Tax Planning or Tax Avoidance?

The conventional view arising from the judicial decision in *IRC v Duke of Westminister (1936)* that "every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be" trickled the flourishing of tax planning.

The internationalisation of business activities has, in more recent years, created a new environment where opportunities may be exploited and tax avoidance schemes creatively planned and executed.

Conceptual difference between tax planning and tax avoidance

While tax planning and tax avoidance fall into the two different sides of the law, a fine line separates the two. A perennial debate between taypayers and tax authorities around the world is "where to draw this line".

Tax planning

Tax planning connotes the idea that every person is entitled to arrange his affairs in such a way as to attract the least tax liability. For this, the taxpayer avails himself of the tax concessions, exemptions or privileges under the law.

Should the taxpayer conduct his tax planning based on what is permissible without recourse to artificiality, he should not be denied the right to arrange his own affairs. Tax authorities would generally accept legitimate tax planning rendered by tax professionals in the right spirit of professionalism.

As businesses internationalise, they are increasingly exposed to the tax risks of the jurisdictions that they operate in. Different countries have tax laws embodying different tax concepts. The interaction of these tax laws often leads to double taxation for the taxpayer, where both the country of residence and the country of source would attempt to levy tax on the same income. Careful tax planning is required to help businesses avoid, or reduce the impact of, the tax traps resulting from the interaction of the tax laws.

Tax avoidance

Unlike tax planning, tax avoidance often involves the creation of artificial steps to alter an arrangement without genuine business or commercial reasons. Michael Edwardes-Ker, author of *The International Tax Strategy*, defines tax avoidance as the structuring of a transaction so that its profits legally avoid tax.

When a taxpayer has apparently circumvented the law by using an arrangement, often of a complex nature, the main or sole purpose of which is to defer, reduce or completely avoid tax liabilities under the law, his actions would likely exceed what is allowed for tax planning and instead constitute tax avoidance.

Based on the case of *McDowell & Co Ltd v CTO (1985)*, the Supreme Court of India concerned itself not merely with the genuineness of a transaction but also with its intended effect on fiscal principles. The Court also emphasised that artificial devices cannot be a legitimate aspect of tax planning.

Tax avoidance often involves a scheme which sole or dominant purpose is to obtain a tax benefit. Other considerations to determine if there is tax avoidance include:

(a) Apart from tax considerations, does the transaction/arrangement make good investment or business sense? – In other words, would the taxpayer carry out the same transaction if there were no tax benefits?
(b) Does the transaction have any commercial substance, or is it purely form?
(c) Is the overwhelming motivation to undertake the transaction tax driven?
(d) What are the legal rights and obligations of the parties?
(e) Is the buyer in effectual and constant control of the seller?

In helping us to decide whether a transaction constitutes tax planning or tax avoidance, we could examine the nature of the trade. Lord Denning put it very succinctly in *Griffiths v J.P. Harrison (Watford) (1963)* – "If the transaction is, in truth, a transaction in the nature of trade, it does not cease to be so simply because the trader had in mind a tax advantage. But if it is, in truth, a tax-recovery device and nothing else, then it remains a tax-recovery device notwithstanding that it is clothed in the trappings of a trade".

Anti-avoidance Rules

As governments around the world modernise their country's anti-avoidance rules, the question arises as to how much reliance can be placed on cases decided under old legislations in interpreting such new anti-avoidance rules. Based on *John v FC of T 89 ATC 4101 (1988– 1989)*, the Australia court held that in accordance with the maxim *expressum facit cessare tacitum*[1], the fiscal nullity principle cannot be applied where there are already specific statutory provisions on a topic, such that there is no room for implication of any further matter on that same topic.

In Singapore, Section 33 of the Income Tax Act is the general anti-avoidance provision. This section provides that where the Comptroller is satisfied that the purpose or effect of any arrangement is directly or indirectly:

(a) to alter the incidence of any tax payable;
(b) to relieve any person from liability to pay tax, or
(c) to reduce or avoid any liability imposed,

he may, without prejudice to such validity in any other respect or for any other purpose, disregard or vary the arrangement and make such adjustments as he considers appropriate, including the computation or recomputation of gains or profits, or the imposition of liability to tax.

The word "purpose" means "object" or "end in view"; it does not mean "motive", so it is irrelevant whether the offending steps have a commercial motive or not. The purpose must be what it is intended to achieve, and this may be ascertained from the terms or inferences. The purpose of an arrangement can be seen from its effects or end results.

The word "effect" means the end accomplished or achieved.

What constitutes "*bona fide* commercial reasons" is a pure question of fact. Even if the taxpayer is able to clear this hurdle, he has also to show that one of the main purposes of the arrangement is not the avoidance of tax.

To successfully oppose the operation of the section, the taxpayer will have to prove that on the proper inference which could be drawn from an objective assessment of the terms of the arrangement and the manner in which it was carried out, the tax reduction effect is not a purpose of the arrangement but merely a necessary consequence of the arrangement.

[1] Legal maxim which means "what is expressed makes what is implied silent", that is, when a matter is clearly provided in a document, the clear and precise meaning is to be adopted. http://definitions.uslegal.com/

OECD Action Plans on BEPS

As the world economy moves from the traditional business model to a more technology-based business model, the Organisation for Economic Co-operation and Development (OECD) has initiated efforts to tackle problems relating to Base Erosion and Profit Shifting (BEPS), whereby businesses exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. As OECD updates its action plans for BEPS, taxpayers and tax authorities alike should ready themselves for the changes and challenges ahead.

Conclusion

Taxpayers should avoid overly-aggressive tax planning with no real commercial or business reasons as this is likely to be perceived by tax authorities as tax avoidance. With the changing tax landscape and the recent action plans on BEPS, taxpayers and tax authorities should be prepared for the changes and challenges coming their way.

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