the Revenue for tax purposes. The full disclosure by the participating taxpayer to the Revenue of the false or tax position devised by the enabling professional advisers is, therefore, still a concealment or misrepresentation of the true or economic position that exists in the real world for other purposes. In *Charlton*, therefore, Farquharson LJ stated:

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[824] *Fraud*, p.60-61.
[825] (1889) 14 App. Cas. 337, 374.

> "It was the case for the Crown that the accounts presented to the Revenue by the United Kingdom companies were false in that **by using Charlton's scheme** to transfer part of their profits to the Jersey companies they were not disclosing the full extent of the profits they had made. It was this lack of disclosure which formed the basis of the false representations alleged in the indictment. Each of the Appellants was charged in the relevant counts with cheating the Revenue by '... falsely representing that the apparent purchases (by the United Kingdom company) from (the Jersey company) were bona fide commercial transactions'."[826]

The conviction of the professional enablers for "cheating the Revenue by '... falsely representing that the apparent purchases (by the United Kingdom company) from (the Jersey company) were bona fide commercial transactions'"[827] shows that the concept of fraudulent misrepresentation encompasses devising, marketing, implementing, concealing and otherwise facilitating the use of a tax avoidance scheme. According to Farquharson LJ:

> "It was apparent, therefore, as the learned Judge said on a number of occasions in the course of his summing-up, that there was no dispute by the end of the evidence that the schemes were being operated in fraud of the Revenue. The issue for the jury, as he correctly pointed out, was whether any, and if so which, of the Appellants took part in the **devising**, **operation** or **concealment** of the schemes and whether they were doing so dishonestly."[828]

The underlined terms confirm that concealment ("not disclosing" and "lack of disclosure") and misrepresentation ("false representations" and "falsely representing") are not mutually exclusive, and that tax avoidance, like tax evasion, can be described in both terms. The critical misrepresentation or concealment is, however, the mismatch between the true and tax positions built into the scheme by the professional enablers.

The frequent argument that tax avoidance could not be fraudulent because the participating taxpayer makes a full disclosure of the scheme misconceives the fundamental fact that the scheme already constituted a cheat and a fraud when it was devised and long before the taxpayer disclosed it to the Revenue.

If the taxpayer implements such transactions in a scheme devised by professional advisers and puts all his cards on the table in his tax return, the scheme remains a

[826] *Charlton*, p.506. Emphases supplied.
[827] Ibid, p.507.
[828] *Charlton*, p.510.

cheat or fraud and the conduct of the professional advisers remains cheating or fraud. The corollary of the principle affirmed in *Hanson* that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his tax return then he will not be liable"[829] for negligence or fraud if the advice proves to be wrong is that the taxpayer putting his cards on the table might mean that the false representation is honest (rather than fraudulent or negligent), but that is a fundamentally different issue from the nature in law of the conduct of the professional advisers that devised the scheme.

This thesis has not been concerned with the question whether a tax avoidance scheme 'works' as a matter of statutory construction because it remains a cheat and a fraud as a matter of law whether it "works" or not.

A tax avoidance scheme is defined in chapter two (for the purposes of the civil law where the constructional approach applies and used throughout the discussions on the civil law) as **two or more interrelated transactions of a kind which had never taken place before the tax Act it was devised to cheat or defraud was passed, devised as a result of it** in order to reflect Lord Diplock's theory of retrospective judicial legislation which shows that the constructional approach is the recipe for what Avery Jones described aptly as "the judge induced disease of tax avoidance"[830]:

> "Whenever the Court decides that kind of dispute it legislates about taxation. It makes a law taxing all gains of the same kind or all documents of the same kind. Do not let us deceive ourselves with **the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant**. Anyone who has decided tax appeals knows that most of them concern **transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all.** Some of the **transactions are of a kind which had never taken place before the Act was passed**: they were **devised as a result of it**. The Court may describe what it is doing in tax appeals as interpretation. So did the priestess of the Delphic oracle."[831]

As demonstrated in the Introduction and throughout, therefore, a tax avoidance scheme or *two or more interrelated transactions of a kind which had never taken place before the* tax *Act it was devised to cheat or defraud was passed, devised as a result of it*, cannot be judged legitimately or countered effectively by "the legal fiction that the Court

[829] Cannan J.
[830] Avery Jones. Emphases supplied.
[831] *The Courts As Legislators* (University of Birmingham, March 26, 1965) p.6. Emphases supplied.

is only ascertaining and giving effect to what Parliament meant" but by applying an overriding legal principle that operates on a juristic basis independent of the tax Acts, such as the common law offence of cheating the public revenue and the pre-existing common law of cheating or fraud, to the conduct of the professional advisers that devised, marketed, implemented and otherwise facilitated its use and the conduct of the taxpayer that used it, as proposed in the fundamental contribution.

As demonstrated in the Introduction and in chapter five, however, in the overwhelming majority of cases that are dealt with administratively, the Revenue replicates "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant." As Gribbon (then Director of the Inland Revenue's Compliance Division) put it:

> "In relation to tax avoidance the ... Revenue's role involves ascertaining the facts (which may require full and detailed investigation) and exercising first judgment as to the interpretation of law and its application to those facts. The determination of the facts and law is, of course, ultimately for the ... Courts, but it is very much the minority of cases that come before ... the Courts and in practice, therefore, they operate as a check on the ... Revenue's function. **Just as the Courts, in interpreting legislation, will not confine themselves to a close literal interpretation, so the ... Revenue will seek to ascertain the intention of Parliament when applying legislation to novel situations**."[832]

By purporting "to ascertain the intention of Parliament when applying legislation to novel situations" or more accurately "transactions ... of a kind which had never taken place before the Act was passed ... devised as a result of it", therefore, "[w]henever the [Revenue] decides that kind of dispute it [also] legislates about taxation." In the words of Beighton:

> "The general intention of the legislation, and hence its application to particular sets of circumstances, can certainly be divined from the words with which it is expressed. But to apply the words themselves precisely to those circumstances cannot be said to reflect the conscious intention of anyone."[833]

Like every tax avoidance appeal, *D'Arcy v Revenue and Customs Commissioners*[834] demonstrates that such decisions by the Revenue and the courts tell us little or nothing about the nature and meaning of tax avoidance in law.

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[832] 'A Sterile Activity', *Tax Journal* (1997) p.4.
[833] 'The Finance Bill process: scope for reform?' [1995] *B.T.R.* 33, 42.
[834] [2006] STC (SCD) 543.

The agreed statement of facts set out in full by the Special Commissioner in his Decision falls within the definition of tax avoidance as **cheating the public revenue by the professional advisers that devise, market, implement and otherwise facilitate the use of tax avoidance schemes in which the taxpayer using an individual scheme may or may not be complicit**:

> "(1) The appellant is Mrs Philippa D'Arcy who is the founder and chief executive officer of a company called The Rose Partnership which carries on specialist executive search business in the City of London.
>
> (2) **The appellant was introduced to the relevant transactions by Mr Philip Shirley, a tax adviser. Mr Shirley wrote to the appellant by letter dated 10 January 2002**.
>
> (3) Attached to this letter was a projection, prepared by Mr Shirley, of the returns, costs and tax effects of the proposed transactions, subject (as mentioned in the letter) to the possibility of a movement in the value of the gilts.
>
> (4) On 16 January 2002, the appellant countersigned the letter of 10 January 2002 thereby accepting its terms.
>
> (5) The letter and projection referred to proposed transactions with a nominal value of £33.5m; in the event the actual transactions had a nominal value of £31m.
>
> (6) Having been contacted by Mr Shirley, NCL Investments Ltd (NCL), a firm of agency brokers and members of The Stock Exchange, wrote a letter dated 23 January 2002 addressed to the appellant and headed 'Execution Only Service Terms and Conditions' setting out their standard terms and conditions. This letter was countersigned by the appellant on 24 January 2002.
>
> (7) By a second letter dated 23 January 2002 addressed to the appellant and headed 'Stock Lending Master Loan Agreement,' NCL set out the terms on which they would provide a facility to 'repo' securities on behalf of the appellant. This letter was dated and signed for and on behalf of NCL on 24 January 2002 and countersigned by the appellant on 25 January 2002.
>
> (8) Annexed to the second letter of 23 January 2002 was a Global Master Repurchase Agreement (GMRA) between NCL and Royal Bank of Scotland Plc (RBS) dated as of 13 August 2001, setting out the standard International Securities Market Association (ISMA) terms on which NCL would enter into 'repo' transactions with RBS.
>
> (9) By letter dated 24 January 2002 Mr Shirley told the appellant that he was expecting to do the transactions around 13–14 February 2002 and that he would contact her shortly before 12 February to inform her of the margin to be provided to NCL.
>
> (10) The appellant transferred £350,000 to NCL on 12 February 2002 by transfer from her account with HSBC Republic.

(11) On 13 February 2002, NCL entered into a 'repo' transaction with RBS on the standard ISMA terms whereby NCL agreed to buy £31m nominal value Treasury 9% 2002 gilts (the gilts) from RBS for settlement on 14 February 2002 for a purchase price of £33,664,926.15 [at the price of £108.596536 which includes accrued interest]; and NCL agreed to re-sell to RBS equivalent gilts for settlement on 20 February 2002 for a resale price of £33,683,464.92 (interest element £18,538.77). The gilts were transferred from RBS's account with the Central Gilts Office (CGO) to NCL's CGO account in accordance with normal practice.

(12) NCL carried out transactions on behalf of a number of other persons at the same time as the appellant and the aggregate transaction related to gilts with a nominal value of £139.4m and the documentation in relation to the transactions with RBS and JPMS (see below) refer to the aggregate values of the transactions.

(13) Since the term of the 'repo' extended over an 'Income Payment Date' (as defined as the record date, here corresponding to the ex div date), it was a term of the repo transaction that NCL should pay RBS £1,511,250 by way of 'manufactured interest'.

(14) By letter to the appellant dated 19 February 2002, NCL confirmed the terms of the repo transaction.

(15) On 13 February 2002, NCL agreed with a market maker, JP Morgan Securities (JPMS) to sell to JPMS £31m nominal value gilts for settlement on 14 February 2002 for a sale price of £33,325,176.90. This transaction took place in accordance with the rules of the stock exchange with the market maker offering the best price prevailing at the time.

(16) NCL subsequently confirmed to the appellant the terms of the transaction with JPMS by issuing a contract note dated 13 February 2002.

(17) On settlement of this transaction, on 14 February 2002 JPMS paid NCL £33,325,176.90, and this amount was credited by NCL to the appellant's account. The gilts were transferred from NCL's CGO account to JPMS's CGO account in accordance with normal practice.

(18) On 20 February 2002, NCL agreed with a market maker, again JPMS, to buy from JPMS £31m nominal value gilts for settlement the same day for a purchase price of £31,855,456.79. This transaction took place in accordance with the rules of the stock exchange with the market maker offering the best price prevailing at the time.

(19) NCL subsequently confirmed to the appellant the terms of the transaction with JPMS by issuing a contract note dated 20 February 2002.

(20) The purchase price was paid to JPMS by NCL on 20 February 2002 and the appellant's account with NCL was debited with this amount. The gilts were transferred from JPMS's CGO account to NCL's CGO account in accordance with normal practice.

(21) Also on 20 February 2002, NCL closed out the repo transaction by transferring the gilts to RBS for the agreed sale price of £33,683,464.92,

> which amount was credited to the appellant's account with NCL. The gilts were transferred from NCL's CGO account to RBS's CGO account in accordance with normal practice.
>
> (22) On 20 February 2002 Mr Shirley sent a fax to the appellant informing her of the terms and effects of the closing out of the short position.
>
> (23) On 27 February 2002 the date on which the half yearly coupon was due to be paid on the gilts, NCL paid the sum of £6,795,750 to RBS and the appellant's account was debited with her share of that amount (ie £1,511,250).
>
> (24) The appellant did not, apart from the above, hold any securities within the meaning of s 710 of the Income and Corporation Taxes Act 1988 (the 1988 Act) in 2000–01 or 2001–02.
>
> (25) **The sole reason why the appellant entered into the Stock Lending Master Loan Agreement with NCL was to reduce her income tax liability**."[835]

In the words of Hardy J's definition, "her income tax liability" as "the founder and chief executive officer of a company called The Rose Partnership which carries on specialist executive search business in the City of London" constituted "the tax in question" and necessitated the tax avoidance scheme that amounted to "prejudice, or … the risk of prejudicing, the Revenue's right to the tax in question". The sole reason why Philip Shirley introduced her to the scheme and the sole reason why she used the scheme was to cheat the public revenue of "her income tax liability."

The fundamental question of law was, therefore, whether each of the professional advisers involved in devising, marketing, implementing and otherwise facilitating the use of the scheme "to reduce her income tax liability", including Philip Shirley and his collaborators in NCL and RBS, cheated the public revenue or "prejudice[d], or [took] the risk of prejudicing, the Revenue's right to the tax in question knowing that he has no right to do so."

Similarly, the less important question of law was whether Philippa D'Arcy cheated the public revenue or "prejudice[d], or [took] the risk of prejudicing, the Revenue's right to the tax in question knowing that [s]he ha[d] no right to do so" by using the scheme "to reduce her income tax liability." The corollary of the principle that "if a taxpayer *reasonably* relies on a reputable accountant for advice in relation to the content of his

[835] Ibid, 546-547, para [3].

tax return then he will not be liable"[836] for negligence, let alone fraud, if the advice proves to be wrong is that she "prejudice[d], or [took] the risk of prejudicing, the Revenue's right to the tax in question" but without "knowing that [s]he ha[d] no right to do so."

Under the constructional approach to tax avoidance, however, the case turned solely on the interpretations by the Revenue, the Special Commissioner and the High Court of the very legislation the scheme was devised to cheat or defraud.

The Special Commissioner's summary of the Revenue's contradictory decisions underscores the proposition that "[w]henever the [Revenue] decides that kind of dispute it legislates about taxation":

> "In brief the appellant entered into a tax avoidance scheme involving transactions in gilts designed to create a tax deduction for a manufactured interest payment. The Revenue issued a closure notice contending that *Ramsay* applied with the effect that no deduction was created (and a smaller amount of income was not taxable), but they have since abandoned that contention and now contend that the deduction is allowable but that appellant is taxable on an amount approximately equal to the deduction under the accrued income scheme."[837]

Justice Henderson's summary of his decision and the decision of the Special Commissioner in favour of the taxpayer similarly supports the proposition that "[w]henever the Courts decides that kind of dispute it legislates about taxation":

> "The substantive issue turns ultimately on a short question of construction of an excepting provision in Chapter II of Part XVII of the Income and Corporation Taxes Act 1988 ('ICTA') as it applied in the tax year 2001/02 to a series of transactions in gilt-edged securities undertaken by Mrs D'Arcy with the avowed object of obtaining an allowable deduction against her taxable income for a so-called manufactured interest payment of approximately £1,511,000. It is no longer in dispute that she is entitled to such a deduction as a result of the transactions she entered into. The question that I have to decide, in outline, is whether the benefit of that deduction is largely cancelled out by a charge to income tax under the provisions relating to the transfer of securities with accrued interest ('the accrued interest scheme') in Chapter II of Part XVII. It is common ground that such a charge arises unless it is excluded by the exception in section 715(1)(b), which applies:
>
> > "if the transferor is an individual and on no day in the year of

[836] [2012] UKFTT 314 at [21]. Emphasis supplied.
[837] Ibid, p.545, para [2].

> assessment in which the interest period ends or in the previous year of assessment the nominal value of securities held by him exceeded £5000."
>
> At first blush it may seem surprising that there could be any question of this exception applying to Mrs D'Arcy, as the transactions which she undertook involved two acquisitions and disposals of gilts with a nominal value of £31,000,000 over a period of seven days in February 2002. However, as I shall explain the exception has to be read in the light of certain interpretative provisions in section 710, including in particular section 710(7)(b) which provides that a person holds securities on a day:
>
> > "if he is entitled to them throughout the day or he becomes and does not cease to be entitled to them on the day."
> >
> > The short point on which the appeal turns is whether Mrs D'Arcy, who admittedly became entitled to £31,000,000 nominal of gilts on 20th February 2002, also ceased to be entitled to them on that day within the meaning of section 710(7)(b), in which case she did not hold them on that day and they do not count for the purposes of the £5,000 threshold in section 715(1)(b); or whether, as the Revenue contend, she did not cease to be entitled to them on 20th February within the meaning of section 710(7)(b) because she is already conclusively deemed to have transferred them on 13th February by virtue of further deeming provisions in section 710(6). If the Revenue's construction is correct, the conclusion follows that Mrs D'Arcy did indeed hold the relevant gilts on 20th February 2002 and the exception in section 715(1)(b) is clearly inapplicable." [838]

As the scheme was devised and implemented after Parliament enacted the "excepting provision in Chapter II of Part XVII of ICTA" that came into force on **April 6, 1988**, the decisions of the Revenue and the Courts "as it applied in the tax year **2001/02**" could not possibly have been made by Parliament. In the words of Lord's Diplock that cannot be over-emphasised:

> "Do not let us deceive ourselves with **the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant**. Anyone who has decided tax appeals knows that most of them concern **transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all.** Some of the **transactions are of a kind which had never taken place before the Act was passed**: they were **devised as a result of it**."

The transactions Philip Shirley introduced to Philippa D'Arcy "by letter dated 10 January 2002" were undoubtedly "transactions … of a kind which had never taken place before the [excepting provision in Chapter II of Part XVII of ICTA] was passed [in 1998] devised as a result of it" and were probably "transactions which Members of Parliament and the

[838] [2007] EWHC 163 (Ch) [4]-[6]. Emphases supplied.

draftsman of the ["excepting provision in Chapter II of Part XVII of ICTA"] had not anticipated, about which they had never thought at all." According to Beighton:

> "The judges are in theory trying to discern the will of parliament but, in seeking to do so by reference to the precise wording with which parliamentary counsel has chosen to express the instructions he or she received, they are straining at a fiction. The range of detailed circumstances which arise in day-to-day life, let alone the arrangements which can be made if it is advantageous to the taxpayer so to do, is so enormous that no one minister, member of parliament, parliamentary counsel or revenue official, or all of them working together, can possibly envisage them.
>
> One major reason why tax legislation is so complex is that the strict basis of construction requires counsel, in putting into statutory language the policy to which ministers wish to give effect, to attempt to cover every circumstance which he or she and those instructing can envisage. Even so it is an idle pretence for anyone to suggest that it is humanly possible for the full set of possibilities to be foreseen."[839]

The different decisions of the Revenue, the Special Commissioner and the High Court "on a short question of construction of an excepting provision in Chapter II of Part XVII of ICTA as it applied in the tax year 2001/02 to a series of transactions in gilt-edged securities undertaken by Mrs D'Arcy with the avowed object of obtaining an allowable deduction against her taxable income for a so-called manufactured interest payment of approximately £1,511,000" cannot, therefore, mean that Philip Shirley, the other professional enablers and Philippa D'Arcy did not cheat the public revenue by using the scheme "to reduce her income tax liability" by "approximately £1,511,000" in law and in fact.

As demonstrated in chapter five, the unprecedented prosecution in *Charlton* highlighted the fundamental flaw in the notion that a decision by the Revenue or the court that a scheme "works" as a matter of statutory construction impels the corollary that it is "legal" as a matter of law. As Masters, who appeared as expert evidence for Charlton, complained afterwards:

> "I can see a general move to blur what is a very clear distinction between illegal evasion and legal avoidance, a move in which the Inland Revenue itself has had a hand as can be seen from the case. ...
>
> A large number of tax mitigation arrangements of many types were implemented in the period covered by the Charlton transactions: from 1978 to 1990 (and indeed in the years before and after that period). Many were accepted by the Inland Revenue as effective, and some were endorsed by

[839] Beighton, p.42.

> the courts. In fact, schemes using structures set up in Jersey and elsewhere were so widespread and so successful that a great deal of specific anti-avoidance legislation has to be introduced over the past two decades. ...
>
> Most major firms of solicitors and accountants advised clients on tax haven operations during the period covered by the indictment. Many would have been involved in arrangements similar to Mr Charlton's schemes. A lot of schemes failed to achieve their objective but that was because they were caught by one or more of the many anti-avoidance provisions now to be found in the tax legislation, or because of the unfavourable approach of the courts to what is now perceived as 'unacceptable', albeit legal, tax avoidance."[840]

D'Arcy shows that the fact that a scheme is "accepted by the … Revenue as effective" by purporting "to ascertain the intention of Parliament when applying legislation to novel situations" and "endorsed by the courts" under "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant" does not mean that it does not amount to cheating the public revenue in law or more specifically that the professional advisers that devised, marketed, implemented and otherwise facilitated its use and the taxpayer that used it did not cheat the public revenue in law.

Part XVII of ICTA, which includes Chapter II, is entitled 'Tax Avoidance' because is a specific anti-avoidance legislation. The fact "that a great deal of specific anti-avoidance legislation has to be introduced" to counter tax avoidance schemes involving transactions in gilts designed to create a tax deduction for a manufactured interest payment, therefore, means that they amount to cheating because anti-avoidance legislation codifies and decriminalises the pre-existing common law of cheating as demonstrated in chapter one. According to Rhodes et al's rebuttal of Masters's argument:

> "It has also been argued that the Revenue and the court were in error in seeking to apply criminal law instead of challenging the arrangements under civil revenue law, such as the transfer pricing provisions of s 770 Income & Corporation Taxes Act 1988. Again, such an argument is fallacious as it would be a cardinal error to assume that, simply because an arrangement can either be challenged under civil law or prosecuted under criminal law, the Inland Revenue and the courts have some overriding obligation to deal with the matter under the former category. Indeed, common sense would suggest that in such instances criminal law should take precedence."[841]

[840] Masters, pp.388-390.
[841] Rhodes, p.219.

The rule of law and tax justice demand that criminal proceedings should take precedence because as things stand they are the only way to determine whether the professional enablers and the participating taxpayers cheated the public revenue in law.

The civil penalty for the enablers and users of defeated tax avoidance schemes introduced by Finance (No. 2) Act 2017 is fundamentally flawed because it can only apply to schemes "defeated" or "counteracted" under the fundamentally flawed constructional approach. The Consultation Document described it as:

> "Proposals for sanctions for those who design, market or facilitate the use of tax avoidance arrangements which are defeated by HMRC and to change the way the existing penalty regime works for those whose tax returns are found to be inaccurate as a result of using such arrangements."[842]

Arrangements will be defeated under the legislation, therefore, where there is a final determination of a tribunal or court that they *do not* "work" under "the legal fiction that the Court is only ascertaining and giving effect to what Parliament meant"[843] in a case between "those whose tax returns are found to be inaccurate as a result of using such arrangements" and HMRC, to which "those who design, market or facilitate the use of tax avoidance arrangements" are not parties; or, in the absence of such a decision, there is agreement between "those whose tax returns are found to be inaccurate as a result of using such arrangements" and HMRC that the arrangements *will not* "work" under the legal fiction in which HMRC "will seek to ascertain the intention of Parliament when applying legislation to novel situations."[844]

The case studies in the Consultation Document fortify the fundamental thesis that tax avoidance is cheating the public revenue by "those who design, market or facilitate the use of tax avoidance arrangements" in which "those whose tax returns are found to be inaccurate as a result of using such arrangements" may or may not be complicit:

> "**Case study 2.1**
>
> John Combos devises a tax avoidance scheme aimed at contractors and freelancers, requiring them to become employees of a special purpose

[842] HMRC, *Strengthening Tax Avoidance Sanctions and Deterrents: A discussion document*, August 17, 2016, p.2.
[843] Diplock.
[844] Gribbon.

employer and to receive money in the form of loans. A company is created to become the employer of the contractors and freelancers and Combos offers cash incentives to existing users of the scheme for each new user they sign up. He also offers similar fees to a variety of accountants and IFAs for any business they refer his way.

The enablers of tax avoidance are:
- Combos as he receives fees for the scheme
- IFAs for receiving referral fees
- Accountants for receiving referral fees
- The company set up to employ the contractors
- Individual contractors that have received referral fees

Although all of these players have a role in enabling the avoidance, currently none of them face sanctions if the scheme is defeated by HMRC. Under the proposals in this consultation, each of them would be within the scope of the new penalty.

Case study 2.2

XYZ is a large scheme involving the creation of Limited Liability Partnerships, each of which has several hundred members. The scheme is devised by Matt Lanyard with external assistance involving advice from accountants and a QC, each of whom receive fees from Lanyard. As part of the arrangements a bank provides the funds required to drive the scheme and takes a fee, which reflects a share of the tax advantage. FCA regulations prevent Lanyard from marketing the scheme direct to potential clients, so he engages the services of a number of IFAs on a commission basis to introduce the concept to their clients. Some of those IFAs make contact with local firms of accountants who, again for a commission, make their clients aware of the scheme and put them in contact with the IFA. Although all of these players have a role in enabling the tax avoidance, if the scheme is defeated by HMRC none of them currently face tax-related sanctions, other than the bank if it has adopted the banking code. However, each would be within the scope of the enabler penalty proposed in this consultation."[845]

Although all of these "players" have a role in enabling the tax avoidance and will be within the scope of the legislation if the schemes "are defeated by HMRC", the question whether they cheated the public revenue in law does not determine whether the schemes "are defeated by HMRC".

III. THE COROLLARIES OF THE FRAUDULENT AND CRIMINAL NATURE OF TAX AVOIDANCE

III.I. A New Approach to Tax Avoidance

[845] Ibid, p.9.

III.I.I *Compulsory Criminal Investigation*

The criminal nature of tax avoidance and the huge amount of revenue involved put it squarely within the following provisions of *HMRC Criminal Investigation Policy*:

> "Criminal investigation will be reserved for cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate. ...
>
> Examples of the kind of circumstances in which HMRC will generally consider starting a criminal, rather than civil investigation are in cases of organised criminal gangs attacking the tax system or systematic frauds where losses represent a serious threat to the tax base, including conspiracy."[846]

As HMRC "aims to secure the highest level of compliance with the law and regulations governing direct and indirect taxes and other regimes for which they're responsible"[847] and "reserves complete discretion to conduct a criminal investigation in any case"[848], HMRC should exercise it as a matter of course in every case of tax avoidance. In the words of the Keith Committee:

> "Enforcement powers are ... necessary not only to coerce the dishonest and the neglectful, but to encourage the honest and conscientious."[849]

III.I.II. *Selective Criminal Prosecution*

Criminal investigation does not have to result in criminal prosecution. The contention here is that the selective prosecution policy, which applies only to tax evasion under the dogma that "tax avoidance is legal", should be applied to tax avoidance because it is a criminal offence perpetrated by professional advisers who are currently outside the scope of the tax appeals system. In the words of Justice Farquharson's sentencing remarks in *Charlton*:

> "It is a feature, no doubt, of the tax or Revenue law of any country that it must, to a large extent, in its tax-gathering activities, rely on the truthfulness of the taxpayer in indicating the extent of his income or whatever other matter is relevant to the particular statute being considered. It follows also that the Revenue not only have to rely on the taxpayer's good faith, but

[846] Ibid.
[847] Ibid.
[848] Ibid.
[849] *Final Report*, p.3.

> more especially on the professional advisors they appoint to act for them and, accordingly, when professional advisors are found to have acted dishonestly towards the Revenue, it is almost inevitable, as I think each counsel before us has recognised, that sentences of imprisonment must follow and we adhere to that position."[850]

The equally landmark prosecution in *Hudson* indicates that prosecution is a requirement of the rule of law and tax justice. As "Watchful" stated in a commentary:

> "All taxation is the creature of statute, and so far as income tax is concerned the relevant statutes are comparatively modern. Yet in the recent case of *R v Hudson*, which was a criminal prosecution arising out of acts alleged to have been done by the defendant in relation to his income tax affairs, all the counts of the indictment were laid at common law under a precedent traceable to the fourteenth century. This is not quite the paradox it seems if we remember that the Tax Acts are but a part of the general law of the land. Just as, on the one hand, nobody can be taxed otherwise than in accordance with the law, so it can and should be insisted that the whole of that law is relevant in any question concerning taxation."[851]

III.I.III. *The Cheating or Fraud Approach to Civil Litigation*

The landmark decision of the Supreme Court in *Ivey* that a common test of dishonesty applies in criminal and civil law confirms that the courts can give effect to the rule of law and tax justice ("Just as, on the one hand, nobody can be taxed otherwise than in accordance with the law, so it can and should be insisted that the whole of that law is relevant in any question concerning taxation") in civil proceedings by applying the pre-existing common law of cheating which "acts upon the offence, by setting aside the fraudulent transaction"[852] and without resorting to the common law offence which "acts upon the offender, and inflicts a penalty"[853] in criminal proceedings.

No new law, whether legislation or case law, is, therefore, required to give effect to the proposed cheating or fraud approach of deciding tax avoidance litigation on the basis of the same legal question whether the participating taxpayer, but more especially the professional enablers, cheated or defrauded or otherwise acted dishonestly towards the Revenue in law, which was applied in *Charlton*.

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[850] *Charlton*, p.532.
[851] "Watchful".
[852] Blackstone.
[853] Ibid.

III.II. Defamation and Malicious Falsehood

The fraudulent and criminal nature of tax avoidance means that an allegation of tax avoidance, like an allegation of tax evasion, should not result in liability for defamation or malicious falsehood because of "the principle that nobody may benefit from his own civil *or* criminal wrong."[854]

The prevailing law and practice rest upon the dogma that "tax avoidance is legal and tax evasion is illegal". In *Pirtek v Jackson*, where the allegation was "that Pirtek is a shady company that practised tax avoidance", Judge Warby stated:

> "The Particulars of Claim allege that all the words complained of are defamatory. By that, I take the pleading to refer to the common law requirement that, in order to be actionable as a libel, words must have a tendency to defame the claimant. That raises a question of law. The law requires that the statement be damaging to the reputation of the claimant in the eyes of ordinary, right-thinking people generally. ...
>
> It is ... defamatory at common law to accuse somebody of being 'shady'. 'Tax avoidance' refers to a lawful activity, distinct from tax evasion which is unlawful. An allegation of 'tax avoidance' may or may not be defamatory, according to the context. [Counsel for the claimant] has quite properly addressed this point. Her argument is that in the present case the imputation, read as a whole, has defamatory overtones. I am inclined to accept that."[855]

In *Tesco v Guardian*, where the allegation was that the claimant had set up an offshore tax avoidance scheme, Justice Eady stated that: "The defendants ... admit that the meanings pleaded by the claimant are defamatory."[856]

As demonstrated in this thesis, tax avoidance refers to an unlawful, and indeed criminal, activity. In their article cited above, however, Freedman et al stated:

> "Practically every media report on avoidance now starts with the statement that the activities it is discussing are legal but still amount to avoidance. It is well understood that there is a difference between evasion, which ... is illegal; and avoidance, which is 'legal'."[857]

The media invariably includes such caveats as "there is no suggestion that company A

[854] Steyn, *Hinks*.
[855] [2017] EWHC 2834 [42]-[44].
[856] *Guardian*, p.93.
[857] Ibid.

or individual B has done anything illegal" or "tax avoidance is perfectly legal" because the courts and the potential expert witnesses in a defamation or malicious falsehood claim perpetuate the fallacy that "avoidance is legal."

III.III. Confidentiality and Whistleblowing

The fraudulent nature of tax avoidance extinguishes the rights of the enabling professional advisers and the participating taxpayers to confidentiality. In the words of Lord Wood's classic statement of the iniquity or fraud or illegality exception to confidentiality in *Gartside v Outram*:

> "The true doctrine is that there is no confidence as to the disclosure of an iniquity. You cannot make me the confidant of a crime or fraud, and be entitled to close up my lips upon any secret which you have the audacity to disclose to me relating to any fraudulent intention on your part."[858]

The terms "iniquity" and "a crime or fraud" show that fraud is used here in the widest sense that encompasses any illegality to give effect to "the principle that nobody may benefit from his own civil *or* criminal wrong".

The disclosure of confidential information in the public interest is well established in law. As I stated elsewhere:

> "Where the general requirements are met under both the old and new law, the courts have consistently refused to uphold the right to confidence when to do so would be to cover up wrongdoing. Originally this principle was narrowly stated, on the basis that nobody can be made the 'confidant of a crime or a fraud.'[859] This approach has been developed in the modern authorities to include any case in which it is in the public interest that the confidential information should be disclosed, whether or not a crime or fraud is involved. [860]
>
> Lord Goff explained the rationale for this public interest exception thus: 'It is that, although the basis of the law's protection of confidence is that there is a public interest that confidences should be preserved and protected by the law, nevertheless that public interest may be outweighed by some other countervailing public interest which favours disclosure. This limitation may apply … to all types of confidential information. It is this limiting principle which may require a court to carry out a balancing operation, weighing the public interest in maintaining confidence against a countervailing public

[858] (1856) 26 LJ (NS) 113, 114.
[859] *Gartside v Outram* (1857) 26 LJ Ch 113, 114 (Sir William Page Wood V-C).
[860].See *Beloff v Pressdram Ltd* [1973] 1 All ER 241 (Ch D) at 260 per Ungoed-Thomas J; and *Lion Laboratories Ltd v Evans* [1985] QB 526 (CA) at 550 per Griffiths LJ.

interest favouring disclosure.'[861]"[862]

Recent public interest disclosures by whistleblowers, such as SwissLeaks, LuxLeaks and Panama Papers, underscore the countervailing public interest favouring disclosure.

The unprecedented investigation by the Permanent Subcommittee on Investigations of the US Senate[863] was also sparked by a public interest disclosure by a KPMG lawyer acting as a whistleblower. According to Rostain:

> "During the late 1990s, large numbers of lawyers joined accounting firms, lured by their rapidly expanding tax services. Many were recruited directly from school; others were well-established partners at corporate law firm, tempted by the enormous income potential of tax product work. It was also a lawyer who finally exposed KPMG's shelter activities.
>
> In the summer of 2002, Michael Hamersley, a tax lawyer who had worked at the firm for four years and was a few weeks shy of partnership, refused to sign off on the tax treatment of a transaction that was part of a KPMG audit of a Fortune 500 company. Pressured to destroy documents related to the audit, which he believed was fraudulent, Hamersley contacted federal authorities. His cooperation in a government investigation during the subsequent year brought the details of KPMG's shelter business to light."[864]

By contrast, in his article analysed in the Introduction, Maugham claimed that "duties of confidentiality" trump his "obligation to report serious misconduct":

> "I have on my desk an Opinion - a piece of formal tax advice - from a prominent QC at the Tax Bar. In it, he expresses a view on the law that is so far removed from legal reality that I do not believe he can genuinely hold the view he says he has. At best he is incompetent. At worst, he is criminally fraudulent: he is obtaining his fee by deception. And this is not the first such Opinion I have seen; they pass across my desk all the time. ...
>
> I have considered my own obligations. To report [them] to the Bar Standards Board would involve me breaching my duties of confidentiality to my clients (through whose instructions I see the Opinions). And this trumps my obligation to report serious misconduct."[865]

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[861] *Attorney General v Guardian Newspapers Ltd (No.2)* [1988] UKHL 6 at [29].
[862] Osita Mba 'Transparency and accountability of tax administration in the UK: the nature and scope of taxpayer confidentiality' [2012] *B.T.R.* 187, 198-199.
[863] PSI (2003) and (2005).
[864] Rostain, pp.1-2.
[865] 'Maugham, pp.8-9.

III.IV. Money Laundering

The common law offence of cheating the public revenue, which is triable only on indictment and punishable by a fine and/or imprisonment at large, became a predicate crime for the purposes of money laundering on April 1, 1994 when the Criminal Justice Act 1988 (CJA)[866] came into effect. As the Chancellor of the Exchequer said at the Commonwealth Finance Ministers' meeting on October 5, 1995:

> "We must recognise that money laundering is associated with all types of crime, from fraud to extortion, arms smuggling to kidnapping. It is quite artificial to draw a distinction between drug related crimes and other crimes. In Britain we have responded to the shifting threat by passing legislation to cover the proceeds of all indictable offences. There is no moral difference between drug trafficking and other serious offences, and the risks from both are great, and this applies as much to fiscal offences as any other crime. All crimes should mean all crimes. Who is the victim is irrelevant. Tax crimes make the law abiding suffer. It is they who make up the shortfall caused by those who cheat."[867]

Tax avoidance, like tax evasion, therefore, fell within the term "criminal conduct" in the definition of the three principal money laundering offences in sections 93A, 93B and 93C. As Rhodes et al stated in their article on *Charlton* which predated the CJA:

> "Although it may be a proposition with which the defendants in *Charlton* are unlikely to agree, the timing of the offences and their prosecution was perhaps fortunate for them. Sections 93A, 93B and 93C of the CJA came into effect on April 1, 1994. ... Any professional adviser indicted on a charge of cheat or conspiracy today might face charges under these sections as well as the predicate crime of cheating the public revenue."[868]

The principal money laundering offences are now found in sections 327, 328 and 329 of the Proceeds of Crime Act 2002 (POCA), which came into force on February 24, 2003. Cheating the public revenue, like fraud under the Fraud Act since 2006, remains a "criminal conduct" for the purposes of these sections. Money laundering is defined as an act which constitutes an offence under any of these sections or a conspiracy or an attempt to commit such an offence, including counselling, aiding, abetting and procuring.

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[866] Inserted by section 29 Criminal Justice Act 1993.
[867] HM Treasury Press Office, October 5, 1995.
[868] Rhodes.

Any professional adviser indicted for cheating the public by devising or marketing or implementing or otherwise facilitating the use of a tax avoidance scheme will, therefore, be liable to charges under these sections as well as the predicate crime of cheating because tax avoided by the participating taxpayer (like tax evaded by a taxpayer who deliberately fails to make a return or deliberately makes a false return without using a tax scheme in tax evasion) constitutes “criminal property” for the purposes of these sections. No further *mens rea* is required.

A person guilty of an offence under section 327, 328 or 329 is liable on summary conviction, to imprisonment for a term not exceeding six months or to a fine not exceeding the statutory maximum or to both; or on conviction on indictment, to imprisonment for a term not exceeding 14 years or to a fine or to both.[869]

[869] Section 334.

APPENDIX ONE

THE INFORMATION IN THE KPMG TAX AVOIDANCE CASE

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------	**X**	
UNITED STATES OF AMERICA	**:**	**INFORMATION**
-against-	**:**	**05 Cr. ( )**
KPMG LLP,	**:**	
Defendant.	**:**	
----------	**X**	

COUNT ONE
(Conspiracy)

The United States Attorney charges:

Background

Pertinent Entities

1. At all times relevant to this Information, KPMG LLP ("KPMG) was a limited liability partnership headquartered in New York, New Your, and with more than 90 offices nationwide. KPMG LLP is and was a member firm of KPMG International, a Swiss cooperative of which all KPMG firms worldwide are members. At all times relevant to this Information, KPMG was one of the largest auditing firms in the world, providing audit services to many of the largest corporations in the United States and elsewhere.

2. In addition, KPMG was in the business of providing tax services to corporate and individual clients, including some of the wealthiest individuals in the United States. These tax services included, but were not limited to, preparing tax returns, providing tax planning and tax advice, and representing clients in Internal Revenue Service ("IRS") audits and Tax Court litigation with the IRS. The portion of KPMG's tax practice that specialized in providing tax advice to individuals, including wealthy individuals, was known as Personal Financial Planning, or "PFP." The KPMG group focused on designing, marketing, and implementing tax shelters for individual clients was known at different times as CaTS ("Capital Transaction Strategies"), and IS ("Innovation Strategies"). The KPMG group focuses on designing, marketing, and implementing tax shelters for corporate clients was known as Stratecon. KPMG also had a department within the tax practice known as Washington National Tax, which was designed to provide expert tax advice to KPMG professionals in the field, and which participated in designing tax shelter and drafting opinion letters relating to those shelters.

3. At all times relevant to this Information, "Bank A" was a foreign bank with its principal United States branch located in New York, New York.

4. At all times relevant to this Information, "Bank B" was a foreign bank with its principal United States branch located in New York, New York.

5. At all times relevant to this Information, "Bank C" was a foreign bank.

6. At all times relevant to this Information, “Bank D” was a foreign bank with its principle United States branch located in New York, New York.

7. In or about 1997, two former KPMG tax professionals, who are co-conspirators not named as defendants herein, formed a limited liability company with its principal office located in San Francisco and a satellite office located in Denver. In or about 1999, these two individuals and another individual formed another limited liability company with its principal office located in San Francisco and a satellite office located in Denver. As detailed more fully below, the conspirators used the two limited liability companies described in this paragraph and certain related entities (collectively referred to herein as “the SF Entities”) to participate in certain tax shelter transactions as, among other things, the purported investment advisor.

Tax Shelter Fraud

8. During the period from at least in or about 1996 through at least in or about 2003, the defendant KPMG, and others known and unknown (hereinafter the “co-conspirators”), participated in a scheme to defraud the IRS by devising, marketing, and implementing fraudulent tax shelters, by preparing and causing to be prepared, and filing and causing to be filed with the IRS false and fraudulent U.S. individual income tax returns containing the fraudulent tax shelter losses, and by fraudulently concealing from the IRS those shelters. This illegal course of conduct was deliberately approved and perpetrated at the highest levels of KPMG’s tax management, and involved dozens of KPMG partners and other personnel.

9. KPMG and its co-conspirators designed and marketed these shelters as a means for wealthy individuals with taxable income or gains generally in excess of $10 million in 1997 and of £20 million in 1998-2000 fraudulently to eliminate or reduce the tax paid to the IRS on that income or gain. As marketed and implemented, instead of the wealthy clients paying U.S. individual income taxes generally exceeding 20% of the income or gain, the client could choose the amount of tax loss desired and pay certain of the conspirators and others an all-in cost generally equal to approximately 5 to 7% of the desired tax loss. This “all-in” cost included the fees of KPMG, the SF Entities, the various law firms that supplied opinion letters, including a prominent national law firm with offices in New York, New York (the “Law Firm”), the bank participants, and others, as well as a small portion that would be used to execute purported “investments” that were designed to make it appear that the shelters were legitimate “investments” rather than tax shelters. The size of the purported “investments,” the timing of the transactions, and the amount of the fees to certain conspirators and participants were all determined based on the tax loss to be generated.

10. In order to conceal the true nature of the tax shelter from the IRS and shield the wealthy clients from IRS penalties for underpaying of U.S. individual income taxes, KPMG, and/or a law firm provided the clients with opinion letters containing false and fraudulent representation and statements and claims that the tax shelter losses where “more likely than not” to survive in court if challenged by the IRS. The law in effect from at least in or about August 1997 provided that if a taxpayer claimed a tax benefit that was later disallowed, the IRS would impose substantial penalties, usually at least 20% of the tax deficiency, unless the tax benefit was supported by an independent opinion relied on by the taxpayer in good faith that the tax benefit was “more likely than not” to survive IRS challenge. Thus, the conspirators issued false and fraudulent opinions letters with the intent that the clients would provide the opinion letter and/or the false and fraudulent representations and statements containing therein to the IRS if and when the clients were audited.

11. Among the fraudulent tax shelter transactions designed, marketed and implemented by KPMG, its personnel, and their co-conspirators were FLIP (“Foreign Leveraged Investment

Program"), OPIS ("Offshore Portfolio Investment Strategy"), BLIPS ("Bond Linked Issue Premium Structure", SOS, ("Short Option Strategy") and their variants.

12. FLIP was marketed and sold from at least in or about 1996 through at least in or about 1999 to at least 80 wealth individuals and generated at least $1.9 billion in phony tax losses; KPMG's gross fees from FLIP transactions were at least $17 million; the Law Firm's gross fees from FLIP transactions were at least $3 million; the SF Entities' gross fees from FLIP transactions were at least $3 million.

13. OPIS was marketed and sold from at least in or about 1998 through at least in or about 1999 to at least 170 wealthy individuals, and generated at least $2.3 billion in phony tax losses; KPMG's gross fees from OPIS transactions were at least $28 million; the Law Firm's gross fees from OPIS transactions were at least $12 million.

14. BLIPS was marketed and sold from at least in or about 1999 through at least in or about 2000 to at least 186 wealth individuals, and generated at least $5.1 billion in phony tax losses; KPMG's gross fees from BLIPS transactions were at least $53 million; the Law Firm's gross fees from BLIPS transactions were at least $13 million; the SF Entities' gross fees from BLIPS transactions were at least $13 million; SF Entities' gross fees from BLIPS transactions were at least $123 million.

15. SOS was marketed and sold from at least in or about 1998 through at least in or about 2002 to at least 165 wealthy individuals, and generated at least $1.9 billion in phony tax losses; KPMG's gross fees from SOS transactions were at least $17 million. Among the individuals who used BLIPS and SOS-type shelters to evade their own taxes were at least 14 KPMG partners, and other co-conspirators.

16. The total amount of taxes evaded through the use of FLIP, OPIS, BLIPS, and SOS transactions was at least $2.5 billion.

The Fraudulent FLIP and OPIS Shelters

17. FLIP and OPIS were substantially similar. FLIP and OPIS were generally marketed only to people who had capital gains in excess of $10 million for FLIP and $20 million for OPIS. These shelters were designed to generate substantial phony capital losses (i.e., in excess of $10 million for FLIP and in excess of $20 million for OPIS) through the use of an entity created in the Cayman Islands (a tax haven), for purposes of the tax shelter transaction. The client purportedly entered into an "investment" transaction with the Cayman Islands entity by purchasing a purported warrant or entering into a purported swap. The Cayman Islands entity then made a pre-arranged series of purported investments, including the purchase from either Bank A or Bank D of either Bank A or Bank D stock using money purportedly loaned by Bank A or Bank D, followed by redemptions of those stock purchases by the pertinent bank. The purported investments were devised to eliminate economic risk to the client beyond the all-in cost and minimize the amount of the all-in cost used for the investment component. The purported investments were also devised to last for only approximately 16 to 60 days.

18. In return for fees totalling approximately 7% of the desired tax loss, including a fee to KPMG equal to approximately 1.25% of the desired tax loss, KPMG and its co-conspirators implemented and caused to be implemented FLIP and OPIS transactions and generated and caused to be generated false and fraudulent documentation to support the transactions, including but not limited to KPMG opinion letters claiming that the purported tax losses generated by the shelters were more likely than not to withstand challenge by the IRS. A New York tax partner at the Law Firm, who is a co-conspirator not named as a defendant herein, also issued "more likely than not" opinion letters in return for fees typically of approximately $50,000 per opinion, which opinions tracked, sometimes verbatim, the KPMG opinion letter. In general, all of these opinion letters were identical, except for the

names of the clients, the names of the entities, the dates, and the dollar amounts involved in the transactions.

19. KPMG and its co-conspirators issued and caused to be issued the opinion letter although, as they well knew, (i) the tax positions taken were *not* more likely than not to prevail against an IRS challenge if the true facts regarding those transactions were known to the IRS, and (ii) the opinion letters and other documents used to implement FLIP and OPIS were false and fraudulent in a number of ways, including but not limited to the following:

a. The opinion letters began by falsely stating that the client requested KPMG's opinion "regarding the U.S. federal income tax consequences of certain investment portfolio transactions," when in truth and in fact, the conspirators targeted wealthy clients based on the clients' large taxable gains and, in return for substantial fees to KPMG, the SF Entities, the Law Firm, certain co-conspirators, and others, offered to generate phony tax losses to eliminate income tax on that gain, and offered to provide a "more likely than not" opinion letter.

b. The opinion letter continued by falsely stating that the "investment strategy was based on the expectation that a leveraged position in the Foreign Bank securities would provide investor with the opportunity for capital appreciation" when in truth and in fact the strategy was based on the expected phony tax benefits promised by certain conspirators.

c. The opinion letters also falsely claimed that the clients "reviewed the economics underlying the investment strategy and believed it had a reasonable opportunity to earn a reasonable profit from each of the transactions . . . in excess of all associated fees and costs and not including any tax benefits that may occur" when in truth and in fact, they was no such opportunity.

d. The opinions falsely claimed that one of the participants in the transactions (an owner of the Cayman Islands entity) was a foreign person unrelated to the other participants, when in truth and in fact this foreign person was simply a nominee who received a fee to assist KPMG, other co-conspirators, and other participants in generating the phony tax losses, and one of the foreign persons had an ownership interest in the SF Entities, which participated in many of these transactions.

e. The opinion letters falsely stated that money was paid by the FLIP and OPIS clients for an "investment" component of the transactions (a warrant or a swap), when in truth and in fact that money constituted fees paid to KPMG, the Law Firm, the bank participant, the nominee foreign person, and other participants, as well as money that was temporarily parked in the deal but ultimately returned to the client.

f. The opinion letters also falsely claimed that there was no evidence of a "firm and fixed" plan to complete the steps making up the shelter in a particular manner, when in truth and in fact, there was such a plan, and the transactions in fact were completed in that particular manner which was designed to generate the tax loss.

g. The opinion letters stated that the clients were "more likely than not" to survive an IRS challenge to the transactions based on the "step transaction doctrine" – a legal doctrine permitting the IRS to disregard certain transactions having no economic substance or business purpose and the purported tax effects of those disregarded transactions. The assertion was false, as the conspirators well knew. Indeed, a co-conspirator not named as a defendant herein ("CC 1"), who at the time was in charge of CaTS, instructed KPMG partners involved in marketing OPIS not to permit KPMG clients who pitched OPIS to retain a copy of KPMG's PowerPoint presentation describing the transaction "under any

circumstances" because to do so "DESTROY any chance the client may have to avoid the step transaction doctrine."

The Fraudulent BLIPS Shelter

20. BLIPS was designed to generate substantial capital and ordinary tax losses through a series of pre-arranged transactions that involved the client purportedly borrowing money from one of three banks – Bank A, Bank B, or Bank C – in order to make purported foreign currency investments including currencies that were "pegged" to the United States dollar. The bank involved in the purported loan also served as the counterparty on all of the purported currency and other transactions involved in BLIPS. The transaction was designed by KPMG and its co-conspirators so that after a short period of time (virtually always approximately 67 days), the client would exit the purported BLIPS transaction and trigger the desired tax loss.

21. In return for fees totalling approximately 7% of the desired tax loss, including a fee to KPMG equal to approximately 1.25% of the desired tax loss, a fee to the SF Entities equal to approximately 2.75% of the desired tax loss, and a fee to the Law Firm generally equal to approximately $50,000 per transaction, KPMG and its co-conspirators and others implemented and caused to be implemented the transactions and generated and caused to be generated false and fraudulent documentation to support the transactions, including but not limited to KPMG and the Law Firm opinion letters claiming that the purported tax losses generated by the shelters were more likely than not to withstand challenge by the IRS. In general, all of these opinion letters were identical, except for the names of the clients and entities involved, the dates, and the dollar amounts involved in the transactions.

22. KPMG and its co-conspirators issued and caused to be issued the opinion letters although, as they well knew, (i) the tax positions taken were *not* more likely than not to prevail against an IRS challenge if the true facts regarding those transaction were known to the IRS, and (ii) the opinion letters and other documents used to implement BLIPS were false and fraudulent in a number of ways, including but not limited to the following:

a. BLIPS was falsely and misleadingly described as an investment program, when in truth and in fact, BLIPS was designed, marketed, and implemented to generate phony tax losses in order to eliminate income taxes for wealthy clients and garner substantial fees and income for KPMG, the SF Entities, the Law Firm, certain co-conspirators, and others.

b. BLIPS was falsely described as a three-stage, seven-year investment program, when in truth and in fact, all participants were expected to withdraw at the earliest opportunity and within the same tax year in order to obtain their tax losses. Indeed, KPGM and its co-conspirators caused the opinion letters to contain a false representation (which BLIPS clients adopted) that the duration of the client's participation in the three-phase, seven-year investment program was dependent upon the performance of the program relative to alternative investments, when in truth and in fact, the duration of the client's participation was dependent on the client's desire to obtain the phony tax losses to be generated.

c. BLIPS was falsely described as a "leveraged" investment program, when in truth and in fact, the purported loan transactions that were part of BLIPS (and were the aspect of BLIPS that purported to generate the tax loss) were shams – no money ever left the bank and none of the banks assigned any capital cost to these purported BLIPS loans. Indeed, at least one of the banks did not fund the loans at all – it neither set aside from its own funds nor obtained from the market any money to cover these purported "loans" and "loans premiums." In addition, the sham loans were not in any way used in the purported "investment" program involving trades relating to pegged currencies but, instead, were used only to generate a phony tax loss. The only money used in making

and securing the trades involving pegged currencies as part of BLIPS was money contributed by the client as part of the 7% all-in cost.

d. The BLIPS opinion letters falsely stated that the client (based on the client's purported "independent review") as well as the SF Entities "believed there was a reasonable opportunity to earn a reasonable pre-tax profit from the [BLIPS] transactions," when in truth and in fact, there was no "reasonable likelihood of earning a reasonable pre-tax profit" from BLIPS, and instead the "investment" components of BLIPS was negligible, unrelated to the large sham "loans" that were key elements of the purported tax benefits of BLIPS, and was simply window dressing for the BLIPS tax shelter fraud.

e. The opinion letters and other documents were misleadingly drafted to create the false impression that KPMG and others were independent service providers and advisors, rather than co-promoters and designers of the BLIPS shelter. Thus, for example, the KPMG BLIPS opinion letter misleadingly claims that the clients "requested our opinion regarding the U.S. federal income tax consequences of certain investments transaction that have been concluded" but the opinion letters, which falsely describe a purported seven-year investment program and a withdrawal from that program based on the purported investment performance of the program, were drafted prior the commencement of any BLIPS transaction.

f. Similarly, the KPMG engagement letter used for BLIPS contained the following false and fraudulent statements, among others, (i) that the client had engaged KPMG "to provide tax consulting services . . . with respect to participation in an investment program involving investments in foreign currency positions," when in truth and in fact KPMG marketed a tax shelter to the clients, and the clients engaged KPMG to assist the clients in generating phony tax losses using the tax shelter; (ii) that KPMG "understands that Client intends to engage" the SF Entities "to provide Client with investment advisory services and trading strategies," when in truth and in fact, the SF Entities were engaged to assist the clients in generating phony tax losses using a tax shelter; (iii) that the SF Entities "had advised the Client that the utilization of a high degree of leverage is integral to the Investment Program," when in truth and in fact the purported "leverage" was a sham loan designed only to support the creating of phony tax losses; and (iv) that KPMG'S fees would not be dependent on "the amount of any tax saving projected," when in truth and in fact the amount of KPMG's fee, as well as the size of the nominal investment made as part of the fraudulent tax shelter, and fees for the SF Entities and other participants in the transaction were all determined by the amount of phony tax losses desired by the client to offset income or gain received from other sources.

23. At various points during the development of BLIPS, KPMG personnel and others identified various significant defects of BLIPS, including that the description of BLIPS and the factual representations contained in the BLIPS opinions letter and in other documents were false, but nevertheless KPMG approved the issuance of BLIPS letters. When Washington National Tax approved the BLIPS documentation in August 1999, one of the KPMG tax shelter salesmen who helped devise BLIPS (a co-conspirator not named as a defendant herein) wrote another co-conspirator not named as a defendant herein "We have received our 'get out of jail free card' from [Washington National Tax]."

24. In addition, in or about March 2000, and prior to the issuance of any BLIPS opinion letters to clients, during a meeting attended by members of KPMG tax leadership, a representative from KPMG's office of general counsel, and others, a top KPMG technical expert involved in reviewing the KPMG BLIPS opinion told the other participants in substance and in part that if the IRS were to litigate BLIPS in court, the BLIPS participants would "lose." In addition, another member of KPMG's tax leadership informed the participants at the meeting, in substances and in part, that the tax position taken in BLIPS, was "close to frivolous." During that meeting, the participants also discussed the risks of proceeding with tax shelter transactions like BLIPS, including the risk of criminal

investigation, civil penalties, civil liability for fraud, action by the IRS's Director of Professional Practice, and action by state Boards of Accountancy. Nevertheless, and despite the obviously fraudulent nature of BLIPS and the warning conveyed, KPMG leadership decided to (i) proceed with the issuance of "more likely than not" opinion letters on all the 1999 transactions, and (ii) continue to implement more BLIPS tax shelter transactions in 2000.

The Fraudulent SOS Shelter

25. SOS and its variants were designed to generate substantial capital and ordinary tax losses through a series of pre-arranged transactions that involved the clients entering into virtually offsetting foreign currency option positions with a bank, including but not limited to Bank A, transferring the offsetting positions to a partnership or other entity, and then withdrawing from the transactions, claiming a loss in the desired amount. KPMG's Washington National Tax office considered whether KPMG should issue "more likely than not" opinions regarding SOS-type transactions, and concluded that the phony losses generated by those transactions were *not* more likely than not to withstand IRS challenge. Nevertheless, between 1998 and 2002, certain KPMG tax partners assisted in implementing SOS-type transactions for KPMG clients for a fee to KPMG generally equal to 1% of the tax losses to be generated, and prepared and caused to be prepared tax returns based on the phony SOS tax losses. For many of these SOS-type transactions, KPMG did not issue an opinion letter, but instead certain lawyers issued "more likely than not" opinion letters with respect to those transactions. The SOS opinion letters, and others associated documents, were false and fraudulent in a number of ways well known to KPMG and KPMG tax partners involved, including the following:

a. They misrepresented SOS as an investment, when in truth and in fact, it was a tax shelter designed to generate tax losses in order to eliminate income taxes for wealthy clients and garner substantial fees and income for KPMG, certain co-conspirators, and others.

b. They falsely claimed that the client would have entered into the option position independent of the other steps that made up SOS, when in truth and in fact, the clients would have not entered into those positions absent the anticipated tax loss to be generated.

c. They falsely claim that the option positions were contributed to a partnership or other entity to "diversify" the client's "investment" when in truth and in fact, the contribution was simply a necessary step in the tax shelter, was executed for the purpose of generating the tax loss, and was not executed to "diversify" any "investment".

d. They falsely claim that the client entered into the offsetting option positions for "substantial non-tax business reasons," and contributed the option positions to the partnership or other entity for "substantial non-tax business reasons," when in truth and in fact, the transactions were undertaken in order to generate the phony tax losses SOS purported to generate and not for any "substantial non-tax business reason."

26. In addition, from at least in or about 1999 through at least in or about 2002, a KPMG partner, who is a co-conspirator not named as a defendant herein ("CC 2"), with the approval of members of KPMG's tax leadership, marketed and implemented dozens of SOS-type transactions to KPMG clients, often charging fees well in excess of 1% of the phony tax losses to be generated. CC 2 also arranged SOS-type transactions for at least 14 KPMG partners, so that those partners could evade their own taxes. In connection with the SOS-type transactions arranged by CC 2, CC 2 issued KPMG opinion letters or caused others to issue opinion letters that falsely claimed that the tax losses purportedly generated by SOS were more likely than not to withstand IRS challenge. These opinions were false

and fraudulent in a number of ways well known to CC 2 and his co-conspirators, including but not limited to the following:

a. They misrepresented SOS as an investment, when in truth and in fact, it was a tax shelter designed to generate tax losses in order to eliminate income taxes for wealthy clients and garner substantial fees for KPMG, certain co-conspirators, and others.

b. They falsely claimed that the clients would have entered into the option positions independent of the other steps that made up SOS, when in truth and in fact, the clients would not have entered into those positions absent the anticipated tax loss to be generated.

c. They falsely claim that the option positions were contributed to a partnership or other entity to "diversify" the client's "investment" when in truth and in fact, the contribution was simply a necessary step in the tax shelter, was executed for the purpose of generating the tax loss, and was not executed to "diversify" and "investment."

d. They falsely claim that the client entered into the offsetting option positions for "substantial non-tax business reasons," and contributed the option positions to the partnership or other entity for "substantial non-tax business reasons," when in truth and in fact, the transactions were undertaken in order to generate the phony tax losses SOS purported to generate and not for any "substantial non-tax business reason."

Fraudulent Concealment of Tax Shelters

27. In addition to preparing and causing to be prepared false and fraudulent documentation relating to and implementing the shelter transactions, and in addition to preparing and causing to be prepared tax returns that fraudulently incorporated the phony tax shelters losses, KPMG and its co-conspirators employed various means fraudulently to conceal from the IRS the fraudulent tax shelters they designed, marketed and implemented, including but not limited to the following: (i) not registering the tax shelters with the IRS as required by law; (ii) preparing and causing to be prepared tax returns that fraudulently concealed the phony losses from IRS; (iii) attempting to conceal from the IRS the tax shelter losses and transactions with sham attorney-client privilege claims; and (iv) obstructing IRS and Senate investigations into their tax shelter activities.

Failing to Register Tax Shelters

28. Under the law in effect at all times relevant to this Information, an organizer of a tax shelter was required to "register" the shelter by filing a form with the IRS describing the transaction. The IRS in turn would issue a number to the shelter, and all individuals or entities claiming a benefit from the shelter were required to include with their income tax return a form disclosing that they had participated in a registered tax shelter, and disclosed the assigned registration number. Notwithstanding these legal requirements, KPMG and its co-conspirators decided not to register as required any of the tax shelters KPMG devised, marketed and implemented, and thereby ensured that registration numbers would not be included on returns relating to unregistered shelters.

29. Thus, KPMG decided not to register FLIP, OPIS, or BLIPS based on a "business decision" that to register the shelters would hamper KPMG's ability to sell them, and that the IRS penalties applicable to a failure to register would be dwarfed by the lucrative fees KPMG stood to collect from selling unregistered tax shelters. Indeed, CC 1 wrote a memorandum to a member of KPMG's tax leadership arguing that, assuming OPIS was required to be registered, KPMG should make a "business decision" not to register OPIS because (i) registering the shelters would put KPMG at a competitive disadvantage as compared to other accounting firms, law firms and other firms that were promoting tax shelters; and (ii) selling unregistered shelters would be so lucrative that the benefits

outweighed the risk of civil penalties that might be imposed. Moreover, KPMG's office of general counsel, among others, advised that by deciding not to register tax shelters, KPMG risked criminal prosecution, but like the CaTS group, advised that KPMG's tax leadership could nevertheless "make a business decision to not register the activity as a tax shelter."

Fraudulently Concealing Shelter Losses and Income on Tax Returns

30. The conspirators would and did prepare and cause to be prepared tax returns that were false and misleading and were intended fraudulently to conceal the fraudulent tax shelters from the IRS in a number of ways, including but not limited to the following:

a. Although the law requires that an individual's items of income, gain, and loss be reported on an individual income tax return, KPMG personnel their co-conspirators advised certain clients that the phony tax shelter losses and the income or gains that were to be sheltered should not be reported on the client's individual income tax return, and instead only the net of those two figures should be reported on the return. One method of "netting" pursued by the conspirators in order fraudulently to hide the tax shelter transactions from the IRS involved using a "grantor trust." A grantor trust is a trust that, because of certain features enumerated in the tax code, is disregarded as an entity for federal income tax purposes. CC 1 and his co-conspirators devised a scheme to insert a grantor trust into a tax shelter transaction, and then, rather than disregarding the grantor trust as required by the tax code, reporting the large phony tax shelter loss and the taxable gain or income those losses were used to offset only on the grantor trust information return, while reporting only the small net of those numbers on the client's individual income tax return. Although members of the Innovative Strategies group were notified that to pursue this "grantor trust netting" scheme was *not* a proper reporting position, and in fact would result in the filing of false income tax returns, KPMG permitted its partners to decide for themselves whether to engage in grantor trust netting. As a result, dozens of tax returns of FLIP, OPIS and BLIPS clients used grantor trusts fraudulently to hide the tax shelter losses (and the gains they were designed to shelter) on the client's individual income tax returns.

b. In order to conceal tax shelter losses from the IRS, a KPMG tax partner who is co-conspirator not named as a defendant herein ("CC 3"), and others, advised at least one client that phony tax shelters losses could be concealed and made to look like losses from the sale of a number of publicly traded stock on behalf of the shelter client, and then distributed those stocks to the client upon the clients withdrawal from the transaction. CC 3 and others then advised that the shelter could be concealed on the client's tax return and instead reported as losses resulting from the sale of stock so distributed. In order to further conceal the phony tax shelter losses from the IRS, in some instances CC 2 and others purchased stocks that had already suffered large losses during the year as the stocks to which the shelter losses would be attached, in order to mislead the IRS into believing that the losses resulted from those stocks' poor performance, rather than from the fraudulent tax shelters.

Concealing Shelters with Sham Attorney–Client Privilege Claims

31. The conspirators also attempted to conceal their fraudulent tax shelters activities by attempting to cloak communications regarding those activities and certain of the activities themselves with the attorney-client privilege, although the communications in question were not privileged. For example, CC 2 attempted to conceal his activities in this manner by purporting to have KPMG clients engage a law firm to provide legal advice, which law firm would then purport to engage KPMG to work under the direction of the law firm. Under *United States v. Kovel,* communications by non-lawyers professionals such as accountants are protected under the attorney-client privilege when the accountant is in fact working under the direction of an attorney. Numerous *Kovel* arrangements established by CC 2 were sham arrangements because the clients did not directly engage the law firm, in many

instances never even spoke to the lawyers who they had purportedly engaged, and CC 2'S work was done outside of the purported lawyer-client privilege. The purpose of this fraudulent conduct was to enable the client, with the assistance of CC 2 and the law firm, to conceal the fraudulent tax shelter from the IRS by attempting to cloak all of the work for the shelter in the attorney-client privilege.

Obstruction of the IRS and Senate Investigations

32. Despite the conspirators' efforts to prevent IRS scrutiny of these fraudulent tax shelters, in or about September 2001 the IRS initiated an examination of KPMG for its failure to register the transactions with the IRS. As part of this examination, in early 2002 the IRS issued 25 summonses to KPMG to designate a knowledgeable person to testify under oath at the IRS. KPMG designated a co-conspirator not named as a defendant herein ("CC 6"), who at the time was the partner in charge of KPMG's Personal Financial Planning group, to testify. CC 6's testimony was false, misleading, and evasive. Indeed, after one day of testimony, another KPMG partner who attended the testimony reported in an email to a KPMG tax leader that KPMG's Office of General Counsel and the outside counsel "determined that the best strategy was 'the less said the better,'" and that CC 6 "felt that he had no choice but to be 'forgetful.' And so the record will reflect repeated 'I don't knows', 'I don't recall' and 'I was out of the loops' – the rope-a-dope/Enron defense."

33. IRS summonses called for production of documents relating to SOS tax shelters, among other things. One of the KPMG tax leaders directing KPMG's response to the IRS summonses, who is a co-conspirator not named as a defendant herein ("CC 7") was aware of KPMG's involvement in promoting SOS transactions. Nevertheless, none of the SOS tax shelter marketed or implemented by KPMG, or in which KPMG personnel participated, were disclosed to the IRS and on a number of occasions, CC7 and others caused KPMG falsely to claim to the IRS that the production of documents and information relating to the summonses was substantially complete.

34. In addition, when the IRS in May 2003 specifically inquired about KPMG's failure to produce SOS information, CC 6 intentionally caused KPMG's representative to falsely respond that KPMG was not involved in SOS, but may have prepared a couple of tax returns containing SOS losses.

35. In January 2003, a Subcommittee of the United States Senate issued a subpoena to KPMG calling for documents and information relating to its tax shelter activities, including a specific request for documents relating to tax shelters used by KPMG partners to evade their own taxes. The subpoena specifically named CC 2 as well as at least two KPMG partners who, in fact, had used SOS transactions to evade their own taxes. CC 7 was among the KPMG personnel directing KPMG's response to the Senate investigation. In addition, CC 7 was aware of at least one KPMG partner who used an SOS-type shelter to offset the partner's own income or gain, and was aware of related documents responsive to the Senate subpoena. However, CC 7 and is co-conspirators caused KPMG's representatives falsely to respond to the subpoena as follows: "to the best of its knowledge and belief, after reasonable inquiry to date, the firm has not yet identified any documents that are responsive to this request."

36. In or about November 2003, CC 6, CC 7, other co-conspirators, and others testified before the Senate Subcommittee investigating tax shelter activities of KPMG and others. CC 6 and other KPMG personnel testified together in panel format. During this testimony, among other things, CC 6 falsely denied that KPMG's fee was a percentage of the tax loss to be generated by the shelters. In addition, when asked by a Senator whether FLIP, OPIS and BLIPS were "designed and marketed primarily as a tax reduction strategies," CC 6 falsely stated "Senator, I would not agree with that characterization." In addition, among other false and misleading testimony presented at the hearing, CC 7 gave evasive

testimony regarding KPMG's involvement in designing, marketing, and implementing tax shelters.

Statutory Allegations

37. From at least in or about 1996 through at least in or about 2003, KPMG, the defendant, and its co-conspirators, unlawfully, wilfully and knowingly, did combine, conspire, confederate and agree together and with each other to defraud the United States and an agent thereof, to wit, the Internal Revenue Service ("IRS") of the United States Department of Treasury, and to commit offenses against the United States, to wit, violations of Title 26, United States Code, Sections 7201, 7206(1), and 7206(2).

Objects of the Conspiracy

38. It was a part and an object of the conspiracy that KPMG, the defendant, and its co-conspirators, unlawfully, wilfully and knowingly would and did defraud the United States of America and the IRS by impeding, impairing, defeating and obstructing the lawful governmental functions of the IRS in ascertainment, evaluation, assessment, and collection of income taxes.

39. It was further a part and an object of the conspiracy that KPMG, the defendant, and its co-conspirators, unlawfully, wilfully and knowingly would and did attempt to evade and defeat a substantial part of the income taxes due and owing to the United States by tax shelters clients and others, in violation of Title 26, United States Code, Section 7201.

40. It was further a part and an object of the conspiracy that KPMG, the defendant, and its co-conspirators, unlawfully, wilfully and knowingly would and did (a) make and subscribe, and cause others to make and subscribe United States individual, corporation, and partnership income tax returns, which returns contained and were verified by written declarations that they were made under the penalties of perjury, and that the defendants and their co-conspirators did not believe to be true and correct as to every material matter; and (b) aid and assist in, and procure, counsel, and advise the preparation and presentation under, the internal revenue law, of certain United States individual, corporation, and partnership income tax returns which were fraudulent and false as to material matters, in violation of Title 26, United States Code, Section 7206.

Means and Methods of the Conspiracy

41. Among the means and methods by which KPMG, the defendant, and its co-conspirators would and did carry out the conspiracy were the following:

a. They would and did concoct tax shelter transactions and false and fraudulent factual scenarios to support them so that wealthy United States citizens would pay certain of the conspirators and other participants in the transactions approximately 5 to 7% of income or gain instead of paying federal and state taxes on that income or gain.

b. They would and did prepare false and fraudulent documents to deceive the IRS, including but not limited to, engagement letters, transactional documents, representation letters and opinion letters.

c. They would and did conceal the contents of tax shelter sales presentations in order to prevent the IRS from discovering the true facts regarding those shelters transactions.

d. They would and did prepare and provide to their clients false and fraudulent representations that the clients were required to make in order to obtain opinion letters that purported to justify using the phony tax shelter losses to offset income or gain. At times, the conspirators presented to their clients these false and fraudulent client

representations after the all-in cost of approximately 5 to 7% of the desired tax loss were collected from the tax shelter clients.

e. They would and did prepare and cause to be prepared tax returns that were false and fraudulent because, among other things, they incorporated the phony tax losses and therefore substantially understated the tax due and owing by the shelter clients.

f. They would and did (i) fraudulently omit on certain tax returns the losses and the gain or income they sheltered: and (ii) disguise the shelter losses on certain tax returns in a manner intended to deceive the IRS.

g. They would and did take various steps to prevent the creation and retention of documents that might reveal to the IRS the true facts regarding the fraudulent tax shelters as well as certain conspirators' role in designing, marketing, and implementing them, including but not limited to concealing from the IRS that the opinion letters provided by KPMG, the Law Firm, and other firms were not independent and were instead prepared by entities involved in the design, marketing, and implementation of tax shelters.

h. They would and did take various additional steps to conceal from the IRS the existence of shelters, their true facts, and certain conspirators' role in designing, marketing, and implementing the shelters including, but not limited to, failing to register the shelters, using sham attorney-client privilege claims, and concealing documents and providing false and misleading information in response to IRS and Senate investigations.

Overt Acts

42. In furtherance of the conspiracy and to effect the illegal objects thereof, KPMG, the defendant, and its co-conspirators, committed the following overt acts, among others, in the Southern District of New York and elsewhere:

a. On or about July 18, 1997, a co-conspirator not named as a defendant herein prepared a memorandum to KPMG tax leaders discussing how KPMG and the SF Entities should jointly devise, market and implement tax shelter transactions and how their fees should be divided.

b. In or about September 1997, KPMG and the SF Entities executed an "operating agreement" regarding joint marketing and implementation of FLIP transactions.

c. On or about June 8, 1998, CC 1 advised the KPMG team marketing OPIS not to leave the OPIS PowerPoint presentation "with clients or targets under any circumstances" because doing so "will DISTROY any chance the client may have to avoid the step transaction doctrine."

d. On or about September 10, 1998, the defendant CC 6 sent an email to a KPMG tax leader and others proposing an "alliance" with a competitor of the SF Entities to implement OPIS transactions and noting that "we have very little time to work with if we are going to execute trades such that our clients can generate the desired benefits in calendar 1998."

e. On or about January 22, 1999, CC 6 instructed KPMG partners that each partner should decide for himself or herself whether to attempt to conceal losses from the IRS using a grantor trust.

f. In or about September or October 1999, Domenick DeGiorgio, a co-conspirator not named as a defendant herein, met at the offices of Bank B in the Southern District of New York with personnel of the SF Entities and others.

g. In or about 1999, in the Southern District of New York and elsewhere, Banks A, B and C prepared and caused to be prepared transactional documents relating to BLIPS tax shelter transactions.

h. On or about December 8, 1999, a KPMG partner who is a co-conspirator not named as a defendant herein advised other KPMG personnel involved in marketing and implementing BLIPS that a document on which the client selected how much of the BLIPS loss should be ordinary and how much should be capital should not be kept in the file because "if the IRS were to discover such as document it could look very bad for the client."

i. On or about March 7, 2000, members of KPMG tax leadership, a representative from KPMG's office of general counsel, and others met in the Southern District of New York to discuss, among other things, the risk of civil penalties and criminal investigation associated with completing the implementation of 1999 OPIS and BLIPS transactions.

j. On or about March 21, 2000, a KPMG tax partner who is co-conspirator not named as a defendant herein advised other KPMG personnel involved in marketing BLIPS that they should "NOT put a copy of" an email in their BLIPS files because "it is a roadmap for the taxing authorities to all the other listed transactions."

k. In or about 1998, 1999, and 2000, in the Southern District of New York and elsewhere, KPMG and other participants in FLIP and OPIS tax shelter transactions, who are co-conspirators not named as defendants herein, prepared, signed and filed tax returns that falsely and fraudulently claimed over $4.2 billion in phony tax losses by FLIP and OPIS transactions.

l. In or about 2000 and 2001, in the Southern District of New York and elsewhere, KPMG and other participants in BLIPS tax shelter transactions, who are co-conspirators not named as defendants herein, prepared, signed and filed tax returns that falsely and fraudulently claimed over $5.1 billion in phony tax losses generated by BLIPS transactions.

m. In or about 1999, 2000, and 2001 KPMG and other participants in SOS tax shelter transactions, who are co-conspirators not named as defendants herein, prepared, signed and filed tax returns that falsely and fraudulently claimed over $1.9 billion in phony tax losses generated by SOS.

n. On or about February 12, 2002, CC 6 provided false and misleading testimony under oath to the IRS.

o. On or about October 2, 20002, CC 7, on behalf of KPMG, sent a letter to the IRS in the Sothern District of New York falsely claiming that "KPMG has at this time virtually completed its compliance with the summonses" although as CC 7 well knew, KPMG had produced no documents or information regarding its involvement in marketing and implementing SOS transactions.

p. On or about February 19, 2003, KPMG caused its representatives falsely to represent to the Senate that "after reasonable inquiry to date, the firm has not yet identified any documents" relating to shelter transactions used by KPMG partners to shelter their own income or gains, KPMG well knew that it had various documents responsive to this subpoena request.

q. On or about November 18, 2003, CC 6 provided false and misleading testimony under oath to a Subcommittee of the United States Senate.

r. On or about November 18, 2003, CC 7 provided evasive testimony under oath to a Subcommittee of the United States Senate.

(Title 8, United States Code, Section, 371.)

DAVID N. KELLY
United States Attorney

APPENDIX 2

THE INFORMATION IN THE HSBC TAX EVASION CASE

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

UNITED STATES OF AMERICA		**Hon.**
	)	
v.	**)**	**Criminal No. _____**
	)	
SANJAY SETHI	**)**	**18 U.S.C 371**

INFORMATION

The defendant having waived in open court prosecution by indictment, the United States Attorney for the District of New Jersey charges:

At all times relevant to this Information, unless otherwise alleged:

Background

1. The Internal Revenue Service ("IRS") was an agency of the United States Department of the Treasury responsible for administering and enforcing the tax laws of the United States and collecting the taxes owed to the Treasury of the United Sates by its citizens.

2. United States citizens and residents had an obligation to report to the IRS on Schedule B of a U.S. Individual Income Tax Return, Form 1040, whether that individual had a financial interest in, or signature authority over, a financial account in a foreign country during a particular year by checking "Yes" or "No" in the appropriate box and identifying the country where the account was maintained. United States citizens and residents also had an obligation to report all income earned from foreign financial accounts on their tax returns.

3. United States citizens and residents who had a financial interest in, or signature authority over, one or more financial accounts in a foreign country with an aggregate value of more than $10,000 at any time during a calendar year were required to file with the Department of the Treasury for that calendar year a Report of Foreign Bank and Financial Accounts on Form TD F 90-22.1 ("FBAR"). The FBAR for a particular calendar year was due by June of the following calendar year.

4. An "undeclared bank account" was a financial account maintained in a foreign country that was required to be, but was not, reported to the United Stated government on a tax return or an FBAR.

5. The Internal Revenue Code and associated regulations required financial institutions, including banks, to issue an IRS Form 1099 to each individual who was paid $10 or more of interest income during a calendar year reporting the recipient's name, address, Social Security number and the amount of interest income paid, and to file a copy of the Form 1099 with the IRS.

6. A "bearer share corporation" is one where the ownership is based on physical possession of the shares of the corporation. Ownership of a bearer share corporation is not readily identifiable, as opposed to a corporation with registered stock shares, where the owners of the entity are identified in the corporation's records. Bearer share corporations are often

set up in tax havens to hide the true ownership of assets, because ownership records are not maintained and nominee officers and directors are often used to appear to control the affairs of the corporation.

Entities

7. San Vision Technologies, Inc. ("SVT") was a U.S. corporation created in 1992 and owned by defendant SANJAY SETHI. SVT provided technical consulting, software development, database management, and other information technology services for banking and insurance clients.

8. Karol Bagh Charitable Trust ("Karol Bagh") was an entity created under Swiss law that defendant SANJAY SEITH used to conceal his ownership of undeclared accounts in Switzerland into which SETHI deposited the proceeds of real estate transactions related to properties located in India.

9. Fundus, Inc. ("Fundus") was a Cayman Islands bearer share corporation that defendant SANJAY SETHI used to conceal his ownership of U.S. bank accounts funded with the proceeds of real estate transactions related to properties in India.

10. SNS Investments, Ltd. ("SNS Investments") was a British Virgin Islands bearer share corporation that defendant SANJAY SETHI used to conceal his ownership of undeclared bank accounts in Switzerland into which SETHI deposited the proceeds of real estate transactions related to properties in India.

11. Driftmore International, Ltd. ("Driftmore") was a British Virgin Islands bearer share corporation that defendant SANJAY SETHI used to conceal his ownership of an undeclared bank account in Switzerland into with SETHI deposited unreported business receipts and reimbursements for actual business expenses of SVT.

12. Ace Marketing, Inc. ("Ace Marketing") was a corporation that defendant SANJAY SETHI owned and used to send funds to an undeclared bank account in Switzerland held in the name of Driftmore.

13. An international bank ("the International Bank") was one of the largest international banks and was headquartered in England. It maintained offices throughout the world, including India, Singapore, Hong Kong and the United States, including in the District of New Jersey.

14. The International Bank operated a division in the United Stated called "NRI Services" that marketed offshore banking services to United States citizens of Indian descent. Through its NRI Services division, the International Bank encouraged United States citizens to open undeclared bank accounts in India.

The Defendant

15. Defendant SANJAY SETHI was born in India, become a lawful resident of the United States on or about March 10, 1989, and became a naturalized United States citizen on or about June 1, 2004. From at least 2004 to the present, SETHI lived in Watchung, New Jersey.

16. Form in or about 2001 until in or about 2009, defendant SANJAY SETHI had a financial interest in undeclared bank accounts located in Switzerland and India. The accounts located in Switzerland and India were maintained at the International Bank.

Certain Co-Conspirators

17. U.S. Banker A, a co-conspirator who is not charged as a defendant herein, was a senior vice president of a cross-border banking group with the private bank division of the International Bank that focused on developing and servicing clients in the United States with ties to India and elsewhere in South Asia. U.S. Banker A was based in the International Bank's New York, New York office.

18. U.K. Banker A, a co-conspirator who is not charged as a defendant herein, was a high-ranking executive of the International Bank and the head of a cross-border banking group within its private bank division that focused on developing and servicing clients worldwide with ties to countries in south Asia. U.K. Banker A was based in the International Bank's London, England office.

19. Swiss Banker A, a co-conspirator who is not charged as a defendant herein, was a financial advisor for the International Bank and was based in Geneva, Switzerland.

20. From in or about 2001 through on or about April 21, 2010, in the District of New Jersey and elsewhere, the defendant,

SANJAY SETHI,

did knowing and intentionally combine, conspire, confederate and agree with others to defraud the United States and an agency thereof, that is, the Internal Revenue Services of the United Sates Department of the Treasury, in the ascertainment, computation, assessment and collection of federal income taxes.

Object of the Conspiracy

21. The object of the conspiracy was for defendant SANJAY SETHI and his co-conspirators to conceal from the IRS the existence, ownership, and income derived from SETHI's undeclared bank accounts in Switzerland and India.

Manner and Means of the Conspiracy

22. It was part of the conspiracy that defendant SANJAY SETHI and his co-conspirators used nominee and shell companies formed in tax-haven jurisdictions and elsewhere to conceal the defendant's ownership and control of assets and income from the IRS.

23. It was further part of the conspiracy that defendant SANJAY SETHI and his co-conspirators used bank accounts opened in the name of shell companies and nominees to conceal SETHI's ownership and control of assets and income from the IRS.

24. It was further part of the conspiracy that defendant SANJAY SETHI and his co-conspirators provided, and caused to be provided, false documents to banks to conceal SETHI's ownership and control of assets and income from the IRS.

25. It was further part of the conspiracy that defendant SANYJAY SETHI and his co-conspirators prepared and filed with the IRS, and caused to be prepared and file with the IRS, false and fraudulent United States Individual Income Tax Returns to conceal SETHI's ownership and control of assets and income from the IRS.

26. It was a further part of the conspiracy that defendant SANJAY SETHI failed to file FBARs with the Department of the Treasury with respect to his undeclared bank accounts.

Overt Acts

27. In furtherance of the conspiracy and in order to effect the object thereof, defendant SANJAY SETHI and his co-conspirators committed and caused to be committed the following acts in the District of New Jersey and elsewhere:

a. In or about 2001, during a meeting with the U.S. Banker A, defendant SANJAY SETHI discussed opening an undeclared bank account in India at the International Bank for the purpose of concealing income and assets from the IRS.

b. In or about 2001, the defendant SANJAY SETHI opened an undeclared bank account in India with the NRI Services division of the International Bank by visiting the bank's New York City offices, using his Indian passport as identification, and causing 27,000 Indian Rupees (approximately $400) to be transferred to his account at the International Bank.

c. In or about 2002, U.S. Banker A telephoned defendant SANJAY SETHI and set up a meeting between SETHI and U.K. Banker A, the head of cross-border banking group within the private bank division of the International Bank, who would be visiting New York City.

d. Shortly thereafter, in or about 2002, defendant SANJAY SETHI met with U.K. Banker A at the offices of the International Bank in New York City and discussed the opening of an undeclared bank account for SETHI at the international Bank in Switzerland. U.K. Banker A told SETHI that the undeclared account would allow SETHI's assets to grow tax-tree and that the bank secrecy laws in Switzerland would allow SETHI to conceal the existence of the account.

e. On or about July 24, 2002, defendant SANJAY SETHI obtained authority to conduct financial transactions and make decisions, contracts, and other commitments on behalf of Fundus.

f. In or about 2003, several months after defendant SANJAY SETHI's meeting with U.K. Banker A in New York City, SETHI travelled to London at the direction of U.K. Banker A to complete the paperwork needed to open the undeclared bank account at the International Bank in Switzerland.

g. On or about January 15, 2003, as a result of meeting with U.K. Banker A in London, defendant SANJAY SETHI caused SNS Investments to be incorporated.

h. In or about 2003, defendant SANJAY SETHI caused approximately £3.4 million to be transferred from a bank account in the name of Fundus to an undeclared bank account at the International Bank in the name of SNS Investments.

i. On or about June 2, 2006, defendant SANJAY SETHI transferred, $2,346,979.80 from an undeclared bank account in the name of SNS Investments into various certificates of deposits held in undeclared bank accounts at the International Bank in India and managed through the International Bank's NRI Service Division.

j. In or about August 2007, defendant SANJAY SETHI sold his home in Watchung, New Jersey for approximately $2.2. million and wired the proceeds from the sale from an account at the International Bank in the United States to the undeclared SNS Investment bank account.

k. In or about 2007, defendant SANJAY SETHI and Swiss Banker A discussed opening a second undeclared bank account in Switzerland in the name of Driftmore for the purpose for concealing income and assets from the IRS.

l. In or about January 2008, Swiss Banker A incorporated Driftmore in the British Virgin Islands for the use of defendant SANJAY SETHI in connection with an undeclared bank account at the International Bank.

m. On or about April 11, 2008, defendant SANJAY SETHI sent Swiss Banker A by private letter carrier a check made payable to Ace Marketing in the amount of $12,500.

n. On or about June 10, 2008, defendant SANJAY SETHI sent Swiss Banker A by private letter carrier a check made payable to Driftmore from SVT, drawn on an account maintained at the International Bank in New York, in the amount of $35,191.20.

o. On or about January 21, 2009, defendant SANJAY SETHI sent Swiss Banker A by private letter carrier a check made payable to Driftmore from SVT, drawn on an account maintained at the International Bank in New York, in the amount of $10,080.

p. On or about February 5, 2009, defendant SANJAY SETHI sent Swiss Banker A by private letter carrier a check made payable to Driftmore from SVT, drawn on an account maintained at the International Bank in New York, in the amount of $11,466.40.

q. On or about March 1, 2007, in North Bergen, New Jersey, defendant SANJAY SETHI caused to be prepared and caused to be filled electronically with the IRS a U.S. Individual Income Tax Return, Form 1040, for the tax year 2006, which falsely reported that he did not have signature authority over any foreign financial accounts, and which failed to report income earned from his undeclared bank accounts.

r. On or about April 21, 2010, in the District of New Jersey, defendant SANJAY SETHI signed, mailed, and filed with the IRS a U.S. Individual Income Tax Return, Form 1040, for the tax year 2009, which falsely reported that he did not have signature authority over any foreign financial accounts, and which failed to report income earned from his undeclared bank accounts.

All in violation of Title 10, United States Code, Section, 371.

PAUL J. FISHMAN
United States Attorney

APPENDIX 3

THE MARKETING LETTER IN THE *RAMSAY* CASE

Dear Sirs,

Exempt Debt/Capital Loss Scheme ('the Scheme').

We now enclose the joint Written Opinion of Tax Counsel Mr George Graham, QC and Mr Andrew Park together with Company Counsel, Mr Michael Wheeler, QC's opinion. This document is sent and the information set out hereunder is furnished to you subject to and in accordance in all respects with the terms of your written undertaking to us dated the 23rd day of February 1973. It is essential both from our point of view in order to protect the Scheme and from your point of view to maximize the chances of success of the Scheme, that it suffers the minimum of exposure and that the implementation of the Scheme is carried out through our offices or those of our duly authorised representatives.

The enclosure to this letter sets out the detailed steps to be taken to implement the Scheme. These however, can be briefly summarised as under (which will be subject to minor variations in the case of a corporate taxpayer):-

(a) The taxpayer ('T') acquires a company ('X' Limited) and appoints himself and two nominees as directors. For the convenience of the Scheme and in certain circumstances to comply with the financing requirements of the Scheme, a representative of this company will be one of the nominated directors.

(b) The subscriber shares are allotted to T and his nominees.

(c) X Limited makes a rights issue, the rights shares being payable as to £5 upon application and the balance of the subscription price being payable on call.

(d) T then offers to make two loans to X Limited ('L1 and L2') L1 being repayable on demand at the expiration of 30 years and L2 being repayable on demand at the expiration of 31 years, in each case at par. X Limited will be at liberty to repay either of the loans at any time and is obliged to do so if it goes into liquidation and the terms of the loans are that if either of them is repaid prematurely by X Limited; the amounts to be repaid will be whichever is the higher of the face value of the loan or the market value of the loan on the assumption that it would remain outstanding for the full period.

(e) Each loan will carry interest at the rate of 11% per annum payable quarterly and T reserves the right, exercisable on one occasion only and only while both L1 and L2 remain in his beneficial ownership, to decrease the interest rate on one of the loans and to increase correspondingly the interest rate on the other loan.

(f) T will after receiving one payment of interest on both the loans exercise the right reserved to him and will direct that the rate of interest on L1 should be reduced to nil and that the rate of interest on L2 should be correspondingly increased to 22% per annum.

(g) Following this, X Limited will call up the amount of capital outstanding on the 98 shares issued to T by way of rights.

(h) T will then sell L2 to a finance company ('F') for its market value, less a discount equal to 5% thereof, and contemporaneously therewith and conditional thereon will grant an option to F to purchase at market value either or both of L1 and the shares in

X Limited, such option to be exercisable at any time while L2 remains outstanding in F's beneficial ownership and then only if X Limited is asked by F to redeem L2 and declines to do so within 14 days of such request. The option will contain undertakings by T that the assets of X Limited will not be depleted, to secure the appointment to the Board of X Limited of a director nominated by F and to alter the bank mandate of X Limited so that X Limited's bank account cannot be operated without the signature of the director nominated by F.

(j) U Limited (a wholly-owned subsidiary of X Limited) will then purchase L2 from F and the option granted by T to F will lapse.

(k) U Limited will then go into a members' voluntary liquidation and the liquidator will distribute its sole asset (L2) to X Limited.

(l) X Limited will then go into a members' voluntary liquidation and L1 will be repaid to T at par.

(m) The value of T's shareholding in X Limited will as a result of the repayment of L2 at a premium and the repayment of L1 at par be reduced, thereby giving rise to a capital loss.

(n) T will then exchange the shares of X Limited with Z Ltd for the allotment and issue by Z Limited of its loan stock of a nominal value equal to the market value of the shares in X Limited.

(o) T will then sell for cash Z Limited's loan stock to H Limited for its nominal value and the Scheme so far as T is concerned will have been completed.

We should point out the following:

(i) The Scheme is a pure tax avoidance scheme and has no commercial justification insofar as there is no prospect of T making a profit; indeed he is certain to make a loss representing the cost of undertaking the Scheme.

(ii) Nevertheless, every transaction in the Scheme will be genuinely carried through, and will in fact be exactly what it purports to be.

(iii) Although the Scheme is a scheme in the sense of a preconceived series of steps, T should understand before deciding to embark upon the Scheme, that there is no binding arrangement or undertaking to the effect that once the first step has been taken, then every other step must be taken in its appointed order. It is reasonable for T to assume that all steps will in practice be carried out, but as a matter of law, T is free to withdraw at any time, and so are all the other contemplated parties to the Scheme. If any party does withdraw, T will have no redress.

(iv) It will be essential for T to provide the necessary finances for the share subscriptions and the loans, either out of his own resources or by entering into suitable borrowing arrangements.

Our fee is 8% of the required capital loss; of this 6 7/8 % is payable as soon as T embarks on the scheme, the balance being incorporated in the profit realised by the purchaser of L2; if T decides voluntarily not to carry through the entire scheme, then no refund will be made. However if any party over whom T has no control decides that it does not wish to embark upon the scheme or having so embarked, withdraws voluntarily, then a refund of the fee will be made, less a deduction in respect of the costs incurred.

Finally, we would point out that we do not undertake any enforceable obligation to procure the implementation of the entire scheme. There is no guarantee that the anticipated tax relief will result from the implementation of the scheme and we can accept no responsibility or liability whatsoever for any expense or loss incurred as a result of the scheme being embarked upon. The decision to enter the scheme should be taken on the advice of T's accountant, solicitor or other professional adviser.

Please sign and return the enclosed copy of the letter by way of acknowledgement that you accept fully the points raised therein.

Yours faithfully.[870]

[870] (1) *W T Ramsay Ltd v Commissioners of Inland Revenue*; (2) *Eilbeck (H M Inspector of Taxes) v Rawling* - 54 TC 101 at 109-111.

APPENDIX 4

THE CONCEALMENT LETTER IN THE KPMG CASE

To: Jeffrey N. Stein
From: Greg W. Ritchie

May 26, 1998

OPIS Tax Shelter Registration

Attached is a memorandum from Jeff Zysik (Tax Innovation Center) concerning the potential financial consequences associated with failing to register a tax shelter under IRC section 6111. For purposes of this discussion, I will assume that we will conclude that the OPIS product meets the definition of a tax shelter under IRC section 6111(c).

Based on this assumption, the following are my conclusions and recommendations as to why KPMG should make the business/strategic decision not to register the OPIS product as a tax shelter. My conclusions and resulting recommendations are [is] based upon the immediate negative impact on the Firm's strategic initiative to develop a sustainable tax products practice and the long-term implications of establishing [such] a precedent in registering such a product.

First, the financial exposure to the Firm is minimal. Based upon our analysis of the applicable penalty provisions, we conclude that the penalties would be no greater than $14,000 per $100,000 in KPMG fees. Furthermore, as the size of the deal increases, our exposure to the penalties decreases as a percentage of our fees. For example, our average deal would result in KPMG fees of $360,000 with a maximum penalty exposure of only $31,000.

This further assumes that KPMG would bear 100 percent of the penalty. In fact, as explained in the attached memo, the penalty is *joint and several* with respect to anyone involved in the product who was required to register. Given that, at a mimimum, Presido would also be required to register, our share of the penalties could be viewed as being only one-half of the amounts noted above. If other OPIS participants (e.g., Deutsche Bank, Brown & Wood, etc.) were also found to be promoters subject to the registration requirements, KPMG's exposure would be further minimised. Finally, any ultimate exposure to the penalties are abatable if it can be shown that we had reasonable cause.

Second, the rules under section 6111(c) have not changed significantly since they were imposed in 1984. While there was an addition to section 6111 in the 1997 Tax Act, it only applies to products marketed to corporate investors under limited circumstances. To my knowledge, the Firm has never registered a product under section 6111 [and it is my opinion that we should not begin with OPIS].

Third, the tax community at large continues to avoid registration of all products. Based on my knowledge, the representations made by Presido and Quadra, and Larry DeLap's discussions with his counterparts at other Big 6 firms, *there are no tax products marketed to individuals by our competitors which are registered.* This includes income conversion strategies, loss generation techniques, and other related strategies.

Should KPMG decide to begin to register its tax products, I believe that it will position us with a severe competitive disadvantage in light of industry norms to such degree that we will not be able to compete in the tax advantaged products market.

Fourth, there has been (and, apparently, continues to be) a lack of enthusiasm on the part of the Service to enforce section 6111. In speaking with KPMG individuals who were at the Service (e.g. Richard Smith), the Service has apparently purposefully ignored enforcement efforts related to section 6111. In informal discussions with individuals currently at the Service, WNT has confirmed that there are not many registration applications submitted and they do not have the resources to dedicate to this area.

Finally, the guidance from Congress, the Treasury, and the Service is minimal, unclear, and extremely difficult to interpret when attempting to apply it to 'tax planning' products. The Code section, regulations and related material were clearly written with a view toward the sale of 'traditional' tax shelters. That is, the rules anticipate that there will be the sale of a partnership interest by a promoter which purports to allow an investor to claim deductions significantly in excess of their investment. While the rules are written broadly enough to arguably include OPIS and other purely tax planning products, they are not easily applied to the marketing of an idea or strategy to a client which carries with it tax advantage.

Although OPIS includes the purchase of securities by the investor, the tax results are driven simply by an interpretation of the application of Code section 302 and the regulations thereunder. When coupled with the Service's apparent lack of enforcement effort, the lack of specific guidance is a further indication that the risk of noncompliance with the rules could be excused.

Based on the above arguments, it is my recommendation that KPMG does *not* register the OPIS product as a tax shelter. Any financial exposure that may be applicable can easily be dealt with by setting up a reserve against fees collected. Given the relatively nominal amount of such potential penalties, the Firm's financial results should not be affected by this decision.

In summary, I believe that the rewards of a successful marketing of the OPIS product (and the competitive disadvantages which may result from registration) far exceed the financial exposure to penalties that may arise. Once you have had an opportunity to review this information, I request that we have a conference with the persons on the distribution list (and any other relevant parties) to come to a conclusion with respect to any recommendations. As you know, we must immediately deal with this issue in order to proceed with the OPIS product.[871]

[871] PSI, *U.S Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals* (November 18 2003) Volume IV, pages 3245-3247.

APPENDIX 5

HMRC'S WRITTEN EVIDENCE TO THE PAC ON THE GOOGLE SETTLEMENT

Supplementary Written Evidence from HM Revenue and Customs

This document has been prepared by HMRC for submission to the Public Accounts Committee to assist the Committee with its examination of witnesses at its hearing on 11 February 2016. The document sets out certain facts in relation to Google and the settlement reached with HMRC. Google UK Limited has consented to the disclosure of the information in this document to the Committee, including information that has not previously been made public.

Google

Google is a US-headed multinational business which owns a unique search engine and automated auctions process which the group exploits to generate profits through sales of advertising services. The US is by far the group's largest market, contributing almost 50% of Google's gross revenues. The UK is the second largest market and has consistently contributed around 10% of global turnover. ln 2014, the group's turnover from the UK market was approximately $6.6 billion.

Google lreland Ltd

Google lreland Ltd (GlL) is the Google group's sales hub for Europe, the Middle East and Africa (EMEA). (Until 2010, GIL also acted as the sales hub for the Asia Pacific region.) All UK advertisers must enter into a contract with GIL in order to advertise on Google.

GIL's operation in Dublin is the only point of contact for around 99% of Google's advertisers in the UK. Since 2012, GIL's operation in Dublin has also provided the account manager service for Google's high value advertisers in the UK (prior to 2012, this service was provided by Google UK Ltd).

The number of employees in 2013 was 2,288.

The turnover shown in the accounts increased from €3,343m in the year ended 31 December 2006, to €18,268m in year ended 31 December 2014.

Google lreland Ltd is not resident in the UK for tax purposes. Even if it had a permanent establishment in the UK, it would only be liable to UK corporation tax on the activities of that UK establishment.

Google UK Ltd

Google UK Ltd (GUK) provides marketing services to GIL, and as part of this service, its UK-based employees can be a point of contact for Google's high value UK advertisers. lt also provides research and development services to Google lnc. (Google lnc is incorporated in the United States and in the period for which our enquiries were concerned, it was Google UK Ltd's ultimate parent company.)

The turnover shown in the accounts from these business activities increased from £27 million in the year ended 31 December 2005 to £1,178 million in the 18 months ended 30 June 2015.

The number of employees in GUK increased from 156 in 2005 to 2,329 by 2015.

The company reported profits before tax in the 2005, 2006, 2012, 2013 and 2015 financial statements. It reported losses before tax from 2007 to 2011.

GUK is resident in the UK for tax purposes, and therefore subject to UK corporation tax on all of its trading profits. As it provides services wholly to other companies in the global group, transfer pricing rules apply to require GUK to pay tax on profits arising from an arm's length price for its services.

HMRC enquiry

HMRC formally opened an enquiry into GUK'S returns in March 2010 after having carried out a detailed risk review.

We concluded our enquiry in January 2016, when we reached agreement with GUK about additional tax that was due. This is a way of settling the correct tax position provided for by law; the other way is to have matters determined by the decision of a tax tribunal or relevant appellate court.

There were two agreements between GUK and HMRC; one covered the period 1 January 2004 to 31 December 2004, and the second covered 1 January 2005 to 30 June 2015.

We examined whether there was a permanent establishment of Google Inc or GIL in the UK.

We also examined the transfer pricing methodology applied to transactions between GUK and other group companies. In particular, we examined the treatment of share-based remuneration and the adequacy of the reward that GUK received for its marketing function. We also examined whether there was any liability to Diverted Profits Tax for the three months from 1 April 2015 - 30 June 2015.

For each year covered by the enquiry, we secured additional tax reflecting the full value of the economic activities carried on by Google in the UK. We agreed that the Diverted Profits Tax did not apply for the three months ended 30 June 2015.

In the course of our enquiry, we:
- questioned senior Google executives, managers, customer-facing staff, customers and intermediaries, such as advertising agencies
- visited Google Ireland Ltd's Dublin offices to understand better the business being carried on there and to talk to Irish employees
- analysed information from many sources about the business, its profits and activities in the UK, including documents provided by a whistle-blower
- exchanged information with tax authorities in other countries to obtain information and documents to help us understand Google's global arrangements and profitability in relation to the UK business
- took extensive legal advice, including consulting external leading Counsel on matters such as whether the activities of Google's staff in the UK gave rise to a permanent establishment of Google Ireland Ltd.

Governance of enquiry

In line with our published processes, this enquiry was subjected to our strong governance procedures to provide assurance that we have secured the full amount due in law. This means that before the enquiry was concluded, the proposals put forward for settlement in this case were considered and approved by three Commissioners of Revenue & Customs, including the Tax Assurance Commissioner.

HMRC is transparent about how it conducts its enquiries and resolves matters under dispute. Our published Litigation & Settlement Strategy makes it clear that we do not settle for less than the full amount that we would expect to get if we proceeded to the courts.

We have published details of the comprehensive governance arrangements we follow when resolving tax disputes which provide assurance that they are resolved correctly. Resolution of large and sensitive disputes is subject to approval of three Commissioners of Revenue & Customs, including the Tax Assurance Commissioner, who is not involved in the conduct of enquiries with taxpayers. Every year our Tax Assurance Commissioner publishes a report about how we have resolved disputes during the year, which provides transparency about how HMRC is performing in this area.

HMRC's analysis of the tax charges in GUK's published accounts

GUK have disclosed in their 2015 financial statements that HMRC's enquiry has been closed, with GUK agreeing that it has to pay additional tax.

GUK have said that, as a result of HMRC's enquiry, they have an additional liability of £130 million in corporation tax and interest for the period ended 30 June 2015 and prior years. This sum is over and above the tax that they have paid for those years (or would pay for the current period were it not for HMRC's enquiry), but does not indicate the full impact of that enquiry. This is because it does not include the agreement reached in respect of 2004 and does not reflect that from 2012 the company's reported profits took account of the revised treatment of share based compensation put forward by HMRC during the course of the enquiry.

The cumulative current tax over the period 2005 to 2015 shown in GUK's financial statements may be seen as a reasonable (although not precise) proxy for the tax payable over that period. GUK's accounts show a cumulative tax charge in the financial statements from 2005 to 2011 of £11.6 million. In their 2012 statements, GUK disclosed that they were under enquiry by HMRC and made a provision of £24 million for potential corporation tax for the years 2005-2011. It is clear from GUK accounts that thereafter they also made more substantial charges for tax in their accounts year on year - the cumulative tax charge in the 3½ years ended 30 June 2015 was £166.8 million. In addition, the financial statements show cumulative interest of £18 million on that tax.

10 February 2016[872]

872 http://data.parliament.uk/WrittenEvidence/CommitteeEvidence.svc/EvidenceDocument/Public%20Accounts/Corporate%20tax%20deals/written/28758.html

APPENDIX SIX

LETTER FROM CHANCELLOR OSBORNE ON BEHALF OF HSBC AND SCB TO CHAIRMAN BERNANKE AND SECRETARY GEITHNER

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

10 September 2012

Ben Bernanke
Chairman
The Federal Reserve System
20th and C Streets NW
Washington DC 20551
USA

Dear Ben,

The ongoing US investigations into HSBC and SCB for breaches of US anti-money laundering (AML) and sanctions regulations have attracted significant market attention in the UK and elsewhere. Following publication of the Order by the New York Department for Financial Services (DFS) on 6 August, SCB's share price fell by almost 30% in a single day of trading. Even though SCB's market value has now recovered much of this loss, the incident raises broader concerns, and gives us an opportunity to reflect more generally on how we might collectively ensure that regulatory and enforcement action does not lead to unintended consequences.

The SCB case raises three main issues. First, is serves as a further illustration of the importance which financial markets attach to access to the US dollar market. It was the perceived threat of SCB's loss of access to this market, rather than any potential penalty, that triggered such a significant reaction. To date, the majority of US enforcement action for AML/sanctions breaches had ended in settlements involving a Deferred Prosecution Agreement: the suggestion of a criminal indictment or, worse, conviction implies a problem that is more akin to the Riggs case, and therefore a more severe outcome. Markets price in this risk accordingly.

Second, the reaction was almost certainly more severe in the SCB case because markets were not prepared for the news. While SCB had disclosed that it was under investigation, nobody expected an Order of this sort to be served. Its unannounced publication and some of the language used ("rogue institution") created uncertainty over the magnitude of the offences and what regulatory action would follow, especially as it quickly became evident that the DFS action had not been co-ordinated with the other US agencies involved.

Thirdly, it highlighted the potential financial stability risks of enforcement action. In particular, if such action created a liquidity crisis for the bank concerned – as might have been the case with SCB, and as might still be the case for HSBC – this could jeopardise its stability. For a systemically important financial institution, this could lead to contagion. I do not want to overstate these risks but I think that they bear consideration.

Next steps

It is not my intention to interfere with criminal or regulatory action and procedures in the US. The UK and the US share an extremely strong partnership on AML and sanctions issues, whether through the Financial Action Task Force or in seeking to exert pressure on the Iranian and Syrian regimes. It (sic) for you, and your partners in

other departments and agencies, to decide how best to supervise, regulate and enforce compliance within your jurisdiction. And Adair Turner, Mervyn King and I are together combined to ensuring that UK financial institutions are fully compliant with global standards and rules.

Going forward, however, I would appreciate your assistance in ensuring that enforcement action does not have unintended consequences. In particular, I would appreciate early warning of such action before it is announced. I know that you recognise the consequences of uncoordinated actions by the authorities, and I appreciate that the SCB Order was not within your control. But, in future, prior sight would help us to manage some of the potential market and stability risks, and consider what (if anything) we should collectively do to manage them.

I would also ask that the outcome of current and future investigations against UK-headquartered banks is consistent with previous settlements, and with US settlements made with banks headquartered throughout the world. I understand, for example, that HSBC is currently facing a series of settlements with the US authorities that may cumulate at around $1.9bn. I have not seen the details of this case, but it has been highlighted to me on a number of occasions that a settlement of this nature would be around three times greater than the largest US settlement to date for comparable AML/sanctions breaches. In HSBC's case, I understand that a criminal conviction would require US regulators to consider whether to revoke its banking authorisations in the US. Questions about HSBC's continued ability to clear US dollars would risk destabilising the bank globally, with very serious implications for financial and economic stability, particularly in Europe and Asia.

The scale of this enforcement action, particularly following the SCB case, is leading many to suggest that UK banks are being unfairly targeted. This narrative is unwelcome, not least given the extremely strong partnership that we continue to enjoy. I would therefore be grateful for your assistance in demonstrating that the US is even handed and consistent in its approach.

I would welcome a discussion of these issues when we see each other next.

I am copying this letter to Treasury Secretary Geithner, with whom I have also discussed this issue.

Best wishes,

GEORGE OSBORNE[873]

[873] 'Too Big to Jail: Inside the Obama Justice Department's Decision not to Hold Wall Street Accountable', Report by the Republican Staff of the Committee on Financial Services, US House of Representatives, July 11, 2016, Appendix 4, pages 42-45.

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