

TAX AVOIDANCE AS LAW-MAKING RATHER THAN LAW-BREAKING

feature
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At the moment taxpayers are free to file returns claiming tax advantages that do not exist. The tax advice industry can make up the law to suit its clients, placing the onus on the revenue authority to mount a challenge. Professional regulatory bodies need to step in and impose stricter duties on tax advisers in order to protect public funds from systematic predation.

When the US and the UK invaded Iraq in 2003, they claimed to be doing so “legally”, pursuant to UN resolution 1441. The UK government obtained an opinion from the Attorney General, Lord Goldsmith, to the effect that the resolution authorised the use of force, and on the basis of that opinion the UK invaded. The fact that Lord Goldsmith’s opinion was universally derided by scholars of international law was irrelevant, because international law doesn’t work like that. States are the source of law, and so the invasion itself was the juridical act; the debate over its ‘legality’ was a mere conversation between onlookers. Where the behaviour of powerful states is in question, international law is like a court case with only one party, who is also the judge.

To some extent, self-assessed tax liabilities work in the same way. You can assess yourself as having a liability to tax that is as low as you want it to be, and file on that basis, provided you have your tax equivalent of

Lord Goldsmith – the adviser who knows which side his bread is buttered on. As with international law, it does not matter if your adviser is right or not; the mere fact that he says it is “legal” makes it so. Of course, the tax authority could challenge your self-assessment, provided that it has the necessary information, resources, and inclination, but at the point of filing of your tax return, you can be your own fiscal war-monger, laying claim to money that would not otherwise belong to you, “creating your own reality”, as one White House aide at the height of the neo-con era famously described it.

To be sure, if your filing position is vulnerable and the tax authority is aware of this, then you might fail to “create your own reality” and, through the mechanisms of tax enforcement, have to pay more tax than you originally said you owed. But tax authorities suffer from radical information asymmetries and savage resource constraints, and generally only challenge the more obviously

vulnerable filing positions in any event. This means that taxpayers who create their own fiscal realities stand a good chance of succeeding, which is why this practice is so common.

As the example of Lord Goldsmith demonstrates, we cannot expect the professional integrity of advisers to stand up as a first line of defence against this kind of practice. Also, it is not just a matter of advisers compromising their professional integrity in pursuit of their clients’ interests because that is what they are paid to do: there is a wide spectrum of ideological positioning which protects tax advisers from confronting their role in the predation of the public purse by wealthy individuals and companies:

Some tax practitioners are positively motivated by their self-image as freedom fighters, liberating wealth (which they view as inherently private) from the clutches of the over-mighty state. Others struggle to understand the agency that they and their fellow professionals have in the prior process of structuring transactions so as to be able to claim the consequent dubious tax advantages. They speak as if the legal form that transactions take is deposited overnight by some sort of tax structuring fairy, and that the only role of tax advisers is to wake up in the morning and decide whether or not to claim whatever tax savings arguably arise. Even those who recognise the agency of tax advisers in structuring transactions nonetheless insist that their contribution cannot be distinguished from the commercial imperatives of the client.

Clearly, then, since they do not perceive themselves to be part of the problem, self-regulation by individual tax professionals is not the solution. Professional regulatory bodies seem to be an obvious alternative,

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but (in the UK at least) they have so far failed to step in. One obstacle preventing a regulatory solution stems from the fact that there is a heterogeneous gaggle of lawyers’, accountants’ and tax advisers’ regulatory bodies, many of which regulate professions with a huge variety of other specialisms, and so do not specifically regulate their members in relation to their tax work.

Even those bodies that do specifically regulate tax advisory work, however, set the bar astonishingly low in terms of the strength of the filing position that their members can encourage (or permit) their clients to adopt. A member of the UK’s Chartered Institute of Taxation, for example, must “not assert tax positions in a tax return which he considers have no sustainable basis.” This is a laughably low threshold. Indeed it is not really a threshold at all; it is a green light to any intelligible argument in favour of a tax saving, irrespective of whether or not it is actually correct. No doubt resolution 1441 would have taken the invasion of Iraq over the “no sustainable basis” threshold, had the threshold applied to war as well as to self-assessment filing positions.

To an extent this low threshold reflects the division of labour as between tax advisers. The person who files a tax return is not necessarily the person who dreamed up the tax planning, who may be a different person again from the person who advised that the tax planning was legally effective in achieving its intended fiscal effect. Someone somewhere along the line will “sign off” on the tax, and the existence of this “sign-off” enables everyone else to get on with their jobs, without having to apply their own professional judgement to the tax planning in question.

The problem with this model is that, where one adviser concerns herself with the accounting treatment, another with the legal analysis, and yet another with the transactional implementation, and someone else even further down the line does the actual filing, there is no imperative on anyone in particular to ensure that that the whole tax proposition stacks up. Typically for example, the legal analysis will assume factual features which cannot realistically be delivered on an implementational level, although I have seen one much-implemented scheme purporting to shelter entire

personal incomes from UK tax where the QC’s advice was wrong in law, the accounting assumptions were incorrect, and the factual propositions did not hold water in any event. If the client is risk-averse then this kind of thing should be called out by a conscientious adviser acting in the client’s interest somewhere along the line, but if the client is a sophisticated taxpayer hungry for the tax risk this stuff represents then nobody is going to call it out on behalf of the public exchequer.

With a view to protecting public money from this kind of predation, it would be possible for such bodies as (in the UK) the Bar Standards Board, the Solicitors Regulation Authority, the Institute of Chartered Accountants of England and Wales and the Chartered Institute of Taxation to oblige regulated professionals call this kind of thing out on behalf of the public exchequer, by imposing a regulatory requirement that tax filing positions, taking all relevant factors into account, have to have a specified minimum prospect of success. At its very lowest the threshold should be “more likely than not to succeed”.

We professionals are at risk of criminal prosecution if we continue to advise a client who is baldly failing to report income to the tax authority; it seems bizarre that, by contrast, we should be completely off-risk for even a non-criminal regulatory breach if we wave through filing positions which we know perfectly well would not survive forensic scrutiny. The difference between

the two is only the difference between the invasion of Iraq with or without the opinion of Lord Goldsmith to support it.

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