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by

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INTRODUCTION

The phenomenon of tax avoidance is almost certainly as old as taxation itself. [2] Over the past few decades, however, several factors have contributed to what numerous revenue agencies and academic authors have characterised as a significant increase in tax avoidance activity. [3] In response, governments have adopted various measures, both legislative and administrative, to combat this phenomenon. [4] Although these reforms appear to have had a noticeable impact on tax avoidance activity in at least some jurisdictions, [5] it is uncertain whether they are fully adequate to address the problem of tax avoidance in the 21st century.

This paper considers both the causes of increased tax avoidance activity over the past several years as well as governmental responses to this phenomenon in key common law jurisdictions, notably Australia, Canada, New Zealand, the United Kingdom and the United States. The first section discusses the concept of tax avoidance, distinguishing unacceptable or abusive tax avoidance both from illegal tax evasion on the one hand and acceptable tax

1 Faculty of Law, University of British Columbia; Fellow, Taxation Law and Policy Research Institute, Monash University and International Research Fellow, Oxford University Centre for Business Taxation.

2 See N Tutt, *The History of Tax Avoidance* (Wisedene, 1989).

3 See, eg, US Treasury, *The Problem of Corporate Tax Shelters – Discussion, Analysis and Legislative Proposals* (1999); J Bankman, "The New Corporate Tax Shelters Market" (1999) 83 *Tax Notes* 1775; D McBarnet and C Whelen, *Creative Accounting and the Cross-Eyed Javelin Thrower* (John Wiley & Sons, 1999); J Braithwaite, *Markets in Vice, Markets in Virtue* (2005); South African Revenue Service (SARS), *Discussion Paper on Tax Avoidance* (November 2005), p 10; C Evans, "Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions" (2007) 37 *Hong Kong Law Journal* 103; and Finance Quebec, *Aggressive Tax Planning* (January 2009), p 3.

4 For excellent summaries of these measures, see Finance Quebec, above, n 3.

5 See, eg, D Weisbach, "Comments on Recent Developments on Tax Shelters in the US", in J Freedman (ed), *Beyond Boundaries: Developing Approaches to Tax Avoidance and Risk Management* (2008), pp 57, 60 (reporting a "consensus that the large-scale retail marketing of tax shelters has slowed significantly").

planning or tax minimisation on the other. This is followed by a consideration of the causes of recent tax avoidance activity and its adverse effects for domestic tax systems. Government responses to tax avoidance are then reviewed, examining both legislative reforms and administrative innovations. The final section returns to the concept of tax avoidance, questioning whether these legislative and administrative measures are sufficient to the address the problem of tax avoidance in the 21st century.

THE CONCEPT OF TAX AVOIDANCE

In a recent article on the Canadian general anti-avoidance rule (GAAR), Tim Edgar defines tax avoidance "in its broadest (and perhaps most simplistic sense)" as "any change in behaviour that occurs as a response to the change in price of particular activities, assets or transactions occasioned by the imposition of taxation".[6] From this perspective, he explains, distinctions between tax avoidance and tax evasion represent "differences in degree rather than differences in kind"[7] while any distinction between acceptable and abusive tax avoidance is "hopelessly unclear".[8]

Based as they are on a purely consequentialist and economic understanding of tax avoidance, these conclusions have limited relevance to the realm of tax law, which traditionally distinguishes illegal tax evasion from legal but unacceptable tax avoidance, and unacceptable or abusive tax avoidance from permissible tax planning or tax minimisation. According to the Organisation for Economic Co-operation and Development (OECD), for example, tax "evasion" involves "illegal arrangements through or by means of which liability to tax is hidden or ignored" as a consequence of which "the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities", while tax "avoidance" constitutes "an arrangement of a taxpayer's affairs that is intended to reduce his liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow".[9] In contrast, "tax planning" is defined as the "[a]rrangement of a person's business and/or private affairs in order to minimize tax liability".[10]

6 T Edgar, "Designing and Implementing a Target-Effective General Anti-Avoidance Rule", in D Duff and H Erlichman (eds), *Tax Avoidance in Canada After Canada Trustco and Mathew* (2007), pp 221, 226. For a similar economic approach to the concept of tax avoidance, on which Edgar's approach is based, see M Brooks and J Head, "Tax Avoidance in Economics, Law and Public Choice", in G Cooper (ed), *Tax Avoidance and the Rule of Law* (1997), p 53.

7 T Edgar, above, n 6, p 233.

8 T Edgar, above, n 6, p 222.

9 OECD, *International Tax Terms for the Participants in the OECD Programme of Cooperation with Non-OECD Economies*, online at http://www.oecd.org/dataoecd/17/21/33967016.pdf (last accessed 17 February 2009).

10 OECD, above, n 9.

Tax evasion versus tax avoidance

As Chris Evans explains, the legal distinction between tax evasion and tax avoidance is "well-recognized" as "the difference between working outside the law and working within the law (though against its spirit)".[11] Somewhat more colourfully, former UK Chancellor of the Exchequer Denis Healey has described the difference between tax avoidance and tax evasion as "the thickness of a prison wall".[12]

While deliberate concealment is generally understood as the "common thread" that runs through all cases of tax evasion,[13] the extent of taxpayer disclosure that is necessary to prevent the ascription of tax evasion is not always clear.[14] Indeed, to the extent that participation in tax avoidance schemes encourages taxpayers to be "economical with the truth"[15] it is not surprising that the line between legal tax avoidance and illegal tax evasion may become blurred – as John Tiley and Graeme Cooper have noted in different contexts.[16] While tax authorities may be tempted to encourage this development in order to deter abusive tax avoidance,[17] an approach more compatible with rule of law principles and taxpayer certainty involves the introduction of mandatory disclosure rules and civil penalties for unacceptable or abusive tax avoidance – two of the most prominent legislative reforms that common law jurisdictions have either introduced or considered adopting in response to recent increases in tax avoidance activity.[18]

Tax avoidance versus tax minimisation

In contrast to the "well-recognized" distinction between tax evasion and tax avoidance, the distinction between unacceptable or abusive tax avoidance and acceptable tax minimisation or tax planning is considerably less clear and often questioned outright. In *McNiven v Westmoreland* [2001] STC 257, for example, Lord Hoffman declared that unless the statutory provisions at issue "contain words like 'avoidance' or 'mitigation', I do not think that it helps to introduce them".[19] In a similar vein, Judith Freedman has dismissed the "attempt divide

11 C Evans, "Containing Tax Avoidance: Anti-Avoidance Strategies" [2008] *University of New South Wales Faculty of Law Research Series 40*, p 4.

12 Cited in C Evans, above, n 11.

13 J Freedman, "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle" [2004] *British Tax Review* 332 at 347.

14 J Freedman, above, n 13 at 349.

15 J Freedman, above, n 13 at 349.

16 J Tiley, *Revenue Law* (4th ed, 2000), p 85; and G Cooper, "Analyzing Corporate Tax Evasion" (1994) 50 *Tax Law Review* 33, n 35. See also SARS, above, n 3, p 22, n 68.

17 According to the Chair of Customs and Excise in the UK, for example, "[i]t may be that as the legal principles of avoidance become defined in case law, a business which implements an avoidance scheme which has been held by the courts to be avoidance could be embarking on a course of conduct which amounts to evasion": R Broadbent, "VAT Compliance in the 21st Century" [2003] *British Tax Review* 122 at 128.

18 See below, "Disclosure legislation" and "Penalties for abusive tax avoidance".

19 [2001] STC 257.

acceptable avoidance, tax planning or mitigation on the one hand, and unacceptable avoidance on the other, in any general sense" as "unhelpful".[20] Although affirming the distinction, Chris Evans observes that it is "generally recognised as not being as clear as the distinction between avoidance and evasion".[21]

In the United Kingdom and many Commonwealth jurisdictions,[22] the challenge of distinguishing between unacceptable or abusive tax avoidance and acceptable tax planning or mitigation is directly traceable to the traditional interpretative doctrine that tax statutes must be construed strictly,[23] and to the judicial principle established in the famous *Duke of Westminster case* that "[e]very 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".[24] To the extent that tax statutes are construed literally and tax avoidance is unfettered by law, it is conceptually impossible to distinguish unacceptable or abusive tax avoidance from acceptable tax planning or mitigation. Although more recent UK decisions have clearly abandoned strict construction in favour of a more purposive approach to the interpretation of tax legislation, UK courts have remained generally reluctant to embrace broad-based anti-avoidance doctrines.[25]

In contrast to the UK approach, US courts have long been willing to adopt general anti-avoidance doctrines such as the business purpose test and a substance over form doctrine.[26] According to the former, tax benefits otherwise available under the relevant legislation can be denied to taxpayers who enter into transactions or relationships solely or primarily to obtain tax benefits not clearly intended by the legislation.[27] According to the latter, transactions should be characterised for tax purposes according to their commercial or economic substance, rather than their legal form.[28] While affirming the "legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them",[29] therefore, US

20 J Freedman, above, n 13 at 350.

21 C Evans, above, n 11, pp 4-5.

22 See, eg, B Alarie and D Duff, "The Legacy of UK Tax Concepts in Canadian Tax Law" [2008] *British Tax Review* 228 at 238-251.

23 See, eg, *Partington v Attorney-General* (1869) 4 LR 100 (HL) per Lord Cairns at 122, stating that "if the Crown, seeking to recover 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".

24 *IRC v Duke of Westminster*, 19 TC 490; [1936] AC 1 at 520 (TC), 19 (AC).

25 See, eg, J Freedman, "Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament" (2007) 122 *Law Quarterly Review* 52.

26 See, eg, J Bankman, "The Economic Substance Doctrine" (2000) 74 *Southern California Law Review* 5.

27 See, eg, *Bazley v CIR* 331 US 737 (1947); and *Goldstein v CIR* 364 F2d 734, 2d Cir, (1966) cert denied 385 US 1005 (1967).

28 See, eg, *CIR v Court Holding* 324 US 331 (1945); and *Waterman Steamship Corporation v CIR* 430 F2d 1185 (1970), cert denied 401 US 939 (1971).

29 *Gregory v Helvering* 293 US 465 (1935) at 469.

courts have drawn a line between legitimate tax minimisation "by means which the law permits"[30] and unacceptable or abusive tax avoidance that is precluded by these judicial doctrines.

Similarly, many Commonwealth jurisdictions have introduced general anti-avoidance rules (GAARs) which limit the scope of the *Duke of Westminster* principle.[31] In Australia, for example, *Income Tax Assessment Act 1936* (ITAA 1936) Pt IVA disallows tax benefits that are derived from a broadly-defined "scheme" that is entered into for the sole or dominant purpose of obtaining a tax benefit.[32] In Canada, s 245 of the federal *Income Tax Act 1985* (ITA) disallows tax benefits resulting from tax-motivated transactions that result in a misuse or abuse of specific statutory provisions or the scheme of the ITA as a whole.[33] In New Zealand, s BB3(1) of the New Zealand *Income Tax Act* (NZITA) authorises the Commissioner to "counteract a tax advantage from a tax avoidance arrangement" while s OB1 defines a "tax avoidance arrangement" as an arrangement that has tax avoidance as its purpose or effect or one of its purposes or effects provided this is not merely incidental.[34] As the New Zealand Court of Appeal has explained, these GAARs establish a general standard "by which the line between legitimate tax planning and improper tax avoidance is to be drawn".[35]

In order to draw this line, it is often considered helpful to identify various "hallmarks" or "badges" of tax avoidance.[36] According to the South African Revenue Service (SARS), for example, common attributes of tax avoidance schemes include:

(1) the lack of economic substance (usually resulting from pre-arranged circular or self-cancelling arrangements);

(2) the use of tax-indifferent accommodating parties or special purpose entities;

(3) unnecessary steps and complexity;

(4) inconsistent treatment for tax and financial accounting purposes;

30 *Gregory v Helvering* 293 US 465 (1935) at 469.

31 See, eg, Pt IVA of the *Income Tax Assessment Act 1936* (Australia); s 245 of the federal *Income Tax Act 1985* (Canada), ss 61 and 61A of the *Inland Revenue Ordinance* (Hong Kong); ss BG1 and GB1 of the *Income Tax Act 1994* (New Zealand); and s 103 of the *Income Tax Act 1962* (South Africa).

32 For a brief summary of the Australian GAAR, see C Evans, "The Battle Continues: Recent Australian Experience with Statutory Avoidance and Disclosure Rules", in J Freedman, above, n 5, pp 37, 38-41.

33 For a short explanation of the Canadian GAAR, see B Arnold, "The Canadian Experience with a General Anti-Avoidance Rule" in J Freedman, above, n 5, p 29.

34 For a brief explanation of the New Zealand GAAR, see SARS, above, n 3, pp. 32-35.

35 *CIR v BNZ Investments* (2001) 20 NZTC 17,103; [2002] 1 NZLR 450 (CA), per Richardson P. See also Finance Quebec, above, n 3, p 14 (explaining that a GAAR "tempers" the *Duke of Westminster* principle "by establishing a line between legitimate tax planning and abusive tax avoidance").

36 See, eg, SARS, above, n 3, p 19.

(5) high transaction costs; and

(6) fee variation clauses or contingent fee provisions.[37]

Other common characteristics identified by the SARS include significant marketing activities by promoters,[38] the use of new and complex financial instruments which allow promoters to "mimic almost perfectly the risks and returns attributable to more traditional financial instruments"[39], and the use of tax havens, particularly involving captive insurance companies, captive finance subsidiaries and intangible property holding companies.[40]

Although these attributes or hallmarks can be useful factors for revenue authorities to take into account when deciding whether or not to subject transactions and arrangements to closer scrutiny (and are therefore valuable criteria for the design of disclosure rules considered later in this paper[41]), they themselves do not determine the existence of unacceptable or abusive tax avoidance nor define the distinction between this concept and acceptable tax planning or tax minimisation. On the contrary, as numerous commentators have explained, the essential element of abusive tax avoidance is the acquisition of a tax benefit that contradicts the scheme and purpose of the statute or the intent of the legislature.[42] As a result, as Lord Nolan emphasised in *CIR v Willoughby* [1997] 4 All ER 65 (at 73):

> The hall mark 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

37 SARS, above, n 3, p 19. For a detailed discussion of these attributes, see also, pp 20-25.

38 SARS, above, n 3, p 19, n 61.

39 SARS, above, n 3, pp 25-26.

40 SARS, above, n 3, pp 26-27.

41 See below, "Disclosure legislation".

42 See, eg, D Weisbach, "Formalism in the Tax Law" (1999) 66 *University of Chicago Law Review* 860 at 879-880 (observing that anti-abuse rules apply to "transactions entered into with a purpose of avoiding the purposes of the statute"); J Bankman, "The Tax Shelter Battle", in H Aaron and J Slemrod (eds), *The Crisis in Tax Administration* (2004), p 9 (defining a tax shelter as "a transaction that (1) is marketed and tax-motivated, (2) succeeds under at least one literal reading of the governing statute or regulation, (3) misstates economic income, and (4) in doing so reduces the tax on capital, (5) *in a manner inconsistent with any purposive or intentionalist reading of the statute or regulation*" (emphasis added); Review of Business Taxation, *A Tax System Redesigned – More Certain, Equitable and Durable* (1999), section 6.2(c) (explaining that "tax avoidance [is] a mis-use or abuse of the law [that] is often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by Parliament but also includes the manipulation of the law and a focus on form and legal effect rather than substance"); SARS, above, n 3, p 4 (defining "impermissible tax avoidance" as "artificial or contrived arrangements with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived 'loopholes' in tax laws in order to achieve results that conflict with or defeat the intention of Parliament"); D Hariton, "When and How Should the Economic Substance Doctrine Be Applied" (2006) 60 *Tax Law Review* 29 at 31 (explaining that the economic substance doctrine should not be applied to disallow tax benefits "unless they are clearly inconsistent with tax policy and congressional intent").

> of a fiscally attractive option afforded to him by the legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.

Since the scheme and purpose of the relevant tax legislation is often difficult to discern and legislative intent is often unclear, it is not surprising that the line between unacceptable of abusive tax avoidance and acceptable tax planning or tax minimisation can be difficult to draw in practice. To the extent that tax statutes recognise and permit artificial sale-leaseback transactions, for example, it is perhaps understandable that courts in different jurisdictions have found it difficult to conclude that even highly artificial transactions designed to obtain capital or depreciation allowances do not constitute abusive tax avoidance.[43] As Judith Freedman explains, "the capital allowance legislation is quite deliberately *not* based on economic reality so that government cannot complain when the leasing industry uses the regime to the full, absent any indication that it should not have the advantage of capital allowances in these circumstances".[44]

The challenge of gauging abusive tax avoidance is even more acute in the international arena, where the tax consequences of transactions and arrangements are governed by the interaction of different domestic tax laws as well as bilateral tax treaties, and the contours and very existence of an international tax regime is a matter of ongoing debate.[45] As a result, it is perhaps not surprising that courts have been unwilling to apply the Canadian GAAR to tax-motivated transactions designed to take advantage of Canada's tax treaty network,[46] and equally unsurprising that responses to international tax arbitrage – to the extent that these have been pursued at all – have taken the form of specific anti-avoidance measures and amendments to bilateral tax treaties rather than judicial remedies under domestic anti-avoidance doctrines or GAARs.[47]

43 *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684; [2005] STC 1; [2004] UKHL 51; *Canada Trustco Mortgage Company v Canada* 2005 SCC 54; *Peterson v CIR* [2005] STC 448. For helpful reflections on these decisions, see J Freedman, "Converging Tracks? Recent Developments in Canadian and UK Approaches to Tax Avoidance" (2005) 53 *Canadian Tax Journal* 1038; M Gammie, "*Barclays and Canada Trustco*: Further Comment from a UK Perspective" (2005) 53 *Canadian Tax Journal* 1047; and M Littlewood, "The Privy Council and the Australasian Anti-Avoidance Rules" [2007] *British Tax Review* 175.

44 J Freedman, above, n 13 at 351-352.

45 See, eg, H Rosenbloom, "International Tax Arbitrage and the "International Tax System"" (2000) 53 *Tax Law Review* 137 (dismissing the idea of an "international tax system" as "imaginary" and questioning the introduction of domestic tax rules to prevent international tax arbitrage); and R Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* (2007) (affirming the existence of an international tax regime as a creature of customary international law and welcoming the adoption of anti-tax-arbitrage rules as a manifestation of this regime).

46 *MIL Investments (SA) v The Queen* [2006] 5 CTC 2552; 2006 DTC 3307 (TCC), aff'd 2007 FCA 23; and *Prévost Car v The Queen* [2008] 5 CTC 2306; 2008 DTC 3080 (TCC), aff'd [2009] FCA 57; 2009 DTC 5053.

47 See, eg, M Boyle, "Cross-Border Tax Arbitrage – Policy Choices and Political Motivations" [2005] *British Tax Review* 527.

CAUSES AND CONSEQUENCES OF TAX AVOIDANCE

As explained in the introduction to this paper, the extent of abusive tax avoidance activity has increased significantly over the past few decades, causing governments to adopt various responses to what is widely regarded as a "growing problem".[48] In order to assess these responses, it is helpful to consider the causes of recent increases tax avoidance activity as well as the adverse effects of increased tax avoidance that have motivated governments to respond.

Causes of tax avoidance

According to the South African Revenue Service, impermissible tax avoidance typically involves the pursuit of four basic goals:

(1) the deferral of a tax liability;

(2) the conversion of the character of an item (for example from revenue to capital or, in more aggressive products, the conversion of a taxable item such as interest to a tax-exempt one such as dividends);

(3) the permanent elimination of a tax liability; and/or

(4) the shifting of income (for example, from a taxpayer subject to the highest marginal rates to a taxpayer subject to a lower (or zero) rate of tax).[49]

As Chris Evans explains, "[a]chievement of any or all of these goals is only possible because of the potential for tax leverage or tax arbitrage that arises as a result of so-called inconsistencies and discontinuities that exist within national tax jurisdictions and across international tax borders".[50] While one might hope to minimise opportunities for tax avoidance by reforming basic tax rules to eliminate or reduce these inconsistencies and discontinuities, they often exist for good reasons (for example to reduce complexity, to accommodate liquidity concerns, to promote social and economic policy objectives, or to recognise national sovereignty) and are unlikely to disappear.[51] As a result, although amendments to what John Braithwaite has characterised as "loophole-ridden tax laws" are an important way to prevent opportunities for abusive tax avoidance,[52] it is also essential to regulate the manipulation of these inconsistencies and discontinuities in order to address this problem.

In recent years, several factors have made it increasingly difficult for domestic tax authorities to carry out this regulatory function. First, as Vito Tanzi argues, globalisation and technological innovation have created a number of "fiscal termites" which are likely to impair each country's ability to

48 SARS, above, n 3, p 7. See also Finance Quebec, above, n 3, pp 8-9 (referring to a "proliferation" of abusive tax avoidance schemes in recent years).

49 SARS, above, n 3, p 16.

50 C Evans, above, n 11, pp 6-7.

51 C Evans, above, n 11, p 7.

52 J Braithwaite, above, n 3, p 21.

collect taxes.[53] Second, as John Braithwaite explains, these "fiscal termites" have facilitated the proliferation of "moral termites" who exploit these opportunities to lessen the taxes that they or their clients pay.[54] Third, judicial decisions in several jurisdictions accepting the legitimacy of aggressive tax planning and affirming a more literal approach to the interpretation of tax statutes have encouraged this development,[55] fostering more accepting attitudes among tax advisors and their clients toward tax avoidance.[56]

According to a recent paper issued by the Finance Department of the Province of Quebec, the recent growth in the market for what it calls aggressive tax planning (ATP) has been driven by increases both in the demand for and supply of ATP schemes.[57] On the one hand, it explains:

> The development of communication technologies and electronic finance, the introduction of innovative financial products and the global integration of national economies … have led to greater competition among businesses as well as a greater need for them to control their costs, including their tax costs, which usually represent a significant expense item.[58]

In turn, it continues:

> This need among businesses … fostered the expansion of firms of tax intermediaries – lawyers, accountants, investment banks, in particular – and the development among the latter of an advanced knowledge of various tax regimes as well as sophisticated expertise for integrated management of their clients' tax situation on a global basis.[59]

In addition, it observes, "[t]he highly competitive market for tax consulting services fuelled the appetite of taxpayers to further reduce their tax costs and encouraged advisors to design ATP schemes",[60] leading to "the development of a new business model based on designing and distributing off-the-shelf tax

53 V Tanzi, "Globalization and the Work of Fiscal Termites" *IMF Working Paper*, WP/00/181 (November 2000) (identifying the following eight "fiscal termites": (1) electronic commerce and transactions; (2) the use of electronic money; (3) intra-company trade; (4) offshore financial centres and tax havens; (5) derivatives and hedge funds; (6) inability to tax highly mobile financial capital; (7) growing foreign activities by highly skilled individuals; and (8) foreign shopping).

54 J Braithwaite, above, n 3, pp 25-26.

55 See, eg, A Freiberg, "Ripples from the Bottom of the Harbour: Some Social Ramifications of Taxation Fraud" (1988) 12 *Criminal Law Journal* 136; and Finance Quebec, above, n 3, pp 12-18. On the shift in Supreme Court of Canada tax jurisprudence during the 1990s, see D Duff, "Justice Iacobucci and the "Golden and Straight Metwand" of Canadian Tax Law" (2007) 57 *University of Toronto Law Journal* 525.

56 US Department of Treasury, above, n 3, (1999) p 19.

57 Finance Quebec, above, n 3, p 9.

58 Finance Quebec, above, n 3, p 9.

59 Finance Quebec, above, n 3, p 9. See also SARS, above, n 3, pp 8-9 (noting that "the lucrative market for tax avoidance schemes and 'tax optimisation' plans has led to an increase in the resources and talent being devoted to those areas by professional firms in many countries" while advances in computer and telecommunication technology have "radically transformed the way in which multinational firms, particularly multinational accounting firms, can share and exchange information" increasing the speed with which tax avoidance schemes can migrate to different jurisdictions).

60 Finance Quebec, above, n 3, p 9.

products”.[61] In this respect, as Braithwaite concludes, the growing market for aggressive tax planning (particularly involving international tax arbitrage) has been driven as much or more by the supply of tax avoidance schemes as by the demand for these arrangements.[62]

Consequences of tax avoidance

While the causes of recent increases in tax avoidance activity are still subject to some debate,[63] the consequences of tax avoidance are relatively uncontroversial. As the South African Revenue Service explains:

> The harms caused by impermissible tax avoidance are varied and pervasive. They include short-term revenue loss, growing disrespect for the tax system and the law, increasingly complex legislation, the uneconomic allocation of resources, an unfair shifting of the tax burden, and a weakening of the ability of Parliament and the National Treasury to set and implement economic policy.[64]

Beginning with short-term revenue losses, it is difficult to accurately estimate the size of the problem, since much tax avoidance goes undetected.[65] According to Finance Quebec, however, the revenue losses from various ATP schemes that were foreclosed by provincial amendments over the last several years would have amounted to roughly half a billion dollars in Quebec alone.[66] At the federal level in Canada, recent administrative efforts to counteract aggressive tax planning are estimated to have yielded $1.4 billion in additional identified taxes for a single taxation year.[67] As a result, as the Quebec Finance Department concludes, it seems clear that ATP has “a negative impact on public finances and that the impact is substantial”.[68]

In addition, as the OECD emphasises, tax avoidance is “economically costly”.[69] As the South African Revenue Service observes:

> impermissible tax avoidance creates significant deadweight losses for the economy by distorting trade and investment flows. In particular, avoidance schemes often involve a re- or misallocation of resources from productive

61 Finance Quebec, above, n 3, pp 2 and 11-12 (explaining that ATP has become “a new specialty in the field of taxation” involving a new business model in which tax intermediaries refine “tax ideas” for target client groups and market “off-the-shelf tax products” that are typically sold in return for remuneration that is “conditional and proportional to the tax that is avoided”). See also J Braithwaite, above, n 3, p 118 (relating one New York tax advisor’s comment that “[i]nstead of a client looking for a transaction to solve their tax problem, we have transactions looking for clients”).

62 J Braithwaite, above, n 3, pp 51-57.

63 See, eg, J Braithwaite, above, n 3, pp 117-118 (relating alternative views on whether the growing market in aggressive tax planning is driven mostly on the demand-side or the supply-side).

64 SARS, above, n 3, p 9.

65 SARS, above, n 3, p 9.

66 Finance Quebec, above, n 3, p 20.

67 Canada Revenue Agency, *2006-2007 Canada Revenue Agency Annual Report*, p 59.

68 Finance Quebec, above, n 3, p 21.

69 OECD, “Forces Shaping Tax Policy” (June 1998), 63 *OECD Economic Outlook* 165.

> investments to activities that are, at best, marginally profitable on a pre-tax basis. These distortions reduce economic efficiency and impede growth.[70]

As well, it explains, "[a]dditional costs are reflected in the resources that are diverted from productive investment to the development, marketing, implementation and subsequent defence of impermissible tax avoidance schemes".[71]

Furthermore, it seems, tax avoidance generally increases the complexity of tax legislation, as legislatures almost invariably respond by enacting specific anti-avoidance measures designed to prevent specific schemes that are discovered on audit as well as through more detailed and complex drafting intended to pre-empt opportunities for tax avoidance in the first place.[72] To the extent that tax avoidance increases the complexity of tax legislation, moreover, it also adds to the costs of tax avoidance as compliance and administrative costs increase for taxpayers and revenue authorities.[73]

More importantly, perhaps, abusive tax avoidance results in an unfair shifting of the tax burden, particularly to less mobile factors like labour and consumption.[74] As the Quebec Finance Department notes:

> Since ATP is usually associated with high-income taxpayers who can afford sophisticated professional services, the proliferation of ATP schemes raises serious issues of fairness among taxpayers.
>
> If the government wants to maintain a balanced budget, it will nonetheless have to collect, from other taxpayers, the tax revenue lost through ATP which directly violates one of the principles of our social organization, ie that everyone participates in funding the state on the basis of his ability to contribute.[75]

Finally and perhaps most significantly, abusive tax avoidance has what even the Tax Section of the New York State Bar Association has labelled a "corrosive effect" on the integrity of the tax system – breeding "significant disrespect for the tax system" and "encouraging responsible corporate taxpayers to expect this type of activity to be the norm, and to follow the lead of other taxpayers who have engaged in tax advantaged transactions".[76]

70 SARS, above, n 3, p 12, citing P Groenewegen, "Distributional and Allocational Effects of Tax Avoidance", in D Collins (ed), *Tax Avoidance and the Economy* (Australian Tax Research Foundation, 1984), p 23.

71 SARS, above, n 3, pp 11-12, citing J Slemrod and S Yitzhaki, "The Costs of Taxation and the Marginal Efficiency Cost of Funds" (March 1996) 43 *IMF Staff Papers* 172.

72 SARS, above, n 3, p 11.

73 SARS, above, n 3, p 11.

74 See, eg, R Avi-Yonah, "Globalization, Tax Competition and the Fiscal Crisis of the Welfare State" (2000) 113 *Harvard Law Review* 1575 at 1578.

75 Finance Quebec, above, n 3, p 21.

76 Statement of Harold R Handler, on behalf of the Tax Section, New York State Bar Association, before the Committee on Finance (27 April 1999), cited in US Treasury, above, n 3, p 3.

As the Quebec Finance Department explains:

> Like a vicious circle, the perceived unfairness and injustice in such a system are such as to discourage … taxpayers to comply with the law, and consequently, increase the changes of damaging the integrity of the system.[77]

As a result, abusive tax avoidance can undermine the integrity of self-assessment tax systems that John Braithwaite has eloquently described as "the remarkable 20th century accomplishment" of common law countries like Australia, Canada, New Zealand, the United Kingdom and the United States.[78]

GOVERNMENTAL RESPONSES TO TAX AVOIDANCE

As tax avoidance activity has increased over the past few decades, governments have adopted various measures, both legislative and administrative, to discourage this phenomenon. In order to reduce the demand for aggressive tax planning, for example, governments have endeavoured to "alter the current risk/reward ratio" for taxpayers engaging in abusive tax avoidance,[79] enacting legislation providing for the disclosure of various tax avoidance arrangements, legislation extending the limitation period for reassessing tax avoidance transactions, legislation introducing or enhancing specific and general anti-avoidance rules (SAARs and GAARs), and legislation imposing penalties for abusive tax avoidance. In order to reduce the supply of "off-the-shelf" tax avoidance schemes, governments have also enacted legislation imposing penalties on the promoters of these schemes. In addition to these legislative initiatives, governments have also initiated administrative reforms to better target abusive tax avoidance.

Disclosure legislation

In 1984, the United States became the first major country to introduce a registration system for tax avoidance schemes, requiring promoters of potentially abusive tax shelters to register these shelters and maintain a list of persons investing in these shelters.[80] Canada introduced similar tax shelter registration rules in 1987,[81] and the UK followed their lead in 2004.[82] While neither Australia nor New Zealand has introduced similar disclosure rules, Chris Evans suggests that "it is a matter of some speculation as to whether it is

77 Finance Quebec, above, n 3, p 21.

78 J Braithwaite, above, n 3, pp 31-32.

79 Finance Quebec, above, n 3, p 2.

80 For a brief description of these disclosure rules, see D Weisbach, above, n 5.

81 For a detailed explanation of these rules, see R Wertschek and J Wilson, "Shelter from the Storm: The Current State of the Tax Shelter Rules in Section 237.1" (2008) 56 *Canadian Tax Journal* 285.

82 C Evans, above, n 11, p 26.

merely a question of time before the revenue authorities in those countries manage to persuade their political masters of the absolute necessity for such wide-reaching provisions".[83]

According to the current US rules, which have been broadened considerably in recent years, taxpayers who participate in reportable transactions as well as material advisors who assist in the organisation, management, promotion, sale or implementation of reportable transactions must disclose these transactions in information returns submitted to the Internal Revenue Service (IRS).[84] For the purpose of these rules, reportable transactions include: "listed transactions" identified by the Internal Revenue Service (IRS); confidential transactions offered by an advisor under conditions of confidentiality for a fee; transactions with contractual protection, for which fees are contingent on the realisation of tax benefits from the transaction; loss transactions resulting in losses above stipulated dollar amounts; and "transactions of interest" which are the same or substantially similar to transactions identified by the IRS. Taxpayers and material advisors who fail to file these information returns may be subject to substantial penalties ranging from $10,000 to $200,000 plus in the case of taxpayers a percentage of the understated amount of tax.

According to the current UK rules, which have also been expanded since their introduction, promoters (and in certain circumstances users) of "hallmarked" schemes are required to disclose information about "tax arrangements" that enable or could enable a person to obtain a tax benefit, where the tax benefit is the main benefit or one of the main benefits arising from the arrangement.[85] For the purpose of these rules, "hallmarked" schemes include: (1) arrangements which the promoter might reasonably be expected to require the user to keep confidential in order to facilitate repeated use; (2) arrangements from which the tax advantages are expected to be obtained from the inclusion of a financial product in which the promoter or a person connected with the promoter becomes a party where the price of the financial product differs significantly from similar financial products in the open market; (3) arrangements that are standardised tax products; (4) arrangements implemented by a promoter for more than one individual, the main purpose of which can reasonably be regarded as the provision of deductible losses; (5) arrangements for which it might reasonably be expected that the promoter or a person connected with the promoter could obtain a premium fee attributable to the tax advantage or contingent on the user obtaining the tax advantage; (6) arrangements related to certain high value plant or machinery leases involving a tax-exempt party, the removal of risk, or

83 C Evans, above, n 11, p 28. In Germany, the Ministry of Finance has proposed statutory disclosure rules along the lines of those in the US and the UK, but these have yet to be enacted. See W Schön, "Statutory Avoidance and Disclosure Rules in Germany", in J Freedman, above, n 5, p 47.

84 This summary of the US rules is based on the description in Finance Quebec, above, n 3, pp 60-63.

85 This summary of the UK rules is based on the description in Finance Quebec, above, n 3, pp 63-67.

a sale-leaseback or lease and finance leaseback; and (7) in-house schemes, where there is no promoter, that are intended for use by large enterprises which seek confidentiality from the tax administration in order to facilitate repeated or continued use. [86] Where the promoter or taxpayer does not file the required return within time periods stipulated in the legislation (five days for promoters following the day the arrangement is available for implementation by another person, 30 days following the first transaction carried out by users of arrangements implemented for their own use), they may be subject to penalties starting at £5,000 and increasing by £600 for each day the return is not filed after the initial penalty is applied.

As Braithwaite explains, "disclosure is the first line of defence against aggressive tax planning" [87] – allowing revenue authorities to concentrate scarce resources on tax arrangements that are most likely to involve abusive tax avoidance. In the UK, for example, Evans notes that the new disclosure rules have "provided HMRC with unparalleled access to real-time intelligence that has enabled it to move swiftly to legislate against avoidance activity deemed to be a threat to the revenue base". [88] Indeed, the introduction in the UK in 2005 of anti-avoidance rules targeting cross-border tax arbitrage has been attributed, in part at least, to the introduction only the year before of disclosure rules that revealed "the number, scope and variety of such schemes". [89]

Between the US rules and the UK rules, however, the Quebec Finance Department maintains a strong preference for the former, noting that the requirement of a predominant tax benefit in the UK rules "leaves more room for interpretation, with the potential for disputes on the existence of such a tax benefit and uncertainty concerning whether or not early disclosure is required". [90] For this reason, it is perhaps not surprising that tax professionals in the UK appear to have accepted the disclosure regime after initial "widespread concern". [91]

Limitation periods

As a general rule, revenue authorities have only a limited period of time to reassess taxpayers before the tax consequences for the relevant taxation year become statute barred. [92] As a result, as the Quebec Finance Department

86 For a detailed discussion of this "hallmarking" approach, see R Bland, "Hallmarks and the Direct Tax Disclosure Regime" [2006] *British Tax Review* 653.

87 J Braithwaite, above, n 3, p 131.

88 C Evans, above, n 11, p 27.

89 M Boyle, above, n 48 at 536.

90 Finance Quebec, above, n 3, p 78.

91 C Evans, above, n 11, p 27. See also J Tiley, "The Avoidance Problem: Some UK Reflections" in J Freedman, above, n 5, p 67.

92 In Canada, for example, this limitation period is generally three or four years from the date that the first notice of assessment is sent to the taxpayer.

observes, "the passage of time works in favour of the taxpayer and can influence his decision to participate in an ATP scheme".[93]

In several countries, however, the limitation period for reassessments is extended where taxpayers have engaged in tax avoidance transactions. In this circumstance, for example, Australian rules extend the limitation period for individuals who do not carry on a business and for individuals carrying on a small business from two years to four years.[94] In Ireland, the tax administration can issue an opinion on a tax avoidance transaction at any time, unless the taxpayer provides a protective notification identifying the transaction as a possible tax avoidance transaction within 90 days.[95]

Given the challenges that revenue authorities face both detecting and assessing complex tax avoidance transactions, an extended limitation period seems like a reasonable measure to alter the risk/reward ratio for abusive tax avoidance. As the Quebec Finance Department explains:

> What characterizes these transactions is the complexity of the legal structures on which they are based. In addition, the Minister of Revenue's task is made more difficult since he must detect these transactions within a self-assessment system. Accordingly, the Minister can only become aware of these transactions as a result of a thorough examination of the tax return filed by the taxpayer.[96]

For these reasons, the Department recommends that the limitation period to reassess transactions subject to the provincial GAAR should be extended from three to four years to six to seven years.[97] For taxpayers who fail to file a prescribed form disclosing confidential transactions and transactions with conditional remuneration, the Department proposes that the limitation period should commence only when the prescribed form is filed.[98] Whether these proposals are enacted into law remains to be seen.

SAARs and GAARs

In addition to disclosure rules and limitation period changes, governments have also endeavoured to combat abusive tax avoidance through specific anti-avoidance rules (SAARs) and general anti-avoidance rules (GAARs). According to Chris Evans, the former constitute "smart bombs" in the war against abusive tax avoidance, while the latter represent "weapons of mass destruction".[99]

93 Finance Quebec, above, n 3, p 10.
94 Finance Quebec, above, n 3, p 70.
95 Finance Quebec, above, n 3, pp 74-75.
96 Finance Quebec, above, n 3, p 93.
97 Finance Quebec, above, n 3, p 93.
98 Finance Quebec, above, n 3, p 83.
99 C Evans, above, n 11, p 32, citing as his inspiration for this analogy A Halkyard, "Not a Weapon of Mass Destruction: Can the *Ramsay* Approach Apply to the Inland Revenue Ordinance in Hong Kong?" (2005) 9 *Asia-Pacific Journal of Taxation* 56. See also C Evans, above, n 32.

The advantages and disadvantages of SAARs are well known and nicely summarised by the Quebec Finance Department.[100] On the one hand, SAARs tend to have a clearly defined field of application, contributing "an element of certainty" to tax legislation and "foster[ing] a better understanding of the object, spirit and purpose of the legislation".[101] On the other hand, because they apply only to "stipulated or suspected" transactions and are almost never retroactive in application, they "cannot prevent avoidance transactions not previously detected".[102] In addition, as Evans observes, they can also "contribute … enormously to the length and complexity of … tax … legislation" and "can lead to legislative layering, which can itself facilitate more avoidance possibilities (what Lord Walker has referred to as 'avoidance karate')".[103]

Notwithstanding their deficiencies, however, and presumably because of their advantages, countries continue to rely on SAARs to counteract abusive tax avoidance schemes, and may have actually increased their use of these measures as a result of the "boost to real time intelligence" created by the enactment of disclosure regimes.[104] This is particularly the case in the United Kingdom which, alone among developed common law countries, has yet to adopt general anti-avoidance doctrines or a statutory GAAR.[105]

In rare circumstances, moreover some jurisdictions have bypassed one of the main deficiencies of most SAARs, by enacting retroactive amendments to invalidate tax benefits from abusive tax avoidance arrangements. Although retroactive legislation is generally denounced as unfair and contrary to the rule of law,[106] the Quebec Finance Department contends that this approach may be justified in exceptional circumstances, "for example, where taxpayers try to take advantage of a weakness or ambiguity in the legislation to develop schemes considered abusive because they are clearly contrary to the objectives of fiscal policy".[107] Similarly at the federal level in Canada, the Department of Finance is prepared to implement retroactive clarifying legislation in "exceptional situations" where:

- the amendments reflect a long-standing well-known interpretation of the law by the Department of National Revenue (now the Canada Revenue Agency);
- the amendments reflect a policy that is clear from the relevant provisions that is well-known and understood by taxpayers;

100 Finance Quebec, above, n 3, p 28.

101 Finance Quebec, above, n 3, p 28.

102 Finance Quebec, above, n 3, p 28.

103 C Evans, above, n 32, p 43, citing Lord Walker of Gestingthorpe, "*Ramsay* 25 Years On: Some Reflections on Tax Avoidance" (2004) 120 *Law Quarterly Review* 412 at 416.

104 C Evans, above, n 11, p 15. See also M Boyle, above, n 48 at 536.

105 C Evans, above, n 11, p 23.

106 See, eg, T McDonnell, "Retroactivity: Policy and Practice", in Canadian Tax Foundation, *2006 Conference Report* (2007), 2:1-33.

107 Finance Quebec, above, n 3, p 51.

- the amendments are intended to prevent a windfall benefit to certain taxpayers;
- the amendments are necessary to preserve the stability of the Government's revenue base; [or]
- the amendments are corrections of ambiguous or deficient provisions that were not in accordance with the object of the Act.[108]

As a result, it seems, SAARs (generally proactive and occasionally retroactive) are certain to play a continuing role in the tax laws of most common law countries.

As a supplement to specific statutory rules and SAARs, many Commonwealth countries have also found it useful to introduce statutory GAARs to discourage abusive tax avoidance. As Stanley Surrey argued 40 years ago, the enactment of general anti-abuse provisions along these lines saves the tax system from "the far greater proliferation of detail that would be necessary if the tax avoider could succeed merely by bringing his scheme within the literal language of substantive provisions written to govern the everyday world".[109] To the extent that inconsistencies and discontinuities inherent in detailed tax rules create unforeseen and often unforeseeable opportunities to avoid tax consequences compatible with the purposes of the statute and legislative intent, a general standard like a GAAR can be a more effective and economical way to prevent abusive tax avoidance than specific rules and statutory SAARs.[110] For this reason, it is not surprising that most Commonwealth countries have enacted statutory GAARs and several countries have amended these GAARs in order to make them more effective.[111]

In assessing the effectiveness of these GAARs, it is useful to recognise their limited role as provisions of last resort that are designed to prevent abusive tax avoidance only when ordinary tax rules and SAARs fail to prevent a tax benefit that is incompatible with the object and purpose of the relevant provision or statutory scheme. For this reason, one can sympathise with the view of at least one commentator that the Australian GAAR (which does not include language limiting its application to abusive transactions) "is drafted so widely as to be capable of enabling the Commissioner to annihilate any transaction which provides a tax advantage".[112]

One should also appreciate that judicial cultures change gradually, so that judges who are steeped in the *Duke of Westminster* principle may be slow to give full effect to a newly-enacted GAAR, like the statutory provision introduced in

108 Canada, *Comprehensive response of the government to the seventh Report of the Standing Committee on Public Accounts*, parliamentary document no 8512-351-79 (18 September 1995), cited in Finance Quebec, above, n 3, pp 54-55.

109 S Surrey, "Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail" (1969) 34 *Law & Contemporary Problems* 673 at 707, n 32.

110 See, eg, D Weisbach, above, n 42.

111 See, eg, C Evans, above, n 11, pp 23-24.

112 M Cashmere, "Towards an Appropriate Interpretive Approach to Australia's General Tax Avoidance Rule – Part IVA" (2006) 35 *Australian Tax Review* 231.

Canada in 1988. For this reason, Brian Arnold's fear that early Canadian GAAR decisions "will inexorably render the rule largely ineffective"[113] was unduly pessimistic – as illustrated by subsequent Supreme Court of Canada decisions in which the GAAR has been applied.[114]

Finally, it is important to recall that a GAAR can operate effectively to distinguish abusive tax avoidance and acceptable tax planning or tax minimisation only where the object or purpose of the relevant tax legislation is reasonably clear, and that this task is made particularly difficult by the multitude of detailed statutory rules that characterise the tax statutes of most common law jurisdictions. For this reason, as Judith Freedman has emphasised, the effectiveness of a statutory GAAR may depend on the introduction of principles-based legislation as a complement to detailed statutory rules, as much as it does on the actual design of the GAAR itself.[115] In the United Kingdom, however, recent initiatives to introduce more principles-based drafting appear to be an alternative to a GAAR more than a complement.[116] As these initiatives have yet to yield actual legislation, however, it is too early to assess their merits.[117]

Penalties for abusive tax avoidance

Alongside other measures to discourage aggressive tax planning, some countries impose penalties where the GAAR is successfully applied to disallow a tax benefit. In Australia, for example, taxpayers may be subject to a penalty of 50% of the amount of the income tax attributable to this tax benefit, or 25% of the amount of tax if it is reasonably arguable that the GAAR might not have applied.[118] Similarly, in New Zealand, taxpayers who engage in abusive transactions that are subject to the GAAR are liable for a penalty up to 100% of the resulting tax shortfall, though this percentage is reduced for taxpayers who make voluntary disclosures and taxpayers who have not been subject to a penalty within the last four years.[119] A penalty on abusive tax avoidance is also

113 B Arnold, "The Long, Slow Steady Demise of the General Anti-Avoidance Rule" (2004) 52 *Canadian Tax Journal* 488.

114 *Mathew v Canada* [2005] 2 SCR 643; *Lipson v Canada*, 2009 SCC 1.

115 J Freedman, above, n 25 at 73. See also J Braithwaite, above, n 3, p 149 (suggesting that a "hybrid of rules and principles would actually put the brakes on economically wasteful legal entrepreneurship to manipulate the rules. It is a strategy for reaping the benefits of rules – clear guidance to taxpayers in common situations – while limiting their pathologies: exponential growth in legal complexity, burgeoning compliance costs, expanding waste of private and public resources on legal game playing and countering it, a tax system that ordinary people cannot comprehend and therefore has low legitimacy and reduced prospects of voluntary compliance").

116 HM Treasury and HMRC, *Principles-based Approach to Financial Products Avoidance: A Consultation Document* (December 2007).

117 C Evans, above, n 11, p 30.

118 Finance Quebec, above, n 3, p 69 (adding that this penalty can be increased or decreased in various circumstances, and can be waived at the discretion of the tax administration).

119 Finance Quebec, above, n 3, pp 72-73.

imposed under the Irish GAAR,[120] but is not included in the Canadian GAAR. In Quebec, however, the Department of Finance has indicated that "[i]ntroduction of a penalty contingent on the application of the [provincial] GAAR is under consideration".[121] To the extent that such a penalty alters the current risk/reward ratio that encourages aggressive tax planning, it seems like a reasonable reform.[122]

Promoter penalties

To the extent that the market for aggressive tax planning is driven as much or more by the supply of tax avoidance schemes as it is by the demand for these schemes, it is often argued that penalties should be imposed on the promoters of these schemes as well as their users.[123] For this reason, Australia introduced a new system of penalties, which became effective on 6 April 2006, imposed on promoters of "tax exploitation" schemes.[124]

According to these rules, promoter penalties may be imposed where an entity or natural person either engages in conduct resulting in it or another entity or natural person being a promoter of a tax exploitation scheme or engages in conduct that results in a scheme that has been promoted on the basis of conformity with a product ruling being implemented in a manner that is materially different from that described in the product ruling. For the purpose of these rules, a promoter is generally defined to include entities and natural persons who either market or encourage tax exploitation schemes, receive consideration in respect of this marketing or encouragement, or have a substantial role in this marketing or encouragement, and a tax scheme is generally defined as a tax exploitation scheme "if it is reasonable to conclude that the entity implementing the scheme does so for the sole or main purpose of obtaining a tax benefit and it cannot reasonably be maintained that such a benefit can be obtained under the tax legislation".[125]

Where an entity or natural person is determined to be a promoter of a tax exploitation scheme, the Australian rules contemplate three possible consequences. First, the tax administration can accept a voluntary undertaking from promoters who are willing to provide a full statement regarding their promotion activities, to cease these activities, and to reimburse participants in the scheme. Second, where the tax administration concludes that there is little likelihood that the promoter will honour such an undertaking in view of the promoter's past compliance behaviour or promotion of other schemes, it may

120 Finance Quebec, above, n 3, p 74.

121 Finance Quebec, above, n 3, p 96.

122 Although taxpayers reassessed under the GAAR may be required to pay interest on overdue amounts if tax benefits are eventually denied, these interest expenses are at least partly offset by the additional income that the taxpayer may be able to earn during the interim as a result of the initial tax saving: Finance Quebec, above, n 3, p 10.

123 See, eg, J Braithwaite, above, n 3, p 182.

124 The following summary is based on the descriptions in C Evans, above, n 32, pp 43-44, and Finance Quebec, above, n 3, pp70-71.

125 Finance Quebec, above, n 3, p 71.

ask the Federal Court to issue an injunction to halt the implementation or promotion of the scheme or remedy an apparent violation of the law. Finally, the tax administration can ask the Federal Court to impose a civil penalty up to a maximum amount equal to the greater of 5,000 penalty units (currently $550,000) for individuals or 25,000 penalty units (currently $2.75 million) for corporate entities, and twice the amount received or receivable by the promoter from the tax exploitation scheme. In selecting an appropriate penalty, the Federal Court can have regard to all matters that it considers relevant, including the loss or damage incurred by scheme participants and the honesty and deliberateness of the promoter's conduct.

Although some commentators have expressed serious reservations about the potential impact of these rules on tax advisors providing tax planning advice,[126] the Explanatory Memorandum accompanying the new rules explains that the civil penalty regime is not intended to inhibit the provision of independent and objective advice, including advice regarding tax planning.[127] Recognising the extent to which the growing market for aggressive tax planning has been driven by the supply of these schemes, it is not surprising that other jurisdictions have either followed or are considering following the Australian example. In New Zealand, for example, promoters of tax avoidance arrangements are subject to penalties where they offer, sell or promote an arrangement to 10 or more people in a taxation year and this arrangement constitutes an abusive tax position,[128] and the Quebec Finance Department is actively considering the introduction of promoter penalty rules in the Province of Quebec which would be contingent on the application of the provincial GAAR.[129] Other jurisdictions can be expected to follow these developments with keen interest.

Administrative responses

A final set of government measures to counteract abusive tax avoidance includes administrative initiatives that are designed to better target limited regulatory resources on the detection and prosecution of the most abusive tax avoidance schemes. Reflecting the more flexible and innovative regulatory strategies associated with theories of "responsive regulation",[130] these measures are premised on the concept of a "regulatory pyramid" comprising a range of regulatory responses escalating from the least intrusive for the

126 See, eg, J King, "New Measures Deterring the Promotion of Tax Exploitation Schemes" (2006) 35 *Australian Tax Review* 163, cited in C Evans, above, n 32, p 44.

127 Paragraph 3.50 of the Explanatory Memorandum to *Tax Laws Amendment (2006 Measures No 1) Act 2006*, cited in C Evans, above, n 32, p 44.

128 Finance Quebec, above, n 3, p 73.

129 Finance Quebec, above, n 3, pp 96-102.

130 See, eg, I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (1992); and J Braithwaite, *Restorative Justice and Responsive Regulation* (2002). For a recent symposium on responsive regulation and taxation, see (2007) 20 *Law & Policy* 1-158.

majority of complying taxpayers at the bottom of the pyramid to the most intrusive for a minority of consistent non-compliers at the top of the pyramid.[131]

In the UK, for example, Her Majesty's Revenue and Customs (HMRC) has adopted a twofold approach toward the regulation of large businesses, seeking to facilitate tax compliance on the one hand by reducing complexity, increasing communication, clarity and certainty, and providing for the speedy resolution of contentious tax issues (thereby "making it as easy as possible for business to get their tax affairs right" and "helping them to meet their obligations"[132]), while simultaneously "deal[ing] firmly with those who intentionally fail to meet their responsibilities"[133] through a risk-based approach to tax administration that will direct increased resources to high-risk businesses including those which do not adequately manage their "tax compliance risks" or "repeatedly push … at the boundary of the law".[134]

Consistent with this regulatory strategy, HMRC has established an Anti-Avoidance Group (AAG) charged with implementing the revenue authority's efforts to counteract abusive tax avoidance. According to HMRC, the AAG will pursue this strategy by: quickly and expertly preventing and closing down avoidance by effective legislation; engaging with taxpayers about how it will address tax avoidance; knowing what avoidance schemes or bespoke arrangements are being marketed and used; knowing which organisations and individuals are more likely to carry out avoidance and organising its resources accordingly; treating those who avoid their tax obligations as higher risk than organisations and individuals who do not; being proactive at challenging avoidance by investigation and effective litigation; and taking a strategic approach in litigating avoidance cases.[135] For this purpose, moreover, the AAG has developed the following list of risk factors that it considers to be "signposts" of potentially abusive tax avoidance:

> Transactions or arrangements which have little or no economic substance or which have consequences not commensurate with the change in a taxpayer's (or group of related taxpayers') economic position …

131 See, eg, V Braithwaite, "Responsive Regulation and Taxation: Introduction" (2007) 20 *Law & Policy* 3 at 4-5.

132 Her Majesty's Revenue and Customs, *2006 Review of Links with Large Business* (the "Varney Review"), (November 2006), para 1.2, available at http://www.hmrc.gov.uk/large-business/review-report.pdf.

133 Her Majesty's Revenue and Customs, above, n 132, para 1.2.

134 Her Majesty's Revenue and Customs, *HMRC Approach to Compliance Risk Management for Large Business* (March 2007), para 1.4, available at http://www.hmrc.gov.uk/budget2007/large-business-riskman.pdf. See also HMRC, *Making a Difference: Delivering the Review of Links with Large Business* (March 2007), available at http://www.hmrc.gov.uk/budget2007/large-business-plan07.pdf.

135 Her Majesty's Revenue and Customs Anti-Avoidance Group, *Our Vision and Strategy*, available at http://www.hmrc.gov.uk/avoidance/vision-strategy.htm (accessed on 28 February 2009).

> Transactions or arrangements bearing little or no pre-tax profit which rely wholly or substantially on anticipated tax reduction for significant post tax profit …
>
> Transactions or arrangements that result in a mismatch such as: between the legal form or accounting treatment and the economic substance; or between the tax treatment of different parties or entities; or between the tax treatment in different jurisdictions …
>
> Transactions or arrangements exhibiting little or no business, commercial or non-tax driver …
>
> Transactions or arrangements involving contrived, artificial, transitory, pre-ordained or commercially unnecessary steps or transactions …
>
> Transactions or arrangements where the income, gains, expenditure or losses falling within the UK tax net are not proportionate to the economic activity taking place or the value added in the UK – especially where the transactions or arrangements are between associates within the same economic entity and would not have occurred between parties acting at arm's length and/or add no value to the economic entity as a whole … [and] …
>
> [T]ransactions or arrangements designed to sidestep the effect of [tax] legislation [that is enacted to target particular transactions or arrangements and give them a particular tax result], but which otherwise achieve the same result.[136]

Similarly, the Australian Taxation Office (ATO) has developed a comprehensive compliance program designed to counteract aggressive tax planning, which it defines as "the use of transactions or arrangements that have little or no economic substance and that are created predominantly to obtain a tax benefit that is not intended by the law".[137] Echoing the approach of HMRC, the Commissioner has emphasised that the revenue authority hopes to "create certainty through transparency and cooperation" with large businesses, at the same time as it targets aggressive tax planning.[138] Consistent with this approach, the ATO has entered into a number of Annual Compliance Arrangements (ACAs) with large enterprises under which the enterprise must develop a risk management plan and disclose information to the ATO, in return for which the ATO agrees not to audit low-risk issues and to inform the enterprise about issues that it considers to be high risk.[139] In the mid-1990s, the ATO adopted a similar approach for administering its transfer pricing rules,[140] negotiating Advance Pricing Agreements (APAs) and targeting scarce regulatory resources on high-risk enterprises – an approach that yielded a 32%

136 Her Majesty's Revenue and Customs, *Guidance from Anti-Avoidance Group*, available at http://www.hmrc.gov.uk/avoidance/aag-risk-assessing.htm (accessed on 28 February 2009).

137 C Evans, above, n 11, p 16. For the most recent compliance program, see Australian Taxation Office, *Compliance Program 2008-09*, available at http://www.ato.gov.au.

138 M D'Ascenzo, *A New Dimension*, Speech to the Corporate Tax Association Convention, Sydney, 12 May 2008, available at http://www.ato.gov.au/corporate/content.asp?doc=/content/00139238.htm (accessed 19 May 2009)

139 M D'Ascenzo, *A New Dimension*, Corporate Tax Association Convention, Sydney, 12 May 2008, cited in C Evans, above, n 11, p 16.

140 J Braithwaite, above, n 3, pp 89-97.

increase in tax payments from 1996 to 1997, despite a 5% reduction in corporate income.[141] Not surprisingly, other jurisdictions have adopted a similar approach, encouraging the negotiation of APAs for transfer pricing purposes,[142] and devoting additional regulatory resources to the fight against aggressive tax planning.[143]

In addition to these domestic initiatives, revenue authorities have also embarked on international joint initiatives, cooperating with other revenue authorities to address tax avoidance arrangements involving more than one jurisdiction. In 2002, for example, the OECD established a Forum for Tax Administration (FTA), with a mandate to develop effective responses to current administrative issues in a collaborative way, working with member and non-member countries. At the third meeting of this Forum in September 2006, 35 Commissioners or Deputy Commissioners of Taxation from FTA member countries signed the Seoul Declaration, stating that:

> Each country differs in the level and structure of its taxes, but all countries – both in low and high tax countries, developed and developing – agree that once national tax laws have been enacted, they need to be enforced. Enforcement of our respective tax laws has become more difficult as trade and capital liberalisation and advances in communication technologies have opened the global marketplace to a wider spectrum of taxpayers. While this more open economic environment is good for business and global growth, it can lead to structures which challenge tax rules, and schemes and arrangements by both domestic and foreign taxpayers to facilitate non-compliance with our national tax laws. It is our duty as heads of our respective countries' revenue bodies to ensure compliance with our national laws by all taxpayers, including activities beyond our borders, through effective enforcement and by taking preventative measures that deter non-compliance.[144]

Subsequent work of the FTA has focused on the role of tax intermediaries, culminating in a study published in 2008.[145] According to this report, while some tax advisors play a major role designing and promoting abusive tax avoidance schemes, it is overly simplistic to focus on the supply side as the main response to aggressive tax planning. On the contrary, reflecting an approach consistent with the idea of responsive regulation, the report recommended that revenue authorities should "encourage large corporate taxpayers to engage in a relationship with revenue bodies based on co-

141 J Braithwaite, above, n 3, p 93.

142 See, eg, Canada Revenue Agency, *Information Circular 94-4*R: "International Transfer Pricing: Advance Pricing Arrangements (APAs)" (16 March 2001).

143 In Canada, for example, the Canada Revenue Agency (CRA) launched a major initiative in 2004, increasing the audit rate for taxpayers considered to be high risk. See also Finance Quebec, above, n 3, pp 25-26 (describing a central unit established by the Quebec revenue authority to counteract aggressive tax planning).

144 OECD, *Seoul Declaration*, third meeting of the OECD Forum on Tax Administration, Seoul, Korea, September 2006.

145 OECD, *Study into the Role of Tax Intermediaries* (2008). For a brief summary of this report, see L Wise, "OECD Study in to the Role of Tax Intermediaries", in J Freedman, above, n 5, p 185.

operation and trust"[146] while simultaneously establishing "effective risk-management processes … to identify [non-compliant] taxpayers and allocate the necessary level of resources to deal with them".[147]

Another example of international cooperation in tax administration is the formation of the Joint International Tax Shelter Information Centre (JITSIC) in April 2004 through a Memorandum of Understanding among the revenue authorities in Australia, Canada, the United Kingdom and the United States.[148] According to this document, the purpose of JITSIC is to:

> Provide support to the parties through the identification and understanding of abusive tax schemes and those who promote them.
>
> Share expertise, best practices and experience in tax administration to combat abusive tax schemes.
>
> Exchange information on abusive tax schemes, in general, and on specific schemes, their promoters, and investors consistent with the provisions of bilateral tax conventions.
>
> Enable the parties to better address abusive tax schemes promoted by firms and individuals who operate without regard to national borders.[149]

According to a press release announcing its formation, the initial focus of JITSIC's efforts will include "ways in which financial products are used in abusive tax transactions by corporations and individuals to reduce their tax liabilities, and the identification of promoters developing and marketing those products and arrangements".[150] More generally, according to then Commissioner of the IRS Mark Everson, the establishment of JITSIC "sends a strong, unmistakeable message to promoters who cross borders to cloak tax schemes".[151] As a result, it seems, while the FTA appears to have emphasised cooperation with relatively compliant taxpayers at the bottom of regulatory pyramid, JITSIC is aimed at non-compliant promoters and taxpayers at the peak of the pyramid.

CONCLUSIONS

As tax avoidance activity has increased in recent decades, governments and revenue authorities have been unwilling to permit the erosion of their tax bases and the integrity of their tax systems, and have responded through various legislative reforms and administrative initiatives to discourage this

146 OECD, above, n 145, p 5.

147 OECD, above, n 145, p 6.

148 Joint International Tax Shelter Information Centre Memorandum of Understanding (23 April 2004), available at http://www.irs.gov/newsroom/article/0,,id=123016,00.html.

149 Joint International Tax Shelter Information Centre Memorandum of Understanding, above, n 148.

150 Internal Revenue Service, *Australia, Canada, UK and US Agree to Establish Joint Task Force*, IR-2004-61 (3 May 2004), available at http://www.irs.gov/newsroom/article/0,,id=123016,00.html.

151 Internal Revenue Service, above, n 150.

phenomenon. By enacting new or enhanced disclosure rules, for example, governments obtain "real-time intelligence" on abusive schemes that can be used to formulate legislative responses and are better able to manage the risks of aggressive tax planning by directing scarce regulatory resources to the review of schemes and arrangements that are most likely to involve abusive tax avoidance. Together with extended limitation periods and penalties on taxpayers and promoters engaged in abusive tax avoidance, these disclosure rules alter the risk/reward ratio for taxpayers and promoters engaged in abusive tax avoidance, reducing both the demand for and the supply of abusive tax avoidance schemes. Domestic and international initiatives adopting a more flexible or responsive approach to the enforcement of tax obligations can also be expected to lessen the incidence of abusive tax avoidance by encouraging and rewarding taxpayers and advisors who comply with the letter and spirit of a country's tax laws and specifically targeting the least compliant and highest-risk taxpayers and promoters.

Whether these measures are fully adequate to address the problem of tax avoidance in the 21st century, however, remains uncertain. First, as I have argued elsewhere, to the extent that legal standards governing the application of general anti-avoidance doctrines and statutory GAARs are contested or unclear, administrative guidelines may contradict the rule of law by establishing "signposts" of abusive tax avoidance without clear legal authority.[152] For this reason, effective and legitimate anti-avoidance measures may depend on the presence of a statutory GAAR (which the UK has yet to adopt) and statutory guidance on common forms of abusive tax avoidance (which is lacking in the Canadian GAAR). Second, as suggested earlier, because the distinction between unacceptable or abusive tax avoidance on the one hand and acceptable tax planning or tax minimisation on the other depends on legislative intent and the purpose of the relevant tax legislation, the effective operation of a statutory GAAR is apt to depend on greater use of principles-based drafting as well as SAARs to provide interpretative guidance. Finally, to the extent that these interpretative guideposts are often lacking in the international arena, where treaty shopping and international tax arbitrage exploit inconsistencies and discontinuities between the tax systems of differing jurisdictions and competitive pressures make it difficult for individual jurisdictions to act alone, effective efforts to counteract international tax avoidance are likely to demand greater legislative as well as administrative coordination among different jurisdictions. Despite many measures to discourage abusive tax avoidance, therefore, there is also much that remains to be done.

152 D Duff, "Relationships, Boundaries, and Corporate Taxation: Compliance and Avoidance in an Era of Globalisation", in J Freedman, above, n 5, pp 197, 205. In the UK context, on the other hand, HMRC's AAG has provided judicial authority for each of the "signposts" which it considers indicative of abusive tax avoidance.