Judicial Anti-Avoidance Practice

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Literal interpretation of tax statutes

"As I understand the principle of all fiscal interpretation it is this: if the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be."

Lord Cairns in Partington v Attorney-General (1869) LR 4HL 100, 122

Judicial Anti-avoidance Doctrines

The following approaches can be identified:

- “Sham” transactions (UK/US/India)
- Purposive interpretation of tax statutes (US)
- Substance over form (US)
- Business purpose test (US)
- Ignore tax motivated steps in composite transactions (step transaction doctrine) (US)
- Fiscal nullities (UK)
- Purposive interpretation (UK/HK)
- Identify the statutory question (UK/US)
- In civil law countries - fraus legis / abuse of law concept

The traditional view

"My Lords, the highest authorities have always recognised that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so within the law, and that he may legitimately claim the advantage of any expressed terms or any omissions that he can find in his favour in taxing Acts. In so doing, he neither comes under liability nor incurs blame."

Lord Sumner in IRC v Fisher's Executors [1926] AC 412

"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, however unappreciative the Commissioners of Inland Revenue or his fellow tax gatherers may be of his ingenuity, he cannot be compelled to pay an increased tax."

Lord Tomlin in IRC v Duke of Westminster [1936] AC 1

“Sham” – US style (no business purpose)

“The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended. . . . Putting aside, then, the question of motive in respect of taxation altogether, and fixing the character of the proceeding by what actually occurred, what do we find? Simply an operation having no business or corporate purpose – a mere device which put on the form of a corporate reorganisation as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan.”

Sutherland J in Gregory v Helvering 293 US 465 (1935)

“Sham” – US style (substance over form)

“A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages. On the other hand, the Government may not be required to acquiesce in the taxpayer’s election of that form for doing business which is most advantageous to him. The Government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purpose of the tax statute.”

Reed J in Higgins v Smith 308 US 473 (1940)

“Sham” – US style (economic substance)

“In many cases in which the Gregory principle is called into play the question is whether a tax significant transaction has occurred…. The principle is also fully applicable where there is no doubt that a very real transaction has taken place and the question is whether the characterization urged by the taxpayer accords with substantial economic reality. In each case the taxpayer must show that his treatment of the transaction does not conflict with the meaning the Congress had in mind when it formulated the section *sub judice.”*

Medina CJ in Gilbert v Commissioner 248 F 2d 399 (1957)

“Sham” - UK style

“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 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.”

Diplock LJ in Snook v London and West Riding Investments Ltd [1967] 2QB 786

Purposive Interpretation of tax legislation (UK)

"A subject is only to be taxed upon clear words, not upon 'intendment' or upon the 'equity' of an Act. Any taxing Act of Parliament is to be construed in accordance with this principle. What are 'clear words' is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should be regarded . . . ."

Lord Wilberforce in Ramsay v IRC [1982] AC 300

The *Ramsay* Principle in self-cancelling transactions ("the new approach") (UK)

" 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 gain at a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there 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."

Lord Wilberforce in Ramsay v IRC at p. 326.

The new approach: fiscal nullities (UK)

"The formulation by Lord Diplock [in *Burmah Oil*] expresses the limitations of the *Ramsay* principle. First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end. . . .Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of liability to tax – not 'no business effect.' If these two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied."

Lord Brightman in Furniss v Dawson [1984] AC 474

Fiscal nullity not the new approach (UK)

". . . Lord Brightman's formulation in the *Furniss* case . . . is not a principle of construction. It is a statement of the consequences of giving a commercial construction to a fiscal concept. . . . It is necessary to make this point because, in the first flush of victory after the *Ramsay, Burmah* and *Furniss* cases there was a tendency on the part of the Inland Revenue to treat Lord Brightman's words as if they were a broad spectrum anti-biotic which killed off all tax avoidance schemes, whatever the tax and whatever the statutory provisions."

Lord Nicholls in MacNiven v Westmoreland [2004] UKHL

The “real” new approach? (HK)

“The driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.”

Ribeiro PJ in Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] Hong Kong SAR Court of Final Appeal 46

India – the traditional view

"Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it arises or accrues to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may be lawfully circumvented."

Shah J in CIT V A Raman and Company (1967) 67 ITR 11 (SC)

The new approach in India - perhaps?

"We think that the time has come for us to depart from the Westminster principle as emphatically as the British courts have done and to dissociate ourselves from the observations of Shah J and similar observations made elsewhere. . . . In our view the proper way to construe a taxing statute, while considering a device to avoid tax, is not to ask whether the provisions should be construed literally or liberally, nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is a device to avoid tax, and whether the transaction is such that the judicial process may accord its approval to it."

Chinnappa Reddy J in McDowell v Commercial Tax Officer (1985) 154 ITR 146 (SC)

But perhaps not . . .

"With respect, therefore, we are unable to agree with the view that the Duke of Westminster is dead, or that its ghost has been exorcised in England. The House of Lords does not seem to think so, and we agree, with respect. In our view, the principle of the Duke of Westminster is very much alive and kicking in the country of its birth. And as far as this country is concerned, the observations of Shah J in *CIT v Raman* are very much relevant today."

Srikrishna J in Union of India v Andolan (2003) 263 ITR 706 (SC)

Lord Hoffman has the last word

"The lesson, in my opinion, is that tax avoidance in the sense of transactions successfully structured to avoid a tax which Parliament intended to impose should be a contradiction in terms. The only way in which Parliament can express an intention to impose a tax is by a statute which means that such a tax is to be imposed. If that is what Parliament means, the courts should be trusted to give effect to its intention. Any other approach will lead us into dangerous and unpredictable territory."

Lord Hoffmann, "Tax Avoidance" [2005] BTR 197,206