

Good-bye and good riddance to the GAAR?

by Francis Bennion

The Revenue's consultative document

Keith Daniels, the retiring President, told us in his valedictory address (June issue, page 34) that the Chancellor has shelved his plans to introduce a General Anti-Avoidance Rule (GAAR). Others are not so sure. In his report on the Lawress Hall conference (page ? of this issue), the Editor warns that Gordon Brown is personally committed to introducing a GAAR. The Chancellor is a determined man, who usually gets what he wants. So in this article I am treating very seriously the threat of GAAR legislation. Clearly it is still necessary to demonstrate convincingly what an undesirable concept this is, in the hope that its supporters will see reason and at last drop the idea. I speak not as a tax adviser or tax inspector, but as a constitutional lawyer. In the last resort, the question whether or not to equip the United Kingdom with a GAAR is a question of legal policy.

The new dawn was foreshadowed in the consultative document published by the Inland Revenue last October entitled *A General Anti-avoidance Rule for Direct Taxes*. Appropriately, the foreword was written by Dawn Primarolo, Financial Secretary to the Treasury. Dawn (as I hope she will not mind me calling her for brevity, with no disrespect intended) told us that Gordon Brown wants us all to look at the possibility of introducing a GAAR. I have tried saying this word out loud. The resulting canine growl would do very well as my entire response to Dawn's paper, but I had better go into a little bit more detail.

In her foreword to the consultative document, Dawn assures us that 'artificial tax avoidance undermines the fairness in the system, making the burden fall more heavily, and unnecessarily heavily, on others. And there is less money, as a result, in the public purse to pay for government programmes such as healthcare (sic) and education'. I push aside the irritable response that there is no such word as 'healthcare', so why do we find it in an official Revenue document? (It would never have happened in my days as a Finance Bill draftsman, but they are long past.) I also stifle another irritable response, that there is much more to education (and should be) than its being just a 'government programme'. I proceed to the nitty-gritty. What does Dawn mean by those glib words 'artificial tax avoidance'? That is a puzzling question, to which I have found no answer. So I am going to commit the sin of quoting my own words on the matter (since I have them handy).

Avoidance and evasion

'It is necessary to distinguish, as respects the requirements imposed by an enactment, between lawfully escaping those requirements by so arranging matters that they do not apply (generally referred to as avoidance) and unlawfully contravening or failing to comply with the requirements (generally referred to as evasion).' (Bennion, *Statutory Interpretation* (3rd edn 1997) p 789.)

That was written not in a tax context, but in the context of statutory interpretation generally. It applies to legislation of all kinds. As Maxwell said in his famous treatise, it is not evading an Act to keep outside it (*Maxwell on the Interpretation of Statutes*, 12th edition 1969, p 143). Or, as Grove J expressed it, there can be no objection to getting away from the remedial

operation of the statute while complying with its words (*Ramsden v Lupton* (1873) LR 9 QB 17 at 32) This brings me to my first point. Avoidance (contrasted with evasion) should not be looked on as a tax matter only. It applies throughout the realm of legislation, *and the way the law regards it should be the same in all cases*. Why? Because it is a principle of legal policy that the law should be in all circumstances consistent (see Bennion, *op. cit.*, section 268). So avoidance is not just a matter for the tax inspector.

The general interpretative rule of distinguishing avoidance and evasion was applied specifically to taxation in the famous *Westminster* principle that if a financial transaction is genuine the courts cannot go behind it to some supposed underlying ‘substance’-

‘Every man is entitled, if he can, to order his affairs so that tax attaching under 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 taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.’ (*IRC v Westminster (Duke)* [1936] AC 1, *per* Lord Tomlin at 19).

The feeling that this was not quite good enough started to emerge during World War II. It was fuelled by remarks of Viscount Simon LC uttered at the height of the bombing in 1943. After pointing out that those who adopted tax avoidance schemes often enjoyed the (then doubtful) benefits of residence in Britain without accepting their share of the burden of British taxation, Lord Simon said-

‘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.’ (*Latilla v IRC* [1943] AC 377 at 381.)

This has a false premise. No one is suggesting that tax avoidance schemes are ‘commendable’ or ‘a discharge of the duties of good citizenship’. The question is a different one. Are they, or should they be, unlawful? Lord Simon answered the first half of this by saying of the tax avoiders ‘they are within their legal rights’.

The *Ramsay* principle

The pressure grew, and the *Westminster* principle gave way to the *Ramsay* principle. Lord Browne-Wilkinson summarised this, as developed in later cases, as follows-

‘The commissioners or the court must identify the real transaction carried out by the taxpayers and, if this real transaction is carried through by a series of artificial steps, apply the words of the taxing provisions to the real transaction, disregarding for fiscal purposes the steps artificially inserted. The provision of the taxing statute is to be construed as applying to the actual transaction the parties were effecting in the real world, not to the artificial forms in which the parties chose to clothe it in the surrealist world of tax advisers.’ (*IRC v Fitzwilliam* [1993] 1 WLR 1189 at 1226-1227.)

This is on the traditional line, applicable to legislation of every kind, of sharply distinguishing (unlawful) evasion from (lawful) avoidance. Thus, in relation to tax as to other matters, the courts have done their duty. That duty was laid down by the judges themselves more than four hundred years ago in the famous resolution in *Heydon’s Case*. This included the following passage, still highly relevant today-

‘The office of all the judges is always to make such construction as shall-
(a) suppress the mischief and advance the remedy, and

- (b) suppress subtle inventions and evasions for the continuance of the mischief *pro privato commodo* (for private benefit), and
- (c) add force and life to the cure and remedy according to the true intent of the makers of the Act *pro bono publico* (for the public good).’ (*Heydon’s Case* (1584) 3 Co Rep 7a.)

Dawn’s paper finds the *Ramsay* principle inadequate. She wants to go beyond it in various ways, for example by ruling out ‘tax avoidance’ generally. This would be done by having a ridiculously wide definition of that expression, saying things like ‘tax avoidance means not paying tax, paying less tax or paying tax later’ (para. 6.5.2) There would then be a letout for ‘acceptable tax planning’, defined as ‘arranging one’s affairs so as to avoid tax in a way that does not conflict with or defeat the purpose of the tax legislation’ (para. 6.5.10). All this shows a profound misunderstanding of the principles of British statute law regarding evasion and avoidance. Have our eminent lawyers noticed?

Sometimes the rule stated in *Heydon’s Case* has been referred to as ‘the mischief rule’. However the type of construction it requires is nowadays called purposive construction, because it concentrates on the legislative purpose. Instead of talking about ‘the mischief rule’ the courts now call it ‘the purpose rule’. The meaning is the same. So the first mistake in Dawn’s proposal can be characterised as overlooking the fact that purposive construction is *already* the basis for modern statutory interpretation generally. The courts stand ready to apply the very same test as she suggests as a novelty in her proposed recipe for ‘acceptable tax planning’.

Constitutional role of the judges

Dawn’s second mistake relates to the constitutional role of the judges in statutory interpretation. This was stated by Lord Scarman as follows: ‘It has been axiomatic among lawyers and, indeed, in our legal professional thinking for a very long time that the interpretation of statutes is a matter for the judges; it is not a matter for legislation’. (HL Deb. 13 February 1980 col. 276). To introduce a GAAR by legislation conflicts with this vital principle, based on the idea that the courts stand as a protection for the citizen against the executive and Parliament. Again I ask, have our eminent lawyers noticed? Or is mine a lone voice?

Dawn’s third mistake is that her idea infringes this great concept of judicial protection against the executive even more than I have already indicated. She wants there to be a clearance system *operated by the executive-*

‘Companies or their advisers would be expected to submit full details of a proposed transaction or series of transactions to a clearance body [within the Inland Revenue]. The body would examine the proposal and could give a clearance, guaranteeing that the Inland Revenue would not seek to apply the GAAR to the transaction, *provided it was carried out precisely as described.*’ (para. 8.2).

Representatives from business and the professions have supported the idea of a clearance procedure, says Dawn, ‘on the grounds (sic) that companies need some degree of certainty about how this new kind of law would affect them, before carrying out a transaction’ (para. 8.1). That was, she says, also the view of the Tax Law Review Committee (TLRC). Well it wasn’t my view, even though I was a member of the TLRC. It is true that my view may have escaped the attention of those compiling the TLRC report. When at a meeting of the TLRC I ventured to remind the committee that a lot of blood had been spilt in the 17th century to give citizens the Bill of Rights, parliamentary democracy, and protection against the executive, the chairman, Graham Aaronson QC, quickly shut me up by riposting: ‘We aren’t living in the

17th century'. He was quite right of course: we aren't. But that doesn't mean we should not remember and carefully preserve the advantages won for us by brave souls in that century. I kept rather quiet after that, and later resigned from the TLRC.

It is understandable that those affected by a GAAR would seek some kind of clearance procedure, but that is only because the whole idea is obnoxious. The words 'provided it was carried out precisely as described' show its impracticality. Commercial schemes have a life of their own, and do not stand still for a minute. Anyone who has ever devised a commercial scheme with tax consequences (and what commercial scheme does not have tax consequences?) will confirm this. I am not talking about a tax avoidance scheme, but a perfectly genuine plan for some form of commercial adventure or enterprise. When the plan is found to have tax consequences the finance director will think of the GAAR and advise getting clearance. Since the Revenue will be flooded with such applications it will take months to secure this clearance, if not years. It may be necessary to satisfy the Revenue by explaining the scheme further, or adjusting it. It may be necessary to appeal against the Revenue's rejection of the scheme. During this time the commercial realities surrounding the scheme are likely to vary from week to week (if not from day to day). For sound business reasons it will be desirable constantly to adjust the scheme before finally putting it into operation (or even while it is in operation). But the finance director will issue warnings about those dread words 'provided it was carried out precisely as described', and the enterprise will be stifled. The GAAR is also impractical from the Revenue viewpoint. How, when considering a particular commercial scheme laid before them, can they be sure how it will work out before it has even begun to operate? Delays imposed for all these reasons by the clearance procedure would add greatly to business costs, and hamper the country's economic progress. Is that really what Dawn and her master want?

Empowering the executive

However the most serious criticism of the proposed clearance system is that it gives far too much power to the executive. It is for the courts to hand down binding interpretations of legislation, not civil servants in the Inland Revenue. This is certainly not a role for civil servants who think they have a mission to 'introduce morality into business' (as some seem to think is the case with a GAAR). Business people have the same duty as other citizens to pay their taxes and so contribute to the costs of running their country, but when a particular business already contributes a great deal in tax (as many do) there is no moral obligation to contribute still more if the relevant tax legislation does not truly require this. That brings me to a further point. At present, it is up to the Finance Bill drafter to get the text right. If drafters know a GAAR is there as a safety net to rescue the Exchequer from their errors, what effect will that have on the standard of drafting? It can scarcely improve it.

Dawn tells us the United Kingdom is unusual in not having a GAAR (para. 4.3). I do not care. The United Kingdom is unusual in many ways: we rather pride ourselves on that. If, as I have tried to show, a GAAR is unconstitutional, impractical, restrictive of enterprise and wasteful of the time of expensive people then we should not feel any shame in rejecting it. Our constitutional system, though it is fashionable to despise it and call for a brand new 'modern' written constitution, is in fact a flexible repository of the wisdom of many centuries. It is based on nearly a thousand years of practical experience in running a country to the advantage of all its inhabitants. I do not hesitate to say that those foreign countries which have lumbered themselves with a GAAR have taken a wrong turning. We should not like sheep follow their mistaken example.

So let us leave it to the judiciary to carry on doing the job they are appointed to do. If the *Ramsay* principle needs developing, let the courts go on developing it. I suggest Dawn asks

her boss the Chancellor to take back his mischievous consultative document and put the GAAR out of his mind for good (and believe me it would be for good).

Francis Bennion is a former Parliamentary Counsel. His published books include 'Statutory Interpretation' (3rd edn 1997) and 'Statute Law' (3rd edn 1990). He is the author of the Statutes title in Halsbury's Laws of England (4th edn reissue).