TAX RELATED BEHAVIOUR AND CORPORATE RESPONSIBILITY

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Abstract

Many companies engage in behaviour that is intended to reduce, mitigate or avoid the amount of taxation that would otherwise be due. This behaviour may result in changes to the tax code of a country and in comments being made and actions undertaken by governments, academics and other interested parties.

This thesis argues that there exists a lack of clarity, coherence and consistency when considering and seeking to understand the relationship between tax codes, companies and society.

This thesis argues that it is necessary to critically examine the nature of the tax related behaviour and also to identify and describe the rights, duties and obligations that are associated with the type of organisation which can be identified as a UK incorporated limited company. It is further argued that such a critical examination will require consideration of the nature of a company and the role played by directors of a company.

The thesis provides an explanatory framework for tax related behaviour and uses that framework to identify and describe various types of tax related behaviour. The thesis also provides a critical discussion of the nature of the corporation and argues for the existence of a core set of rights, duties and obligations which help to illuminate the relationship between a UK incorporated limited company, the tax code and society.

Publications

Journal article

Hasseldine, J., Morris, G. (2013). Corporate social responsibility and tax avoidance: A comment and reflection. Accounting Forum, 37(1)

Book chapter

Morris, G. (2012) Is Corporation Taxation Practice a CSR Issue? The Duke of Westminster's Guide to Tax "avoidance". In Corporate Social Responsibility: A Research Handbook (Eds) Haynes, K., Murray, A., Dillard, J., Routledge, ISBN-13: 978-0415781718.

The article and book chapter above would not have been written without the research undertaken for this thesis.

The article and the book chapter are referred to in the thesis.

Themes, concepts and arguments that appear in the article and the book chapter appear within the thesis.

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Part A

Chapter One: Background, terminology, method and contribution

1.1: Introduction

Christian Aid, a nongovernmental organisation ("NGO"), claims that $160 billion of corporate tax is lost to the developing world each year. This loss arises as a consequence of "transfer mispricing" and "false invoicing" (Christian Aid 2008).

Vodafone Group PLC is a UK incorporated company that is listed on the London Stock Exchange. On 22 May 2012 it announced consolidated accounting profits of over £9.5 billion for the financial period ended 31 March 2012 (Vodafone 2012). Following the announcement of these results the UK national newspaper, The Telegraph, on its website ran a story under the headline "Vodafone paid zero UK corporation tax last year" (Telegraph 2012a) which linked the profitability of the company with the amount of tax payable.

On June 13 2012 Justice Simon in the Administrative Court of the Royal Courts of Justice in London ruled that a loosely structured organisation, UK Uncut[1], could bring an action for a judicial review of a decision by Her Majesty's Revenue & Customs ("HMRC") in respect of an arrangement relating to the tax position of Goldman Sachs, the investment bank. Justice Simon is quoted as saying that the matter was "plainly in the public interest" (Guardian (2012c)).

These three examples, each of which is associated with various aspects of taxation, are only a few of many similar examples that could have been cited. These and other examples have been the subject of a considerable amount of discussion and debate in various parts of the media. Indeed an important Parliamentary Committee of the UK, the Committee of Public Accounts (CPA

[1] UK Uncut is an organisation that has been influential in raising media and public awareness in respect of a number of tax matters, both corporate and personal. The website of the organisation is to be found at http://www.ukuncut.org.uk.

(2011)) and the National Audit Office in the UK (National Audit Office (2012)) have also published written opinions on such matters.

Examples of company behaviour and the varied responses to such behaviour provide an indication of the extent to which the relationship between taxation and the activities of certain companies is considered by many sectors of society to be important and worthy of comment[2]. Yet the level of understanding of what is behind the headlines and the various responses and comments such as those indicated above leaves much to be desired. What gives rise to examples such as those cited are the arrangements entered into and the actions undertaken by a certain type of organisation which is commonly identified and referred to as a company. As a result of certain arrangements and actions the consequences that follow have been identified and described.

NGOs, the media, committees and official bodies have then responded to the resulting consequences and to the behaviour that produced such consequences.

The nature of a company, the nature of taxation and the obligations and responsibilities that are pertinent to the relationship between companies and taxation are three of the important topics that underlie these examples and the responses instanced above. As will be argued in this thesis, it is in part a

[2] The introductory paragraphs to this thesis and subsequent paragraphs in this introduction and elsewhere suggests some type of "link" or "connection" (as yet unexamined as to its nature) between (i) the form of arrangement that is recognised by the legal systems and social systems of many countries and which is commonly referred to and identified as a "company" and (ii) the consequences of one or more actions, arrangements or even omissions that are "associated" with or "attributed" to or "undertaken" by (the nature of such association or attribution or undertaking is also as yet unexamined) any such company. One of the purposes of this thesis is to consider certain aspects of the nature of such link and the nature of such associations and/or attributions. Until the consideration of those aspects has been undertaken, any reference to the effect and/or impact and/or consequences a company can have on or in the world is to be considered as a "pragmatic heuristic" which is used to illuminate the relationship between, the nature of a company, the actions, arrangements and omissions associated with or attributed to or undertaken by a company and the consequences in the world that are in some manner (as yet unexplored) "linked" with a company.

poor and confused understanding of these topics that prompts many of the responses to such types of actions and arrangements.

This thesis considers a number of key issues that focus on the relationships that exist between "tax related behaviour" [3] and the rights, duties and responsibilities[4] that are linked to or associated with certain types of company. Companies incorporated under the UK corporate code are of particular interest in this thesis.

This Chapter:

- provides an explanation of a number of terms that are used in this introduction (Section 1.2);
- outlines the areas that are relevant to the subject matter of this thesis (Section 1.3);
- states and discusses the research question of this thesis (Section 1.4);
- identifies and explains the methodology used in this thesis (Section 1.5);
- provides a summary of the contribution made by this thesis (Section 1.6)
- indicates various matters that this thesis will not address (Section 1.7); and,
- outlines a summary of the structure of the thesis (Section 1.8);

1.2: Terminology

Before continuing it is necessary to explain the meaning of two key terms which are used in this thesis:

- tax related behaviour; and,

[3] The phrase "tax-related behaviour" (with hyphen) has been used by Professor Judith Freedman (Freedman 2004). However the author of this thesis was not aware of this use of the term by Professor Freedman until a considerable part of the thesis had been written. See section 1.2.1 for an explanation of the meaning of this term in this thesis.
[4] The different types of responsibility are discussed in Section 9.4.

- state of affairs.

1.2.1: Tax related behaviour

The term "tax related behaviour" refers to and denotes behaviour that has the following characteristics:

(i) a person[5] intentionally[6] undertakes an action or activity or enters into an arrangement or omits to undertake an action or activity (or combination of actions and/or activities and/or arrangements and/or omissions);

(ii) the action or activity undertaken or the omission or arrangement entered into can be identified and described;

(iii) the reason or motive for undertaking the action or activity or omission or entering into the arrangement is that person referred to in sub-paragraph (i) above believes[7] that a tax reduction[8] will occur as a consequence of undertaking the action or activity or entering into the arrangement; and,

(iv) the tax reduction will benefit the person referred to in sub-paragraph (i) above and/or another person or persons associated[9] with that person in (i).

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[5] See Section 5.2.1 for a discussion of the use of the term "person"

[6] The application of the concept of "intention" to the activities attributed to a company is not straightforward. This thesis does not attempt to unravel the complexities associated with the issues that arise when considering the intention of a company. These issues will include the relationship between the collective and individual intention of each director and the collective intention of the board of directors of the company, the actions or activities attributed to a company which are in some manner prompted by the decisions of individuals who are not board members and the relationship between the legal, moral and social meaning of "intentional" behaviour.

[7] For the purposes of understanding tax related behaviour as used in this thesis, there is a relationship between the intention referred to in sub-paragraph (i) and belief referred to in this sub-paragraph (iii). This understanding of tax related behaviour will not include a case in which a liability to taxation crystallises but the person who has the liability does not know of the liability and as a consequence does not satisfy the liability.

[8] A tax reduction occurs when less or no tax is paid (or otherwise satisfied), to a tax authority as compared to the amount that is due to be paid (or otherwise satisfied) or in respect of at least one counter-factual situation would have been due to be paid (or otherwise satisfied) but for the actions or activities undertaken or the arrangement entered into.

[9] In this definition, the term" associated" is used in a very loose manner. Within its meaning would be included a parent company and its wholly owned subsidiary, a wife and husband and a supplier and customer.

The term "tax related behaviour" is used in this thesis because, as will be briefly indicated below and as will be discussed in more detail in Chapter 3, although many different terms are used to refer to various types or categories of behaviour that are in some manner associated with or linked to taxation a number of the more commonly used terms, such as "tax avoidance", "tax mitigation" and "tax planning" are not terms the meaning of which is agreed by all users. A consequence of such lack of agreement is that there will almost certainly be a lack of clarity whenever any discussion or consideration of the meaning of such terms occurs. Such lack of clarity can give rise to confusion and misunderstanding. In addition mistakes in reasoning and inappropriate decisions can be taken when matters relating to such types of behaviour are considered.

In contrast, it is suggested that the term "tax related behaviour" can be considered to be more neutral and not tainted by the connotations[10] that appear to infuse the other terms, reference to a number of which has been made.

In explaining the meaning of tax related behaviour, the phrase "a person undertakes" is used. For this thesis, the meaning of "a person undertakes" has two important dimensions.

The first dimension focuses on the importance of being able to identify ***all*** of the actions, omissions, events and arrangements that have occurred and that were necessary or required in order to bring about of a state of affairs in which the said person is capable of being identified as a participant. This identification and description of what has happened and was required to

[10] The literature falling within the topic of what has been designated as tax related behaviour is extensive. Within that literature different meanings are given to terms that are used to identify various categories or types of tax related behaviour. An indicative selection from the literature which provides examples of a terms such as "tax avoidance" being used in different ways is as follows: Barker (2009), SARS (2005), Prebble et al. (2010), Ventry (2008) and Weisbach (2002). Further references to this extensive literature are made throughout the thesis.

happen in order to identify the state of affairs that obtains might involve actors and/or arrangements other than the specifically identified person.

The second dimension is that when considering the state of affairs which has been brought about, it is important to be able to identify the action(s) or event(s) or omission(s) or activity (or activities) of the specifically identified person without which the said state of affairs would not have obtained. In the form of a question: what has the specifically identified person contributed to the state of affairs? What is or what was that person's role or function?

For example if a company (Company A), which is part of a group of companies enters into an arrangement and as a consequence of that arrangement becomes entitled to a tax relief that arises as a result of the payment of interest, under the UK tax code the benefit of that tax relief might be utilisable by a different company (Company B) within the same group of companies. If a claim for the tax relief is made, then under the first dimension referred to above there will be included all of those arrangements and events that gave rise to the tax relief. This will include the actions undertaken and arrangements entered by Company A and Company B and all of the other parties involved. The second dimension will identify, for example, the arrangements and actions that are specific to Company B. This might be an action as simple as Company B signing a tax relief claim form. Although Company B only provides one signature, many more decisions, actions and arrangements were required (the first dimension) in order to enable the tax relief claim by Company B to occur (the second dimension),

Based on this explanation it is suggested that "a person undertakes" as used in this context is linked to the idea of the existence of a necessary condition or necessary conditions without which the relevant state of affairs would not have come into existence. The necessary condition being the action(s) or events or omission(s) or activity (or activities) of that person without the occurrence of which the relevant state of affairs would not obtain.

It is important to note that in this explanation of the meaning of the term "tax related behaviour", a state of affairs is brought about as the result of the intentional action(s), event(s) or omission(s) or activity (activities). The relevant person requires some form of intention to seek a tax reduction before that behaviour will be classified as "tax related behaviour".

Receiving the benefit of a tax reduction accidently[11] will not be treated as tax related behaviour.

Secondly, it should be further noted that, the explanation of the meaning of the term "tax related behaviour" is provided in terms of the behaviour of a person rather than being limited to the behaviour of a company. It is intended that the analysis of tax related behaviour to be found later in this thesis will apply to all potential tax payers not just to companies. That the subject matter of this thesis primarily concerns the behaviour of companies does not, at this stage in the thesis, require a more narrow understanding of tax related behaviour to be considered.

1.2.2: State of affairs

The notion of a state of affairs is itself a complex concept. At the beginning of the twentieth century ontological assumptions were made about states of affairs (Russell (1912), Wittgenstein (1921)). The ontological status of states of affairs played an important part in the subsequent development of certain systems of thought.

However this thesis does not consider the ontological status of states of affairs. Rather a pragmatic position is adopted in this thesis. A reference to a state of affairs is a useful means of identifying a combination of persons and circumstances that obtain at a particular time. A state of affairs is broadly

[11] There is a difference between wilfully being negligent and not satisfying a liability to taxation and being ignorant of a liability to taxation and as a consequence not satisfying such liability. In both cases a liability to taxation has not been satisfied but in the case of being wilful, a person has acted positively, even if only by way of some form of negligent omission.

understood to include[12] the existence at a particular time of a persons or other entity(ies), in respect of which it is possible to identify and provide a description of the person or other entity(ies), actions undertaken and arrangements entered into in order to bring about a set of circumstances. It is also possible to identify the rights and obligations (whether legal or moral) to which that person or other entity is entitled or subject at that particular time.

The description of a state of affairs will take account of various aspects of the context within which the action(s), omission(s) and activity (activities) undertaken and arrangements entered into by the specifically identified person, (including certain beliefs, intentions and expectations that are possessed by or associated with that person), occurs. A description will also be required of the rights and obligations of the relevant person because in matters associated with taxation such rights and obligations (and the description of them) will be an important feature of any state of affairs.

For the purposes of this thesis such rights and obligations (in the case of many of the types of states of affairs considered by this thesis), are often linked in some manner to the ownership of property considered in a wide legal sense[13].

A state of affairs is said to obtain when it comes into existence. It is possible to identify and describe states of affairs that might never come into existence in which case the said state of affairs never obtains. Such states of affairs can be referred to as counterfactual states of affairs and can play a role in explaining and understanding tax related behaviour.

1.3: Background to taxation and behaviour and corporate social responsibility

Having provided in the previous section an explanation of how the terms "tax related behaviour" and "states of affairs" are to be used in this thesis, further

[12] It is acknowledged in this thesis the state of affairs with which this thesis is concerned is a subset of the total class of states of affairs that could exist.

[13] The idea of property as used in this thesis includes not only tangible property such as land, buildings and chattels but also intangible property including choses in action and other rights.

explanations will now be offered in order to provide a context for the research agenda of this thesis. This section offers a more detailed explanation of the importance and relevance of tax related behaviour and what is referred to as corporate responsibility and introduces the relationship between the two areas of study.

1.3.1: Taxation and behaviour

In the UK, tax may be charged and a liability to make a payment of tax may crystallise in many different types of circumstances, when various states of affairs obtain. In addition many different types of "entity" are potentially liable to make such payments. By way of example a liability to make a payment of taxation might arise:

- on the attribution of income which has been earned possibly as a result of activities carried out over a period of time, for example, trading income[14];
- on certain instances of single or one off transactions, for example the disposal of a capital asset)[15]; and,
- in certain circumstances, on the amount of wealth held by an individual when he or she dies[16].

The crystallisation of a liability to pay tax in the UK is something that infuses life (and sometimes death) and arises on the occurrence of many different types of activities, arrangements and events. An exposure to taxation also exists in other countries throughout the world even though the detailed rules of the tax code in each country will differ from country to country.[17]

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[14] See for example section 5 Income Tax (Trading and Other Income) Act 2005

[15] See section 2 Taxation of Chargeable Gains Act 1992.

[16] See section 1 Inheritance Tax Act 1984.

[17] This thesis does not consider in detail the law making capacity or process of any state and does not even consider the nature of a state or what could constitute a state. This thesis assumes that states exist, states are recognised by other states and that states have law making capacity (including tax law making capacity) and that law making capacity and the resulting laws are also recognised by other states.

UK tax resident companies that have made profits are usually exposed to a liability to pay UK tax on those profits; in the UK the tax liability is called corporation tax. If a company in the UK buys a building, situated in the UK a tax commonly referred to as stamp duty land tax ("SDLT") will often be payable. SDLT is usually paid by the purchasing company. UK resident employees of a company are usually liable to income tax and social security tax (in the UK, the social security tax paid by employees is known as employee's national insurance contributions) on any wages or salaries paid to them and on the value of certain types of benefits in kind that are received by them. The employing company is also usually liable to pay an additional amount of social security tax (employer's national insurance contributions).

In the UK, and indeed in many other countries, a company[18] is considered to be able to act and to bring about a particular state of affairs. Such an instance of corporate behaviour may have very little direct connection with the tax code of a country. The decision to invest in a new factory is likely to be a primarily commercial decision. If the investment goes ahead a new state of affairs will obtain in which the company owns a property. Tax considerations might have little or no bearing on such an investment decision.

However a company can also choose to undertake an action, enter into an arrangement and/or engage in an activity which consists of the company being a party to a specific set of action(s), arrangement(s) and/or activity (or activities) the outcome of which is that a state of affairs obtains and as a consequence less tax falls due[19] than would have been the case if the company had not entered into the selected, specific set of, action(s), arrangement(s) and/or activity (or activities). As a consequence of the

[18] Chapters 10 and 11 discuss a number of the issues associated with the manner in which a company can be said to act to bring about a particular state of affairs.

[19] Following the state of affairs obtaining reference is made to a position in which "less tax falls due". This situation will be different from a state of affairs obtaining, an amount of tax falls due but such obligation is not satisfied. Both are instances of tax related behaviour but each instance is very different, one from the other. This distinction is addressed in more detail in Chapter 8.

selected behaviour, a tax reduction occurs[20]. In such circumstances the company could be said to have engaged in a form of tax related behaviour which is often referred to as being some form of "tax avoidance" or "tax planning" or "tax mitigation" (Baker, Goldberg (2008), McClaren (2008), Bankman (2004), Halkyard (2004)).

In a similar manner, the parent company of a multinational group of companies will on occasion have opportunities to arrange the affairs of one of more of the companies[21] within the group so as to reduce the overall amount of tax that is due to one or more of the tax authorities of the various countries in which companies that are members[22] of the multinational group operate or otherwise have a presence under the terms of a relevant tax code. Again arranging the affairs of one or more of the companies within a group of companies can be described as tax avoidance, tax planning or tax mitigation.

In recent years, from many disciplines within the academic community as well as from many bodies outside the academic community, for example governments, charities, labour organisations and international organisations[23], there has arisen an acknowledgment that there would appear to be an important link between the requirement of a company to pay tax, the nature of a company as some form of entity or arrangement (the existence of and at least part of the operation of which falls under the provisions of a company law code of a particular country) and a wider set of

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[20] See explanation of tax related behaviour above.

[21] The reference to the parent company of a group of companies arranging the affairs of other companies within the group of companies refers to the power of a parent company to procure that a subsidiary company or subsidiary companies, the shares of which are owned directly or indirectly by the parent company, engage in tax related behaviour that is selected and directed by the parent company. The relationship between a parent company and other companies that are directly or indirectly controlled by the parent company raises many complex issues. Chapters 10 and 11 discuss in more detail the relationship between the capacity or power to act, the capacity or power to bring about a state of affairs and what is referred to as a company.

[22] This reference to "members" is a reference to companies that are part of a multinational group of companies and is not a reference to the shareholders of a UK incorporated company that are often referred to as members. See for example Section 112 CA 2006.

[23] There is a considerable body of literature, not all of it peer reviewed, which discusses these issues. Reference will be made to some of this literature throughout this thesis.

issues which include addressing the role of a company in society (for a very small sample of the extensive literature see for example: Actionaid (2008), Actionaid (2011), Aprill (2001), Avi Yonah (2008), Braithwaite (2003), Christian Aid (2005) and Sikka et al. (2010a)). Indeed, as will be discussed in this thesis, the crystallisation or indeed non crystallisation of a liability to taxation in a company, (and the possible subsequent payment of taxation), is seen by many academics and other commentators to be a very useful and by some (Hasseldine et al. (2013), McBarnet et al. (2009) and Sikka (2010b)), a key indicator that can be used to appraise the activities of a company and also to appraise the extent to which, if at all, the company is acting in a responsible[24] manner. This is because the crystallisation of a liability to taxation and the satisfaction of that liability or indeed the non crystallisation of a liability to taxation may prove to be very illuminating when seeking to describe, understand and appreciate the nature and significance of the relationship that does exist, can exist and/or even should exist between the activities undertaken by a company, various state of affairs that obtain as a result of those activities and the role or function or purpose of a company in society[25].

1.3.2: Corporate social responsibility[26]

The area of study encompassed by the phrase "corporate social responsibility" (or "CSR")[27] is interesting for a number of reasons. Not least of these reasons

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[24] The term "responsible" is a term that is capable of bearing a number of distinct meanings. A number of these meanings are discussed in Chapter 9.

[25] When considering the relationship between the activities of a company and the role or function or purpose of a company operating within society it is appropriate to make reference to a version of legitimacy theory. As summarised by Suchman (1995): ***"Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions"*** (emphasis in original), as quoted in Tilling (2006). However a discussion of legitimacy theory and its application to the tax related behaviour and corporations is not within the scope of this thesis. It is assumed in this thesis that the act of creating a company under a particular corporate code is a legitimate act. The subsequent behaviour of that company can be assessed by reference to *"norms, values, beliefs and definitions"* that are socially constructed by that society. In part such assessment is the purpose of this thesis.

[26] There is a considerable amount of published academic literature, books, reports and journalistic articles that address the subject of corporate social responsibility. Not all of the published literature has been peer reviewed. Although some publications are referred to in this chapter the primary consideration of parts of the CSR literature considered relevant to the subject matter of this thesis will be considered and referred to throughout this thesis.

is that it is an area of study to which many thousands of hours of effort have been and continue to be devoted by academics, consultants, various NGOs, corporate employees and others in an attempt to understand, develop and seek to apply its subject matter (see for example Lockett et al. (2006) for a summary of the literature, and Crane et al. (2008b) for a general overview of the history, development and currents areas of interest). Yet many hours of effort are also devoted to denying its existence as a separately identifiable area of study and/or denying its relevance to business activity other than for reasons of self interest (the classic such example is Friedman (1970) but see also Porter et al. (1999) and Porter et al. (2002)).

Over the last few decades, in an attempt to clarify, delineate and even develop and extend this area of study various other names or descriptions have been proposed as alternatives to the phrase "corporate social responsibility". These names and descriptions are used to identify and frame classes of behaviour and activities and the consequences of such behaviour and activities that are considered by the various proponents of such "new" names and descriptions to be the appropriate subject matter within this area of research. "Corporate social responsiveness", "corporate social performance" (Ackerman, (1973), Ackerman et al. (1976), Sethi (1975), Wood (1991)), "stakeholder theory" (Freeman et al. (2004)), and "corporate citizenship" (Windsor (2001), Davis (1973), Crane et al. (2008a) are all designations that have been proposed and defended.

Each of these proposed designations or descriptions have been justified on the grounds that the new alternative understanding and description being offered more ably, competently and comprehensively captures an identified set of behaviours and activities in which individuals, companies and other entities actually engage or should engage with the "should" often operating in a normative or prescriptive manner.

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[27] The term "corporate social responsibility" is used in the introduction because that is the term that is commonly recognised when considering the behaviour that should be undertaken by companies (Economist (2008), Porter et al. (1999)).

In part this proliferation of different approaches has been and is prompted by the vagueness associated with the area of interest and study referred to by the term "corporate social responsibility". Many decades ago this vagueness was comprehensively captured by Votaw:

> *"The term [social responsibility] is a brilliant one; it means something, but not always the same thing, to everybody. To some it conveys the idea of legal responsibility or liability; to others, it means socially responsible behaviour in an ethical sense; to still others, the meaning transmitted is that of "responsible for", in a causal mode; many simply equate it with a charitable contribution; some take it to mean socially conscious; many of those who embrace it most fervently see it as a mere synonym for "legitimacy", in the context of "belonging" or being proper or valid; a few see it as a sort of fiduciary duty imposing higher standards of behaviour on businessmen than on citizens at large."* (Votaw (1973), quoted in Crane (2008b) page 31).

Given what might appear to be a confusion at the very centre of the concept of CSR, it is not surprising that it has even been argued that CSR, following the original work of Gallie, (Gallie (1956), is an "essentially contested concept" (Gond et al. (2011), Okoye (2009)). Whether or not CSR is an "essentially contested concept" what is clear is that the types of behaviour and practices which have been identified over the last thirty years or so[28] as falling within the area of research and study included within the sphere of CSR are many and varied.

Rather than being an area of research with strictly delineated edges it has been suggested that CSR continues to be a developing area of interest (Lockett et al. (2006)) and that the term "corporate social responsibility" is proving to be a useful and wide ranging umbrella term which can be applied

[28] The field of practice and study referred to as CSR traces its origin back more than thirty years but it is in the last thirty years or so that interest in the topics addressed by CSR has really grown.

to identify, in a very pragmatic manner, an important area of practice and study (Prieto-Carron et al. (2006)).

However this thesis is not intended to be a research project on the topic of CSR. The aim of this thesis is not to establish a definitive meaning of or to set limits to the matters to which the term "corporate social responsibility" can be applied. Rather, the aim of this thesis is to identify and consider the nature of tax related behaviour and the rights and obligations and responsibilities associated with the corporate form that have a bearing on any tax related behaviour undertaken. Topics that are considered to fall within the sphere of CSR studies will be considered in the course of this thesis. To re-quote some of the words of Votaw above:

> *"To some it conveys the idea of legal responsibility or liability; to others, it means socially responsible behaviour in an ethical sense; to still others, the meaning transmitted is that of "responsible for", in a causal mode;..."*

Reference is made in this quote to legality, to ethics and to causation. These are aspects of tax related behaviour that will be considered in this thesis and to the extent that such matters can be considered to fall under the umbrella terms CSR then this area of research and study is relevant to the research undertaken within this thesis.

If accepted as being in the nature of an umbrella term, then the concept of CSR can also be considered similar in application to a concept such as "game". "Game" is usually accepted to be a broad generous concept. Within its denotation are included activities as different as football and blackjack. As a concept it allows the admittance of new types of activities which have a "family resemblance" to one or more existing games (Wittgenstein (1958) page 33, paragraph 67). Just as any game will possess certain characteristics that are shared by some other games, such as skill, chance, competition,

enjoyment, so matters falling under the umbrella term of CSR will share certain characteristics that overlap from one use of the term to another.

Crucially however the topics that are generally classified as falling within the remit of corporate social responsibility will seek to address the manner in which the assets and other resources of a corporation are used, whether by action or omission and the reason or reasons for such use. CSR seeks to address the appropriateness or otherwise of actions or omissions as a result of which the assets and other resources of a corporation are utilised.

It is generally accepted by many contributors who are active researchers or otherwise (for example CSR consultants) in the field of CSR that the test of appropriateness to be used in these circumstances is not always and not necessarily to be applied by reference to economic measures such as the maximisation of shareholder value, creation of profit or seeking of utility (see for example Freeman et al. (2004), Carroll (1979), Carroll (1991), Crane (2008a), Donaldson et al. (1995)) principles which are thought by some to be the main or only objective of corporate activity (Brummer (1991), Macey (1999), Jensen et al. (1976) and generally chapter 2 Keay (2011b)).

As indicated it is beyond the scope of this thesis to address in detail the CSR issues that is all possible corporate actions, inactions and omissions that might be considered relevant by academics and practitioners who are active in the area of CSR[29]. Instead this thesis will consider one aspect of corporate behaviour which has received attention over the last few years and, as previously indicated, is considered by many academics, researchers, commentators and others to be a category of corporate behaviour which might be important when seeking to understand the relationship between companies and society.

[29] Matters not considered in detail would include employee's rights, discrimination, the environment and intergenerational justice. All of these matters (and many others), fall within the remit of CSR.

However the subject matter of this thesis and the discussion and argument that is contained therein, will be of more general interest to the debates taking place within the field of corporate social responsibility both in the specific context considered in this research but also in making a contribution to an understanding of the nature of CSR, the nature of corporate activity and the rights, duties and responsibilities which a corporation might possess or to which it might be subject. The area of corporate activity to be considered by this thesis is a type of behaviour that has already been referred to as tax related behaviour.

Accordingly this thesis considers and explores the relationship between tax related behaviour and the corporate social responsibilities, considered in a wide sense, of corporations.

1.3.3: Taxation behaviour and corporate social responsibility

The relationship between the crystallisation of a liability to taxation, the satisfying of that liability[30] and the CSR activity of a company has been identified by a number of leading academics and commentators as significant.

For example in a recent paper Reuven Avi-Yonah, a professor of law at Michigan made the following observation:

> *"From the perspective of the corporation, if engaging in CSR is a legitimate corporate function, then corporations can also be expected to pay taxes to bolster society as part of their assumptions of CSR. If, on the other hand, CSR is illegitimate, there is a question whether corporations should try to minimize their tax payments as part of avoiding CSR and maximizing the profits of their shareholders."* (Avi-Yonah (2008))

[30] A liability to taxation that has crystallised may be satisfied in a number of different ways, payment of the tax liability is only one of them. A liability may also be satisfied by the utilisation of a tax relief or a tax credit.

Although Avi-Yonah's paper highlights the importance of a link between tax payments and CSR, this extract does prompt a number of questions such as, "what is meant by CSR?", "what is the basis for assessing whether a corporate function is legitimate or illegitimate?". It also appears to make use of a number of assumptions. For example it appears to assume an identifiable contrast between on the one hand CSR behaviour and on the other hand minimising tax in order to satisfy an assumed requirement to maximise profits. These and similar assumptions will be referred to again in the course of this thesis.

From a different area of academic research is the following observation by Mihir Desai, a professor of finance at Harvard and Dhammika Dharmapala who is now a professor at the University of Illinois:

> *"How should corporations view their tax obligations, and should tax compliance be part of their social responsibility campaigns? Alternatively, why aren't tax payments more frequently framed within the context of the social responsibility of corporations?"* (Desai et al. (2006b))

It should be noted that the above quotation refers to "tax obligations", perhaps in contrast with Avi-Yonah's reference to "tax payments". As will be discussed in more detail in this thesis (see Section 4.2), a number of academics researching the various aspects of tax related behaviour do not clearly distinguish between important and different types of tax related behaviour (see for example Weisbach (2002) and Brooks et al. (1997)). The lack of a key distinction, which in certain instances is intentional, can lead to lack a lack of clarity when considering these topics.

Although the literature which considers tax related behaviour and CSR is not vast, it is growing. Publications are appearing which consider different aspects of the relationship. These publications address not only the economic and/or financial aspects of any link that might exist between tax related

behaviour and CSR (see for example Watson (2011), Richardson et al. (2011), Geogaraki (2011) and Muller et al (2011)), but also the conceptual and/or normative aspects of the relationship (Christensen et al. (2004), SustainAbility (2006), Preuss (2010), David et al. (2009), Shafer et al (2008), Sikka (2010b) and Hasseldine et al. (2013)).

In addition to the publications that originate from research carried out from within the academic community there are also contributions made from what is a wider non academic grouping. For example the writings of John Christensen of the Tax Justice Network.

> *"There is a significant minority of companies who agree that paying tax is a key part of corporate responsibility, if not the core corporate responsibility to society," Christensen says, "Tax is where CSR begins."* (Guardian (2009a))

In addition to the Tax Justice Network, there are an ever increasing number of commentators from a non academic background who express opinions and views on these topics. As the result of the actions of various NGOs (Actionaid (2011), Christian Aid (2005) and (2008)), and the actions of more amorphous groupings such as UK Uncut[31], demonstrate, the topics addressed by this thesis, that is tax related behaviour and corporate responsibility are becoming more of an issue in the consciousness of the general public.

Although the above quotations are recent, the idea that the payment of taxation is an important test of a tax payer's (and including by extension, a company's) relationship with society has a long history. As Justice Oliver

[31] See footnote 1 above. The Uncut movement is not just a UK phenomenon; the USA has its own version, see http://www.usuncut.org/ (last accessed 27 May 2015). Activists in other countries also look to this organisation, "Stop Corporate Tax Cheats! U.S. Uncut Movement Goes Global", a headline to a blog entry to be accessed at http://www.alternet.org/story/150367/stop_corporate_tax_cheats!_u.s._uncut_movement_goes_global (last accessed 27 May 2013).

Wendell Holmes Jr. said over eighty years ago: *"I like to pay taxes ... with taxes I buy civilisation."*[32]

It should be noted that however attractive at first blush the sentiment expressed by this quote appears to be, it is not without criticism. This often repeated quote has been glossed by a leading UK tax barrister to make a slightly different (and possibly more accurate) point: *"Taxes are the price we pay for services."* (Goldberg 2004). Goldberg's variation suggests that civilisation is more than just the provision of services and that taxation cannot of itself buy civilisation, it can only provide the finance which facilitates civilisation.

Responses to the behaviour of taxpayers that engage in tax avoidance or tax evasion behaviour is varied, see Blank (2009), Burke et al. (2009), Compass (2009), Godar et al. (2005).

This selection of quotations is indicative of an existing and growing interest, which is shared by many different groups, and increasingly by the media and the public in the relationship that exists between, what might be considered at first blush, to be two separate matters. The two matters being (i) tax related behaviour and (ii) CSR[33].

From a CSR perspective, attempts to make the linkage between CSR and tax related behaviour (see previous citations) tend to focus on class of actions, activities and behaviour undertaken by commercial entities, but particularly undertaken by corporations[34]. The class of actions, activities and behaviour consists of those matters that the many participants, academics, consultants and commentators who are active in the broad field of CSR consider to fall under the broad umbrella of CSR. Such interested and active parties will focus

[32] Compania General de Tabacos de Filipinas v Collector of Internal Revenue 275 U.S. 87 (1927) (USSC)

[33] There is a growing interest in the relationship between ethics and taxation and allied subjects such as accounting, see Aharony et al. (2003), Alm et al.(2011), Bayou et al. (2011))

[34] For the purpose of this thesis this interest will primarily focus on the relationship of these to matters to corporations, in particular to companies incorporated under the UK corporate code, CA2006.

on what is considered to be appropriate behaviour for any company or other business entity claiming a measure of commitment to the standards, ideals and norms of CSR[35].

Although CSR is a term commonly used to refer to certain categories of corporate actions, activities and behaviour as has been suggested there is no agreed meaning or even agreed application of the term (see footnotes 27 and 35 and the discussion in section 1.3.2). Amongst other topics, this thesis addresses the responsibilities, obligations and duties (including legal, social and moral obligations, responsibilities and duties) that are linked or in some manner associated with corporations. Even though it has been indicated that CSR can be considered to be a broad umbrella term (see section 1.2.3), in order to avoid limiting the research undertaken by this thesis by reference to a narrow understanding or application of the term "corporate social responsibility" the term "corporate responsibility" will also be used in order to offer a broader understanding of the responsibilities, obligations and duties that are being considered as part of this thesis.

1.4: Research questions

Prompted by the background summarised in the previous section, this thesis considers the relationship between tax related behaviour and corporate responsibility. In particular, it considers the nature of the relationships, if any,[36] that exist between the following areas:

- the nature of the corporate form;

[35] The topics that fall within CSR considered as a field of practice, interest or study are not at present defined or even limited in scope. Therefore it is difficult to identify in a clear and delineated manner what it is for a commercial entity to be a proponent of CSR and exhibit the qualities or characteristics that might be considered to be the "badges" of CSR. Recognising the difficulties of capturing what it is to be CSR compliant, a number of authors have listed the topics addressed by CSR (see for example Blowfield et al. (2011) pg. 11-12). In addition there are a number of organisations who offer guidance and consultancy services to assist commercial entities with the setting of appropriate guidelines for corporate behaviour such as Agenda 21 and the Global Reporting Initiative (see list of websites and websites referred to).

[36] It can be useful to establish a relationship between two matters or topics. It can also be useful to establish that there is no such relationship between two matters.

- the rights, obligations and/or responsibilities possessed by a company or to which a company is subject;
- the activities, arrangements and actions undertaken by a company that fall under the heading of tax related behaviour; and,
- the application of the UK tax code[37] to a particular state of affairs that obtains as a consequence of tax related behaviour.

There are two research questions which together seek to address the nature of these relationships.

First research question:

> **"What are the different qualities, characteristics and/or attributes of tax related behaviour that can be identified and described and used to create a taxonomy of the different types or categories of tax related behaviour?"**

Second research question:

> **"When a UK incorporated company is provided with an opportunity to engage in tax related behaviour which is expected to result in a tax reduction and thereby contribute to the retention of value[38] by that company, what rights, duties and/or responsibilities are to be or should be considered when deciding whether to refrain from or engage in such tax related behaviour?"**

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[37] This thesis will primarily make reference to the UK tax code. However, one of the contributions of this thesis is to provide a framework which can be used to identify and highlight similarities between the tax codes of different countries.

[38] In the research question, the phrase "retention of value" is used. If a tax reduction occurs, whether through non payment of tax, a smaller liability to taxation crystallising or if an entitlement to a greater tax credit or benefit arises, then less value will leave the company and be transferred to the relevant tax authority. Using such a phrase does not commit to a view that advocates that the maximisation of shareholder value is a significant reason (if not the only reason) for engaging in tax related behaviour. In similar vein using the phrase "retention of value" is also neutral when any alternative to the maximisation of shareholder value position is to be considered, one such alternative being the view that a company should be operated for the benefit of its stakeholders.

The research questions are to be used as a starting point and a focus for firstly investigating the nature of tax related behaviour and secondly considering the relationship between any one or more rights, powers, obligations and/or responsibilities (whether legal, moral or otherwise), which a company[39] possesses (in the case of and/or rights) or to which a company is subject (in the case of obligations and/or responsibilities) and which may be relevant to the selection of actions and activities which are related to the retention of value within the company through tax related behaviour.

Answering the research question requires the consideration of topics that are areas of interest in different academic disciplines. These various topics will include:

- tax law and corporate law;
- human rights principles and human rights law;
- compliance behaviour and the payment of tax;
- international business structures;
- ethics; and,
- a number of more normative issues that fall under the umbrella heading of corporate responsibility.

In this thesis therefore, reference will be made to the research conducted in a number of different academic disciplines.

However, for the purpose of focussing on the salient issues raised by the research questions it is useful to approach the answer to the questions through a limited number of broad categories of subject matter. The selected categories will facilitate the identification of areas of academic research that have an important bearing on the research questions. It is partly the critique of the academic research (in various different disciplines) being undertaken in

[39] In this Introduction, it should be noted that the reference to obligations and/or responsibilities to which a company is subject is being used in a heuristic manner. Such usage in this Introduction assumes that a company is an entity or some type of "thing" which can be made subject to obligations and/or responsibilities and might possess powers and rights. Chapters 10 and 11 will discuss this matters in more detail.

these broad categories and the fusion of the resulting critique that enables the research questions to be answered.

The broad categories of academic research through which the research questions will be addressed are as follows:

(i) the relationship between the tax code of a jurisdiction, the obligations and entitlements that can exist under that tax code and the events, arrangements, activities and states of affairs the occurrence of which can give rise to the crystallisation of liabilities to taxation or to an entitlement to a tax relief or tax credit arising; and,

(ii) the nature of a company and the rights, obligations and/or responsibilities that are to be associated with a company; and,

(iii) the standards, principles and expectations that may be considered to apply to tax related behaviour and which fall under the wide area of study and behaviour referred to by the term "corporate responsibility".

It is in the consideration and critique of parts of the existing complex academic work falling within these three broad categories of research and the relationship between these categories that will form the major part of the thesis and the contribution it makes.

As indicated, the thesis focuses on tax related behaviour and what is termed corporate responsibility. As such it focuses on the rights, obligations and/or responsibilities that are relevant when considered from within a primarily legal framework but also takes account of possible additional, non legal, normative dimensions[40] that are derived from theories and practices falling within CSR.

[40] In this paragraph a reference is made to "normative dimensions". It is not within the scope of this thesis to contribute to the positivist/non positivist debate as to the nature of law. It is accepted for the purposes of this thesis that any system of law is normative in nature. To that

Little attention is paid in this thesis to other broad areas of academic research that, in a different thesis, might be very relevant when answering the research question. For example, in this thesis, very few references made to the academic disciplines of economics, sociology, psychology or political science each of which, it is reasonable to suggest, might offer insights and would contribute to an understanding of the issues that arise when considering the research question. The many disciplines in which research is undertaken that could be used to illuminate the research questions indicate perhaps the importance and complexity of the matters which prompt the research question. However interesting it would be to consider the research question from such different perspectives, such a wide ranging interdisciplinary study is beyond the scope of this thesis.

1.5: Methodology

In section1.4 the broad categories of academic research through which the research questions will be addressed are identified.

In answering the research questions this thesis requires consideration of various parts of the UK legal code, in particular the tax code, corporate code and human rights legislation are considered. In so considering, this thesis is undertaking both legal doctrinal research and also legal theoretical research. These two approaches are adopted because, as will be argued in the body of this thesis, concepts exist that are not clearly, consistently or coherently defined and applied. But, notwithstanding such lack of clarity, consistency and coherence, decisions are made and behaviours occur which are based on such concepts.

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extent any powers, rights, obligations and responsibilities that are identified within a legal framework will be normative. Locating tax related behaviour not only within a legal framework but within certain parts of CSR will introduce additional normative issues for consideration. See Harris (2004) for an interesting discussion about the relationship between non canonical human rights and canonical human rights which explores aspects of the normative quality of law.

This thesis seeks to systemise the relationship between various rights, duties, obligations and responsibilities that are considered relevant to answering the research questions. In order to achieve such systemisation it is necessary not only to undertake legal doctrinal research and legal theoretical research but also to use a conceptual analysis approach to various key concepts that are identified in the thesis.

Through a consideration of the decided cases, statutes, commentaries, academic articles and other publications a critical conceptual analysis is undertaken with the intention, through a process of inductive reasoning of answering the research questions. The argument of this thesis is built "concept by concept, proposition by proposition" (McKercher (2009)) and accordingly the thesis will critically examine the concepts of (i) tax related behaviour, (ii) the nature of a company and (iii) a number of the rights, duties and responsibilities to which a company may be entitled or subject.

1.6: Contribution of this thesis

This thesis makes a contribution to academic literature and to the understanding of the various topics addressed in this thesis as follows:

i. Identifies a gap in the literature relating to the identification and explanation of tax related behaviour;
ii. Develops an analytic and conceptual framework within which various categories of tax related behaviour can be located;
iii. Identifies and applies an analysis of duties and rights which is used to provide a framework within which an understanding of the nature of UK limited company and its directors can be located;
iv. Develops an understanding and description of a UK limited company;

v. Provides an explanation of how the obligations of directors apply to company behaviour in general and to tax related behaviour in particular;

vi. Presents an argument for a hierarchy of rights and obligations which positions legal and non legal rights and obligations within such hierarchy;

vii. Prompts a number of further research questions; and,

viii. Answers the research questions.

1.7: What this thesis will not address

This thesis will not consider indirect tax when answering the research questions.

In addition, there are many areas of jurisprudence referred to in the course of the analysis and discussion. This is not intended to be a research project engaging with an area of jurisprudence.

This thesis is not a research project which is directed at the construction of tax legislation. The tax consequences of any arrangement entered into have to be considered based on the facts and the relevant legislation. This thesis does not attempt to establish what for example the Supreme Court means by "tax avoidance" or how a general anti avoidance principle should be drafted and applied.

This thesis will in the main confine itself to the consideration of UK matters; it will not address overseas matters in any detail.

1.8: Remaining structure of the thesis

The remainder of the thesis will be as follows:

Part B: Chapters Two, Three, Four, Five, Six, Seven and Eight will consider various aspects of tax related behaviour.

Part C: Chapter Nine will provide an analytic framework of rights, duties and responsibilities.

Part D: Chapter Ten and Eleven will discuss the nature of company.

Part E: Chapter Twelve concludes.

PART B

Chapter Two: Introduction to identifying and classifying tax related behaviour

Part B of this thesis provides a critical consideration of and a discussion on the subject of tax related behaviour. Tax related behaviour is defined in Part A of this thesis.

In order to address the research question of this thesis, it is necessary to identify and distinguish the characteristics, qualities and attributes of various types or categories of tax related behaviour and in so doing also consider the consequences of tokens or instances of such different types of tax related behaviour actually occurring.

It is also necessary to develop an understanding of what it is for a liability to taxation to crystallise or for an entitlement to a tax relief or tax credit to arise. Before the concept of an obligation to pay tax is adequately understood, in particular, before the necessary circumstances that must obtain before a liability to taxation crystallises are identified and described, no assessment can be made (provisional or otherwise) as to the behaviour of a company in relation to such obligations or potential obligations. At present, the nature of the debate which is addressing certain aspects of such matters is not particularly clear and on occasion is anything but helpful.

It is generally accepted that the crystallisation of a liability to taxation crucially depends upon the application of part of a jurisdiction's tax code to a set of circumstances, its application to a state of affairs.

There is evidence to suggest that in respect of certain categories or types of arrangements, agreement does not exist between various groups of interested parties as to the manner in which a part of a jurisdiction's tax code is to be applied to a particular arrangement. This is not just a consequence of the difficulty that can exist in understanding how a particularly complex part

of a tax code is to be construed and applied. There exist not only differences in approach to tax related behaviour but also differences in understanding the relationship between a tax code and its application to a set of circumstances that occur in the world.

In respect of the application of part of a tax code to a state of affairs, those advising in the area of taxation, be they lawyers, accountants or consultants of one form or another together with their clients might take one view, the courts independently take another, tax authorities take a third and various interested other bodies, for example, charities, unions and political groupings yet another[41]. In addition within each of the groups identified there will be nuances (sometimes significant nuances) of difference in understanding and description across members of the relevant group.

These differences rather loosely revolve around a number of separate but related issues including:

(a) the interpretation and application of statute and regulations by different interested parties such as users (both potential tax payers and tax advisors), administrators (in the UK HMRC) and the judiciary and the relationship between such interpretation and the intention or purpose[42] of the legislative body;

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[41] The different views expressed on these matters by academics, courts, advisors, tax authorities and other commentators are referred to throughout this thesis.

[42] This thesis arises within the context of the UK tax system which in turn is part of the system of law in the UK. This thesis does not address in any detail the jurisprudence that exists and which continues to be a topic of considerable debate on the relationship between the intention or purpose of the lawmaker (in the case of the UK, Parliament), the policy that has prompted the enactment of a set of provisions in the UK tax code, the role of the draughtsman in producing the enacted provisions of the tax code, the role of the government of the day or what has actually gone on in the minds of the elected representatives that vote on the tax code provisions proposed. The view taken in this thesis is similar to the sentiments expressed by Lord Hoffman (Hoffman (2005) and Graham Aaronson Q.C. when he writes: " ...the established principle of statutory interpretation in the UK which holds that the intention of Parliament can be discerned only from the language of the legislation itself." (Aaronson 2011). The position accepted in this thesis being that the intention or purpose of the law maker is contained with the words of the tax code understood in a context that is considered appropriate when both the relevant part of the tax code is considered and the circumstances at issue are considered. It is a decision of the courts to identify what is appropriate.

(b) the relationship between tax avoidance, tax planning tax compliance and tax evasion, these distinctions are important because UK tax resident companies[43] can engage in what some interested parties (including tax authorities) would call abusive, unacceptable or immoral tax avoidance which when it fails is often not re-categorised as tax evasion;

(c) the problems associated with counterfactual behaviour, for example, tax avoidance is often identified by reference to and by comparison with arrangements that a company or other tax payer has not entered into and is unlikely ever to have entered into, in which case, the description of "tax avoidance" is being applied by reference to and by comparison with a state of affairs that does not exist and never existed

An exploration of the matters addressed by each of the above selected topics ((a) to (c) inclusive), and other topics, will help to understand more fully the concept of a liability to taxation as it attaches to a company and also understand how a company may have the opportunity to arrange its affairs so as to "choose" to incur a different liability to taxation (which might be nil). It will also help to provide an understanding of the concept of tax avoidance, tax planning, tax compliance, tax evasion and related matters.

In this context, in considering the nature of tax obligation an account should also be given of the importance of the multinational nature of business. As has been indicated, parent companies of multinational groups often arrange the affairs of companies within the group so as to reduce or postpone the overall rate of taxation[44] for the group from the overall rate that would have obtained if the affairs of the relevant company had not been arranged in that manner.

[43] In the main all UK incorporated companies will be tax resident in the UK but not all companies tax resident in the UK will be incorporated under the UK corporate code.
[44] The reference to the "overall rate of taxation" is a convenient shorthand which refers to a set of circumstances in which less tax is paid to the relevant tax authorities around the world or the payment of more tax is postponed that would otherwise be the case.

Although the research question is stated in terms of a UK incorporated company there is no reference made in the research question to a particular jurisdiction[45], yet liability to pay tax is always linked with legislation of a particular jurisdiction. The tax related behaviour undertaken by a company or companies which has/have some form of tax presence in more than one country in circumstances is a matter of importance when considering the rights powers and duties associated with companies and the behaviour that is to be undertaken.

The following example illustrates a number of issues that can arise in such circumstances.

> *A UK incorporated and tax resident parent company of a multinational group considers that there are compelling reasons[46] not to engage in certain types of UK tax related behaviour in relation to one or more aspects of UK tax legislation in respect of its UK business/commercial activities. However the UK incorporated company considers it acceptable to allow overseas based subsidiaries (which fall within the tax regime of jurisdictions other than the UK) to adopt tax related behaviour which is similar in nature[47] and is expected to result in the overall rate of taxation for the group of companies being less than it would otherwise have been.*

In this context, interesting questions can arise. To what extent is such a position, consistent or coherent for the UK parent company? What principles are relevant when assessing the behaviour of the UK parent company? What is the nature of the behaviour that is being assessed, particularly when there

[45] A UK incorporated company can crystallise a liability to taxation in jurisdictions other than the UK.

[46] As discussed in Chapter 11, the directors of a company should act so as to promote the success of the company. There might be compelling reasons associated with reputation and/or goodwill why certain types of tax related behaviour are not undertaken.

[47] The reference to tax related behaviour which is "similar in nature" is a reference to tax related behaviour in respect of which the type of taxation which is the focus of the behaviour, the arrangements entered into and the resultant reduction in liability to pay tax or additional tax relief that arises are similar to the taxes, arrangements etc that are exist or could be selected in the UK and in respect of which no such tax related behaviour is entertained.

might be intermediate holding companies between the UK parent company and the relevant subsidiary?

Such questions are particularly important in the global economy. Not only are the transfer pricing policies adopted by what are commonly referred to as multinational companies considered by many tax professionals and in-house tax directors to be a significant contributor to overall value retention within the multinational group of companies (Ernst & Young (2012)) but there are many jurisdictions where the tax law, tax administration and enforcement bodies are not as sophisticated and robust as they are in other parts of the developed world which may result in even more opportunities for tax related behaviour the primary purpose or one of the primary purposes of which is the retention of value within the group of companies. In such circumstances, for many tax advisors and in-house tax directors the assumed obligation to retain value is important and tax related behaviour that has as its aim the retention of value in respect of overseas companies and operations is adopted.

Further discussion of these matters is beyond the scope of this thesis.

Part B consists of four chapters. A summary of the contents of each chapter is as follows:

Chapter 3 addresses the lack of clarity and lack of agreement that exists in respect of the meaning of many of the terms that are used to identify various types of tax related behaviour and how the terms that are used and commonly identified, are applied to different types of arrangements and are discussed by commentators[48]. Also in this chapter a number of the consequences of such a lack of clarity and agreement and the importance of

[48] The term "commentator" is used in this thesis as a short form reference to any individual, body or group (such as tax payers, tax advisors, firms, companies, academics (from any discipline), governments, NGOs, journalists etc) who write about or discuss in any manner any aspect of tax related behaviour.

seeking more clarity and agreement in respect of such matters are highlighted.

In Chapter 4 the consequences of a lack of a clear understanding of these matters are outlined.

Chapter 5 provides the first part of what will be an analytic and conceptual framework which seeks to clarify the relationship between a tax code, (in this case the tax code of the UK) and the arrangements, events, circumstances and situations that can arise and/or occur and/or obtain in the world. The reasons why such an analytic and conceptual framework is required when addressing the subject matter of this thesis is explained in this chapter.

In Chapters 6 and 7 the development of the analytic and conceptual framework continues.

Chapter 8 provides an analysis of tax related behaviour based on the discussion that has taken place in Chapters, 5, 6 and 7.

PART B

Chapter Three: Tax related behaviour: sub categories and understanding

3.1: Introduction

In this chapter various terms are considered. Such consideration helps to explain the concept of tax related behaviour.

Many different terms are used and sometimes even misused when describing, considering, identifying and seeking to understand tax related behaviour and the nature of taxation: "profit", "gain", " liability", "obligation", "avoidance", "planning"," mitigation", "compliance", "relief", "evasion" ... the list goes on. Many of these terms can have the word "tax" added as a prefix; "tax avoidance", "tax evasion", "tax relief" etc.

The number of such terms used to refer to different types of tax related behaviour continues to proliferate. In a recent edition of a UK professional tax magazine in the UK a collection of terms was offered which was used to identify various types of categories of tax related behaviour (Barnett (2012))[49].

When seeking to analyse and understand the various sub categories or types of behaviour that fall under the general term of "tax related behaviour" an understanding of:

> (i) the meaning and in particular the denotation[50] of many of these different terms;

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[49] The terms included the expected terms such as "tax planning", "tax mitigation", "tax avoidance" and "tax evasion" but also included a number of created hybrid terms such as "tax evoidance", "tax avoision" and "tax petardance" each of which was given a specific meaning.

[50] In this thesis the term "denotation" is used to refer to a class of things, arrangements, events, occurrences and/or state of affairs which provide the meaning of a particular term. For example the denotation of the term "taxation" will include all those matters that are generally accepted as being a form of taxation. It is acknowledged that there may be some matters in respect of which it is not certain whether such a matter falls within the denotation of the term "taxation". For example, it is possible to ask whether a high level of profit in a state owned enterprise is a form of taxation. Does such an arrangement fall within the denotation of the term "taxation"? There is not one clear and certain answer. Such "hard

(ii) the relationships that might exist between some of them; and,

(ii) the nature and relevance of a description of the various arrangements, events and types of state of affairs that can exist and the actual or possible existence of which is necessary in order to obtain such an understanding,

will have an important bearing on how certain types of tax related behaviour that are of interest to individuals, companies and other entities are classified and assessed[51] by them and by others.

As a result of obtaining such an understanding of these and related terms it should also be possible to identify the qualities, characteristics and attributes that are typically associated with the different types or categories of tax related behaviour and the consequences of such behaviour that are identified as being of ***interest***[52] (for whatever reason), to individuals, companies and other entities in the area of taxation.

It should also be possible to identify qualities, characteristics and attributes that are believed to be possessed by or associated with the different types of tax related behaviour and the consequences of such behaviour that are ***actually selected and undertaken*** by individuals, companies and other entities in the area of taxation as opposed to those that are simply of interest.

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cases" do not however materially dilute an understanding of the denotation of the term "taxation" which will include value added tax and income tax, for example, within the denotation. Denotation is to be distinguished from the connotation of a term. In very crude terms, connotation seeks to identify the aspects of the meaning of a term that are more dependent on a particular societal use of that term, denotation seeks to identify the unadorned facts (it is accepted that all language is by definition constructed by and within a group of language users). The term "red rose" denotes a rose that is red but within parts of the UK, particularly on February 14th, a red rose connotes love.

[51] In this context the term "assessed" is not used in any particular technical sense. An assessment by an individual, company or other entity can be made based on principles or measures of value derived from many areas, such as ethics, self interest, utility, economic efficiency etc.

[52] Different types of tax related behaviour may be of interest to a particular person for many reasons. It is suggested that a major reason for an interest in a particular type of tax related behaviour will be the benefits that are expected to follow from engaging in such behaviour.

Not all types of tax related behaviour that are of interest to an individual, company or other entity will be selected and undertaken.

However, notwithstanding the importance of the role these various terms play when considering the nature of tax related behaviour and taxation, there is no readily identified agreement as to (i) the meaning and in particular the denotation of many of such terms or (ii) even as to the relationships that might exist, whether the relationship is one of necessity[53] or one that simply exists in practice, between some of these terms.

A number of these terms are used in different ways by different individuals, companies or other entities[54] and as a result a particular term might mean something different depending upon the context in which the use occurs[55]. As a consequence many of these terms will often appear to have different meanings and denotations when used by many of the academics, commentators and other entities that have an interest in the various matter and issues that fall under the general heading of taxation and tax related behaviour (Barnett (2012), Barker (2009), Weisbach (2002), Prebble et al. (2010), Christian Aid (2008))[56]. It is often the case that these different meanings and uses are not consistent even when used by academics and other commentators working within the same area of study (Barker (2009), Brooks et al. (1997), McClaren (2008), Sikka (2010b)).

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[53] Reference is made to a relationship of necessity that might exist between certain of these terms. This use of the word "necessity" simply a means of recognising that the meaning of some of the terms are inextricably linked one with another whereas others of the terms have no such link. In respect of the terms referred to there is probably some form of necessary relationship between certain of the terms, for example, "liability", "obligation" and "compliance", whereas in respect of some others of the terms the relationship is less one of necessity and more a relationship that exists in practice, for example between the terms "avoidance", "mitigation" and "planning".

[54] There is a significant difference in the manner in which HMRC (Timms (2009), Gauke (2012) would use the term "tax avoidance" and many Supreme Court judges would use that term (Hoffman (2005), Walker (2004).

[55] The volume of academic and non academic writing in matters relating to taxation and the wide use made of many of these terms is considerable. Rather than undertake a traditional comprehensive literature review in this thesis, reference will instead be made and criticism offered, as considered necessary, to specific examples within the literature.

[56] The references cited are representative examples of the wide range of meaning, use and application that some of these important and commonly used terms can have.

Of particular interest when considering the subject matter of this thesis, is the meaning of a commonly used term "tax avoidance", the relationship of this term to the meaning of such other terms as "tax compliance", "tax obligation" and "tax evasion" and the types of behaviour and arrangements to which such terms apply[57]. The term "tax avoidance" is used to refer to a type of tax related behaviour and its meaning continues to be discussed in a number of different fields of enquiry with such discussion continuing to generate a considerable amount of debate, controversy and uncertainty[58].

3.2: "Tax avoidance" and related terms

In the UK (and elsewhere), for many commentators an interest in the:

- nature of tax related behaviour;
- distinction between what is referred to as tax avoidance and tax evasion;
- relationship of both concepts to tax compliance;
- crystallisation of tax liabilities and, additionally, an interest in the relationship between taxation in general and the tax related behaviour of potential tax payers has increased in more recent times. This in part is as a result of what can be considered to be a change in the understanding of the relationship between on the one hand tax payers and potential tax payers and on the other hand what can be broadly termed society[59].

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[57] See Barnett (2012) for a partly tongue in cheek analysis and Avi-Yonah et al (2011) for a traditional approach.

[58] This thesis is written from a UK perspective and considers various aspects of law and practice in the UK. The approach taken by other countries to such a term as "tax avoidance" might be very different from the approach taken in the UK. For example, in New Zealand, the term "tax avoidance" would not be used to refer to tax related behaviour which any potential tax payer would consider undertaking. This is because in New Zealand, "tax avoidance" refers to a category of tax related behaviour which is unacceptable and ineffective (Hasseldine et al. (2013)).

[59] This change in understanding is exemplified by various announcements made by HMRC and UK Government representatives. From the example of Dave Hartnett who when a senior official within HMRC was reported as arguing for the importance of the moral dimension of taxation and tax obligations (Taxation (2003)) to, more recently, the UK Government Minister,

The announcement or expression of what the "views" of society are is undertaken, whether any claim to formal status of such announcements or expressions is made or not made, by a number of different bodies or groups. For example, each of the UK Government, HMRC, certain sections of the media and a number of NGOs and other organisations claim, in some manner and on some occasions to announce and/or express the "views" of society[60].

This increase in such an interest in tax related behaviour, the consequences of tax related behaviour and the topic of taxation in general has been prompted in particular by two sets of circumstances coming into existence.

The first set of circumstances flows from the impact of the banking crisis of 2008 on the world economy and on the economy of individual countries. The gross domestic product of many countries suffered a decrease in the aftermath of the recession[61]. This has resulted in the total amount of tax revenue actually collected by many nations suffering, with far less tax revenue being collected[62]. Consequently more attention has been directed and continues to be directed, by politicians, tax administrators and other interested parties, to the meaning and application of such terms as "tax avoidance", "tax evasion", "tax liabilities" and "tax compliance" and also to the effective collection of tax (see for example Economist (2009), Guardian (2009c), Reuters (2009) and HMRC (2012b)).

David Gauke, emphasising an obligation for each potential tax payer to pay a "fair share" of taxation Gauke (2012)).

[60] In this context the term "society" is being used in a loose figurative manner and is not being used in a formal sociological or political manner. In this part of the thesis, "society" refers to little more than the interests and aims of those groupings of individuals, companies and/or other entities within a community that have expressed in some manner an interest in the total amount of tax revenue that is being collected and used for the policy and spending purposes adopted and/or accepted by the current government of the relevant country. Some of these interested parties will wish to encourage the raising of tax revenue and possible even to encourage higher levels of taxation to be imposed (see for example TUC (2011). Other parties would wish to see the taxation burden and hence the amount of tax collected be reduced, for example the Taxpayers Alliance (Tax Commission (2011)).

[61] For example in 2009 the output of the UK economy was 4.9% lower than the output in 2008 (Blue Book (2010)).

[62] See Table 11.1 page 254 of the Blue Book (2010) for an indication of the reduction in tax revenue in the UK.

The second set of circumstances which has had a role to play in prompting an increased interest in these various matters follows from the disclosure of a number of significant and widely reported commercial scandals such as those associated with Enron and Worldcom (see Sikka (2010b) for a general discussion of such matters) and, related to these scandals, more attention has been paid by the media[63] to the existence of the "abusive tax shelter" industry which is often associated with firms of tax advisors (Sikka et al. (2010a) Sikka (2010b)). In part, as a result of the focus of various parts of the media on such matters as the Enron and Worldcom scandals in more developed economies[64] a connection now exists in the mind of the general public between aspects of tax related behaviour and various forms of business activity which probably did not exist as recently as fifteen years ago[65].

In part, prompted by these two sets of circumstances and supported and encouraged by a number of national tax authorities (Gauke (2012), Timms (2009), HMRC (2011), McClaren (2008) and Hagger (2012)) and international organisations such as the OECD (OECD (2008), OECD (2009) and OECD (2011)), there has arisen and there continues to develop an approach to identifying certain types of behaviour, attitudes and state of affairs to which many parties (including tax administrations (see previous references in this paragraph)), consider the term "tax avoidance" is applicable.

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[63] In February 2009 the UK Guardian newspaper published a series of essays and articles which were intended to bring to the attention of the public various aspects of taxation including tax avoidance practices, the use of tax havens and transfer pricing activities. Access available at http://www.guardian.co.uk/business/series/tax-gap (last accessed 12 September 2012).

[64] See footnote 220.

[65] Evidence of this awareness is readily available. For example in February 2012, it was disclosed that Barclays Bank had entered into a form of tax related behaviour which was intended to produce a tax benefit in the UK. As a consequence retrospective legislation was introduced in the UK in order to prevent any tax benefits accruing to Barclays (Guardian (2012b)). That such a story was of interest to the public is in part due to the raised awareness of relationship between tax related behaviour and business activity. In addition the protests and activities of a group such as UK Uncut (see http://www.ukuncut.org.uk/ (last accessed 27 May 2013) also indicate a greater awareness within society and, in addition, given the reporting of the activities of UK Uncut that have taken place, a greater awareness within the media of issues associated with tax related behaviour even if the awareness is often misguided.

This use of the term "tax avoidance" by such parties is not being used in a manner that could be considered to be neutral or impartial. Rather "tax avoidance" is being used to label a type or category of tax related behaviour that is not condoned and many tax authorities would like to see discouraged (Hagger (2012) and Gauke (2012)). In turn, this development has changed the way in which certain non tax administrator commentators use the term "tax avoidance" and not surprisingly the types of categories of tax related behaviour to which the term is applied by such commentators (see for example Palan et al. (2009)).

This development is not limited to how certain types of tax related behaviour are labelled. The development understandably impacts on the approach taken to the administration and collection of taxation. Indeed it is now reasonable to believe that in the UK and certain other countries the approach taken to the collection of taxation by tax administrations may even, on occasion, result in a tax administration intentionally seeking the payment of taxation in situations that go beyond those circumstances in which the obligation to pay taxation arises as a consequence of the application of existing tax law to the arrangement and resulting states of affairs that actually obtain (Timms 2009, McClaren (2008), Hagger (2012) and Goldberg (2008))[66].

For example, engaging in tax related behaviour which is simply labelled "tax avoidance" (whether such a label is appropriate or not), has become a reason for reproach in many quarters, not only sections of the media (Guardian (2008)) but also within certain NGOs (Oxfam (2011) and Christian Aid (2008)) and trade unions (TUC (2008)). Senior members of the UK Government in

[66] It is interesting to note the description provided in Goldberg (2008) of the UK tax official who was demanding the payment of taxation in circumstances where in fact there was no liability to taxation. The official was subsequently prosecuted for keeping part of the additional "tax" collected. The exercise of power by tax administration officials is a matter that can have a significant impact on the members of society.

2012 have made very public statements which describe tax avoidance as unacceptable (Guardian (2012a) and Osborne (2012))[67].

These various attempts to provide a meaning and denotation for the term "tax avoidance" (and possibly to change the meaning and denotation of such term), not only have the consequences noted above but will also have an effect on any understanding that can be developed of the nature of tax related behaviour and its various component categories or types. This activity will also impact on how various types of tax related behaviour are assessed by the media, public, tax advisors and tax administrators[68]

It is noted however that even before the credit crisis of 2008 and the commonly referred to accounting scandals referred to previously, the terms "tax avoidance", "tax compliance", "tax obligation" and "tax evasion", the meaning or denotation of these terms and how these terms were applied and used in practice were being considered and discussed by a number of academics and other commentators who were and continue to be active in various different areas of research and investigation. Discussions on these matters have also extended beyond the academic community and the discussions have a practical effect on the actions and behaviour of potential tax payers[69], nongovernmental organisations ("NGOs"), trade unions and, of course, politicians and governments.

For example, as has been noted, debate continues in the area of tax avoidance and CSR (Avi Yonah (2008), Preuss (2010), Freedman (2003), Christian Aid (2005), Sikka (2010b), Hasseldine et al. (2013)), work has been carried out on the relationship between tax avoidance and executive behaviour (Desai et al. (2006a) and Desai et al. (2009)) and the very nature of

[67] There has been speculation that the UK Prime Minister, David Cameron, condemned the tax related behaviour of Jimmy Carr but not that of Gary Barlow (of the music group Take That) because Jimmy Carr does not support Cameron whereas Barlow does (Mail Online (2012)).

[68] It is of interest to note that many judges are not swayed by such attempts to change or even modify the meaning of certain terms. See quotation from Lord Justice Mummery's judgement in Section 5.1.

[69] See Freedman et al. (2009) for an investigation into behaviour and corporate tax payers.

tax law is being considered, in particular how effective tax law can be and should be in achieving the assumed aims of a government and to what extent a tax code should be simplified (see for example Cooper et al. (2009), Prebble (1998) and Osborne (2011).

As has been noted, the existing literature on such matters as tax avoidance, tax evasion and related topics is considerable. The literature arises from research undertaken in many areas of the academy including, economics, law, politics, psychology, sociology and accounting (see Hanlon et al. (2010), Oats (2012) and Lamb et al. (2004)). However, given the length of time over which these debates and discussions have continued and the relevance of the subject matter of these debates to the relationship between taxpayers, potential tax payers, governments and society in general and notwithstanding the particular relevance of these discussions to the economic conditions that have existed since the start of the banking crisis it is of concern that there is still no settled agreement as to the meaning and denotation of many of these terms (for example see Schler (2002), Freedman (2008)) This lack of agreement is of particular concern in the context of the research question of this thesis as without a measure of clarity and understanding as to what can be referred to as that taxonomy of tax related behaviour which in turn would provide a coherent and consistent understanding of the meaning of the term "tax avoidance" and related terms it is almost impossible to conduct research into the relationship between tax related behaviour and CSR which is addressed in this thesis.

Further, when seeking to understand the meaning and denotation of the term "tax avoidance" and the types of behaviour and states of affairs to which the term (and related terms) applies it may not be helpful that different academic disciplines and indeed the discussions that take place on these topics within different jurisdictions, approach these matters in different ways. These different approaches lead to confusion and lack of clarity whenever topics and issues that are linked in some manner with the subject of tax related

behaviour and associated matters are addressed by academics from different fields, commentators, governments, decision makers and other interested parties.

3.3: Tax related behaviour as essentially contested?

Even though in an ideal world there may be a need for greater clarity and for some measure of common understanding on these matters (not just for the purposes of this thesis), it has to be acknowledged that the specific interests and concerns of various parties[70] may be different one from the other. As a consequence, when each party considers the relationship between such matters as (a) commercial activity[71], (b) economic efficiency, (c) the meaning, operation and application of tax law and tax regulations, (d) the circumstances in which an obligation to pay taxation crystallises and (e) the payment of tax and (f) other relevant obligations to which potential tax payers are subject, then, simply on account of the differences in understanding, beliefs and attitude to such topics as:

- business activities;
- the operation and application of law (particularly tax law);
- the use by a government of the tax revenue collected;
- the nature of society; and,
- the importance of economic models;

that exist between the various parties, a profound measure of disagreement between these various parties as to the meaning and application of these terms and the relationship between these terms will also always be present.

[70] For the purposes of this thesis the following (and others) may be considered to be different parties: (i) tax payers and advisors, (ii) tax authorities, (iii) courts, (iv) NGOs, (v) the media and (vi) in some manner which is not considered in any detail, society at large.

[71] For the purpose of this thesis, the term "commercial activity" will include all activity associated with an entitlement to the receipt of income whether arising as a result of employment, business activity or investment and the term will also include accruals on capital assets.

What might be considered such fundamental differences would suggest that no taxonomy of tax related behaviour would be acceptable to each of the various interested parties.

Notwithstanding this possibility, it would be very useful however, if a set of qualities, characteristics and attributes was identified which could then be used to classify and thereby distinguish different types of tax related behaviour, the consequences of such behaviour and appropriate responses to such behaviour. As a result of identifying such a set of qualities, characteristics and attributes a common understanding (or even common disagreement)[72] could develop and discussions continue to take place on the topics relating to taxation which are not only of importance to many of the different interested parties but also of importance to society in general.

3.4: A starting point for a taxonomy: legality versus illegality?

Given that an important characteristic of tax related behaviour is that such behaviour is primarily a response to the existence of a tax code, it is almost certainly necessary to acknowledge that any attempt to categorise and describe different types of tax related behaviour will be based on an understanding of the relevant tax code (Hasseldine et al. 2013). To state the obvious, if there was no tax code operating in a country then tax avoidance, tax compliance and tax evasion would not exist.

On that basis, a possible and traditional starting point when seeking to identify a set of qualities, characteristics and attributes that could be used to provide a taxonomy of tax related behaviour would be to adopt a position which until recently had been commonly accepted by many commentators. Namely, that when considering tax related behaviour there is at least a more

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[72] If a set of qualities, characteristics and attributes is identified then it is suggested, such a set will bring a measure of clarity to any discussion on the topic of tax related behaviour even if the response to the offered set of qualities, characteristics and attributes identified is one of disagreement. It is suggested that this approach is consistent with the scientific method suggested by Popper (see for example Popper(1997)).

or less a clear distinction, based on an understanding of what a tax code is, between tax avoidance and tax evasion.

Even at the level of social understanding this distinction would appear to exist, for example, Kirchler et al. (2003) found that *"...everyday representations differ as respect to tax avoidance [and] tax evasion ... [t]ax evasion was perceived rather negatively ... and tax avoidance positively."* [73]

In the area of law, traditionally the distinction has been articulated in a simple manner, by acknowledging that there is a sense in which, tax avoidance is "legal" and tax evasion is "illegal" (see for example the Oxford Report, page 4). The underlying assumption being that provided an action or arrangement is not illegal, that is, the action is lawful, then it is a matter of choice for the agent as to whether or not the lawful action is undertaken and if the action is undertaken then the agent is simply exercising a right or freedom[74] to arrange his or her affairs as is considered appropriate by that agent.

There are many well known and often quoted judgements of the courts that express the view that provided the actions undertaken by a tax payer are legal then the actions selected can be tax effective.

Two of the most well known being:

> *"Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."* [75]
>
> *"No man in this country is under the smallest obligation, moral or other, so as to arrange his legal relations to his business or to his*

[73] See also Ohlsson (2007).
[74] See Chapter 9 for a discussion on an analysis of the nature of legal rights.
[75] Lord Tomlin, see IRC v Duke of Westminster [1936] A.C. 1; [1919] TC 490, 520.

property so as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow – and quite rightly so – to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can the depletion of his means by the Revenue."[76]

The court judgements that identify the importance of the description "legal" when applied to actions that fall within the meaning of the term "tax related behaviour" are not only decisions of the UK courts.

"[A] transaction, otherwise than within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."[77]

The view expressed above from the judgement in Gregory v Helvering possibly suggests a shared understanding in the UK and the USA that existed as long ago as the 1930s of the importance of the distinction between legal and illegal actions when considering various aspects of tax related behaviour. It is interesting to note that Gregory v Helvering was not cited in the Duke of Westminster case[78] (Walker 2004).

It has been suggested that these judgements are of their time and matters have not changed (for example see Walker (2004), Hoffman (2005) Lord Tomlinson in Ensign Tankers (Leasing Ltd) v Stokes [1992] STC 226). These commentators each suggest that such judgements of the courts and the views expressed in those judgements are in some manner no longer appropriate or

[76] Lord Clyde, see Ayrshire Pullman Motor Services v IRC (1981) 54 TC 200.
[77] Gregory v Helvering (1932) 27 BTA 223 (USBTA), (1934) 69 F 2d 809 (2nd Cir.), affirmed (1935) 293 US 465 (USSC). See Likhovski (2003) for a discussion of this case.

[78] IRC v Duke of Westminster [1936] AC1 (HL)

relevant in the twenty first century when identifying qualities, characteristics or attributes that can be used to distinguish between the different categories of tax related behaviour that might exist.

However, notwithstanding such criticism over the last fifty years or so the acceptance that tax avoidance is legal and that the legality of tax avoidance is an important characteristic, attribute or quality of tax avoidance has been confirmed many times. For example, the 1955 Radcliffe Commission (as quoted by Toumi (2008), in the UK which indicated that tax avoidance was an

> *"act by which a person so arranges his affairs that is liable to pay less tax than he would have paid but for the arrangement, This the situation which he brings about is one in which he is* ***legally*** *in the right ...."* (emphasis added)

Some years later the 1966 Carter Commission (as quoted by Toumi (2008), a Canadian commission, identified "tax avoidance" as every

> *"attempt by* ***legal*** *means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provision or lack of provision in the law ... it presupposes the existence of alternatives, one of which would result in less tax that the other."* (emphasis added)

More recently Freedman (2004) captures the legality of tax avoidance as follows:

> *"tax avoidance is used in its widest sense, comprising all arrangements to reduce, eliminate or defer tax liability that are not* ***illegal.***"
> (emphasis added)

Perhaps unfortunately, it is clear from even a brief foray into the literature that addresses the topic of tax related behaviour that not all of the interested parties wholeheartedly subscribe to the overriding importance of a distinction between the meaning of tax avoidance and tax evasion.

There exists no agreed position that accepts that tax related behaviour which consists of the undertaking of arrangements and the bringing about of a state of affairs that are legal in all respects should be categorised as tax avoidance of some sort. There exists no consensus that, as a consequence of being legal, such acts etc and such types of behaviour are in some manner acceptable.

If the distinction between legal and illegal was the only distinction that was relevant to understanding and categorising tax related behaviour[79] then an approach to distinguishing the different categories or types of tax related behaviour based on such a distinction would make a response to the issues raised by the research question far easier to identify.

It is not only that the events, arrangements and activities which the term "tax avoidance" is used to denote are identified and/or referred to in different ways within different areas of study (such as economics, law and sociology). In addition, a number of interested groups appear to seek to blur the distinction between tax avoidance and tax evasion without explaining or appearing to understand the significance that is claimed for the distinction (Sikka et al. (2010a), Sikka (2010b), Otusanya (2011), Palen et al. (2009)).

This apparent blurring or dilution of the importance of the distinction between on the one hand legal actions and/or arrangements and on the other hand illegal ones does take many forms. The distinction between legal and illegal actions and/or arrangements can be more of less totally ignored (Brooks et al. (1997), Weisbach (2002) or even if accepted in some manner, the illegal/legal distinction is no longer taken to be a distinction that completely correlates with the distinction between tax evasion and tax avoidance (Sikka (2010b) and (Barker (2009)).

There could be many reasons for such a response and it is difficult to discern the primary reasons motivating these interested groups based solely on what is written (for example see Sikka (2010b) and the subsequent criticism of

[79] See the discussion in chapter 8 on tax avoidance behaviour.

Professor Sikka's position in Hasseldine et al. 2013). One common reason is almost certainly a lack of knowledge and understanding of how the tax code of a country is to be applied to actions and arrangements that obtain, or if not a lack of knowledge and understanding, then possibly a wilful disregard of how a tax code works and is applied in practice (see Sikka 2010b, footnote 1 of that paper, for an example of this approach).

Other reasons will include (i) a commitment to certain principles of economic theory (see Leijonhufvud, (1973) for an amusing take on economists) which entail little in the way of any requirement to consider the practical application of the tax code to any particular situation or even (ii) a fundamental disagreement with the principles on which society in developed countries in the twenty first century is based (Sikka 2010b).

3.5: Different approaches to the meaning of tax avoidance

In a recent paper Professor Freedman (Freedman 2008) has even suggested that any legal definition of "tax avoidance" depends upon the *"philosophical starting point"* of the person seeking the definition and *"...[h]elpful legal definitions are possible only where there is a clear underlying concept..."*, the suggestion being that in the case of tax avoidance there is no such underlying concept.

To add to the confusion, fundamental underlying differences of both academic approach and philosophical starting points have not prevented many different descriptions and explanations of tax avoidance being offered.

Difficulties of definition have not prevented attempts to assist in solving the definitional concerns that exist, see Deak (2004), Canellos (2001), Cooper (1994), Dyreng et al. (2008), Arnold (2008), Gammie (2008), Andreoni et al (2008) and Evans (2008).

Desai et al. (2006a) speaks of tax avoidance in terms of *"... the component of the book-tax gap not attributable to accounting accruals ...."*. Desai is here

using, and indeed defining, the concept of tax avoidance in a manner that makes no reference to tax law and no reference to the crystallisation of a liability to pay tax. He does not distinguish between tax avoidance behaviour (whether successful or not in seeking to crystallise a liability to make a payment of taxation that is less than would otherwise be the case) and behaviour which might be categorised by many as tax evasion.

On the other hand Professor Barker in Barker 2009 suggests that *"... tax avoidance deals with incongruence between the intent or object of the statute in taxing a particular situation the way it does .... and the tax outcome advanced by the taxpayer."*. He closely identifies "tax avoidance" with unsuccessful tax planning, (or what should be unsuccessful tax planning), where unsuccessful tax planning refers to those arrangements where the actual liability to taxation that crystallises is greater than the liability to tax that was expected to crystallise or even greater than the liability to tax which the taxpayer believes has crystallised. Unlike Desai, Barker locates his understanding of tax avoidance within the context of a system of tax law and then offers his definition. However Professor Baker does not provide any particularly useful explanation of what the "intent or object of the statute" might be.

Yet another position as to the nature of tax avoidance is taken by Professor Weisbach. In Weisbach (2002), Weisbach refers to *"corporate tax avoidance or tax shelters"* in the same breath and also suggests that *"There is also nothing sacred about a division of the world between evasion and avoidance."* It would appear that for Weisbach any tax related behaviour, whether characterised in a traditional manner as tax avoidance or tax evasion is simply a failure to pay the amount of tax that an economic model expected to be paid.[80]

These references are to but a few of the numerous academic papers and other writings which discuss the nature and consequences of tax related

[80] See Section 4.2 below.

behaviour, in particular the various categories of tax related behaviour referred to as tax avoidance, tax compliance and tax evasion. The approach taken by those who lean to a more economic analysis (for example Desai et al. (2006a), Desai et al. (2009), Frank et al. (2009) and Weisbach (2002)) differ from those from a more legal background (Barker 2009, McClaren 2008) and yet again from those researchers who are more embedded in sociological orientated research (McBarnet (2003), McBarnet (2009)).

3.6: Distinguishing between types or categories of tax avoidance

In addition to the different approaches taken by academics when seeking to identify the qualities, characteristics and attributes of the type of behaviour that is reasonable to classify as tax avoidance, discussion in this area is further muddled because many academics, tax authorities and a number of commentators when discussing and using the term "tax avoidance" qualify this term. For example, such adjectives as "unacceptable", "artificial", "aggressive", "immoral" or "abusive" are used to qualify the more general term "tax avoidance" and related terms such as "tax minimisation" (see for example Christian Aid (2005), HMRC (2009a), OECD (2008), Gauke (2012) without identifying in a lucid manner the characteristics that justify the use of such adjectives. It is not altogether clear why such qualifications occur, perhaps it is an attempt to achieve greater clarity or perhaps to be even more dogmatic about the position they favour[81].

In a recent UK Court of Appeal judgement[82] Lord Justice Mummery took issue with such an approach. He makes clear that the use of terms such as "unacceptable", "aggressive" or "abusive" add nothing to understanding the

[81] It is difficult to generalise on this matter. Tax advisors in the UK (such as solicitors, barristers and accountants) tend to use such adjectives more sparingly, a notable exception being the GAAR Report 2012 which refers to "egregious tax avoidance schemes" (Aaronson (2011). On the other hand, the UK Government (including HMRC), unions, NGOs and large parts of the media tend to use such adjectives more freely.

[82] Commissioners for HMRC v David Mayes [2011] EWCA Civ 407

relationship between the relevant part of a tax code and the events and/or arrangements being considered[83].

It is interesting to note that Graham Aaronson Q.C. referred to a certain type of tax related behaviour as being "egregious" in nature[84]. It is possible that he recognised that using adjectives such as "unacceptable", "aggressive" or "abusive" contribute little of interest to a discussion on the subject of tax related behaviour (he refers to the Ships 2 case[85] in his report) but he needed to find a adjective that could be used to distinguish between types or categories of tax avoidance and decided that egregious was appropriate.

3.7: The OECD and tax related behaviour

The difficulties that exist in this area of capturing an understanding and meaning of the various terms, types of behaviour and arrangements that fall under the general heading of tax avoidance behaviour can be illustrated in a practical manner by work recently carried out by the OECD.

In September 2006 an OECD conference was held in Seoul (the third meeting of the OECD forum on Tax Administration: 14-15 September 2006). The final statement from the conference included the following:

> *"Our discussions revealed continued concerns about ..... the role of tax advisors and financial and other institutions in relation to non-compliance and the promotion of unacceptable tax minimization arrangements"* (OECD (2006)).

It is interesting to note that in this context, the OECD did not refer to "tax avoidance" but to a related phrase "tax minimization"[86]. The concern of the

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[83] See Section 5.1 for an extract from his judgement.

[84] He referred to "tax avoidance scheme known as Ships 2 as being "egregious".

[85] Commissioners for HMRC v David Mayes [2011] EWCA Civ 407

[86] It is assumed in this thesis that the concept of "tax minimization" refers to a person entering into an arrangement as a consequence of which any net tax liability that crystallises for that person (if any net tax liability does so crystallise) is less than it would have been had the person entered into some other form of possible arrangement. To that extent "tax minimization" is a form of tax related behaviour and is closely related in some manner to the concept of "tax planning" which in turn is related to the concept of "tax avoidance". For these purposes "tax planning" refers to selecting a particular course of action when at least

OECD, as prompted by a number of its constituent members, is that a considerable part of the activity which falls within the area of tax related behaviour is encouraged (and possibly even devised) by tax advisors and financial and other institutions (OECD (2008)). The underlying assumption of the OECD appears to be that if the reasons, descriptions and understanding, relied upon by tax payers and potential tax payers (and tax advisors) when engaging in such tax related behaviour were less firmly grounded[87] or even nonexistent there would be less "unacceptable" tax related behaviour (OECD (2008)). In particular there would be less tax planning/tax minimisation/tax avoidance behaviour and, it is assumed, more taxation would be collected by the relevant government agency. A position that would be welcomed by governments.

Following the conference, a study team was established to improve the understanding of the role of tax intermediaries in the area of *"unacceptable tax minimisation arrangements".*

The final report (OECD (2008)) was published in 2008 and contained a glossary of definitions which included an admission:

"The Study Team concluded variations between the legal frameworks of FTA *[Forum of Tax Administrators* (emphasis added)*]* countries mean it is not appropriate or feasible to attempt to reach a definition of "unacceptable tax minimisation arrangements" as used in the Seoul Declaration. ...." (OECD 2008)

This difficulty was admitted in the published report even though the final statement of the Seoul conference, approved by the senior officials attending

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one other course of action was possible, with the selection being made on the basis of an expectation of the tax consequences of each course of action.

[87] In this context "firmly grounded" refers to a requirement to ensure that there is as much understanding of what the relevant part of the tax code is, the arrangements and resulting states of affairs to which such part of the tax code applies and the nature of the particular arrangement and resulting state of affairs that is being considered as is possible. If such an understanding exists the purported spurious reasons (Gauke 2012) for engaging in tax related behaviour would be less relevant and more open to informed criticism and lack of acceptance by potential tax payers.

the conference, had referred to "unacceptable tax minimisation arrangements". Notwithstanding that the inappropriateness of and lack of feasibility in defining "unacceptable tax minimisation arrangements" was acknowledged, the published report did contain a definition: a definition of "aggressive tax planning" (OECD 2008), yet another concept that is a member of the family of concepts falling under the general heading of tax related behaviour.

The definition provided by the OECD has two parts:

> ***"Planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences.*** *Revenue bodies' concerns relate to the risk that tax legislation can be misused to achieve results which were not foreseen by the legislators.*
>
> *This is exacerbated by the often lengthy period between the time schemes are created and sold and the time revenue bodies discover them and remedial legislation is enacted.*
>
> ***Taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law.*** *Revenue bodies' concerns relate to the risk that taxpayers will not disclose their view on the uncertainty or risk taken in relation to grey areas of law (sometimes, revenue bodies would not even agree that the law is in doubt).*
>
> *In this report, these two areas of concern are referred to as 'aggressive tax planning'."* (OECD (2008) (emphasis in original)

The first part of the OECD definition of "aggressive tax planning" refers to behaviour which entails planning involving a tax position that is tenable[88] but

[88] The use of the word "tenable" does raise a number of issues when this OECD definition of aggressive tax planning is considered in any detail. The Oxford English Dictionary (on line

has unintended and unexpected tax revenue consequences. It is reasonable to assume that the organisation or body to whom the tax consequences are "unintended" or "unexpected" is the relevant national tax authority although this assumption is not made clear.

The second part of the definition involves taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law. (see glossary in OECD (2008)). In contrast to the position advanced by the first part of the definition, it seems abundantly clear that this second part of the definition does identify an important aspect of the relationship between:

- certain types of tax related behaviour;
- an understanding and application of the relevant part of a country's tax code to that behaviour; and,
- the response of a potential tax payer when seeking to comply with any obligations that arise on the crystallisation of any liability to taxation.

This brief summary of the various different approaches that have been and are being taken to how the various types of tax related behaviour are identified and categorised, suggests that debate on these topics continues to exist without a clear common understanding of the subject matter. A number of the consequences of this lack of understanding are the subject of the next part of this thesis.

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edition) makes clear the relationship between "tenable" and the ability to hold a position. For example in respect of " ... statements, opinions, etc.: Capable of being maintained or defended against attack or objection". This would suggest that a potential tax payer who has chosen to enter into an arrangement and bring about a state of affairs, if the position of the potential tax payer is tenable, then the tax consequences of the choice are capable of being maintained or defended. The potential tax payer has one or more good and justifiable reasons for making such choice. Yet the OECD identifies this type of behaviour as something not to be encouraged.

PART B:

Chapter Four: Consequences of no clear understanding

Chapter Three argued that there is a considerable amount of uncertainty as the meaning and application of a number of commonly used terms, this chapter considers the consequences of such uncertainty.

The wide differences in understanding that were identified in a summary manner in Chapter 3 of this Part B of the meaning and application of the terms "tax avoidance", "tax minimisation" and similar terms taken together with the difficulties that arise when seeking to understand the meaning of related terms such as "tax evasion", "tax compliance" and "tax liability", demonstrate that when different types of tax related behaviour are discussed or commentated upon within the academic literature as well as in articles, announcements and reports produced by tax authorities, international bodies, court decisions, NGOs and other commentators there is almost certainly no agreed focus to such discussion and comments. There is a wide range of uses and meanings of a number of terms which fall under the general heading of tax related behaviour.

This lack of clarity and agreement is of concern given the subject matter of this thesis. The first research question is directed at establishing a taxonomy of tax related behaviour. The second research question is seeking to identify rights, obligations and/or responsibilities which have a bearing on a decision to undertake certain types of tax related behaviour. In order to answer these research questions it is necessary to seek clarity in respect of the characteristics, qualities and attributes of certain types of tax related behaviour.

Apart from a desire to answer the research question do such differences in the understanding and use of the term "tax avoidance" and other associated terms really matter? If there exists various different understandings of what arrangements and actions fall to be described as instances of tax avoidance,

tax compliance or tax evasion why is this a matter that needs further consideration? After all, it might be the case that the different understandings are directed towards different ends and serve different purposes[89]? Is that not the end of the matter?

Should it be accepted that, rather than seek a set of qualities, characteristics and attributes which can be used to provide a taxonomy of tax related behaviour, the interests of different parties necessitate the acceptance of uncertainty and some degree of confusion in any discussion and debate on the topic of tax related behaviour and CSR?

This section addresses why the taxonomy of tax related behaviour, the meaning of such terms as "tax avoidance", "tax planning", "tax evasion" and related terms and the arrangements and situations to which such terms are applied does perhaps matter and why therefore the meaning and application of such terms requires further consideration.

Recognising and describing the types of behaviour to which the terms "tax avoidance", "tax minimisation" and related terms can be applied and being able to distinguish in some manner the concept of tax avoidance from the concept of tax evasion, the circumstances in which tax liabilities arise and when actions are required in order to satisfy matters of tax compliance is more than just an exercise of academic interest and goes beyond the interest in answering the research questions.

4.1: Consequences for tax payers

Tax payers can go to prison[90] for engaging in tax evasion behaviour. Tax payers can also be subject to investigation by tax authorities and/or incur

[89] This is almost certainly the case in respect of at least part of the research conducted in the area of economics. See Section 4.2 below.

[90] In 1987 Lester Piggott the world famous jockey was jailed for three years for tax evasion. In 1989 Ken Dodd, a British comedian was found not guilty of tax evasion by a jury in a Liverpool court even though suitcases full of cash had been found in his attic.

significant costs[91] in defending the tax consequences of a decision to undertake some forms of behaviour, the selection of which is intended to result in a reduction in what would otherwise have been the amount of the liability to tax that would have been paid if a different arrangement had been adopted.

The reputation of a person can also be damaged by the media or even academic researchers applying what might be a misguided understanding of "tax avoidance" to an arrangement (for example see Guardian (2008) and Guardian (2009b), BBC (2012)[92]) entered into or behaviour selected by that person.

When the meaning of such a term as "tax avoidance" is not clear its use by the media and others can result in responses that are not appropriate.

4.2: Consequences for the academy

Due to the lack of clarity as to the differences between various categories of tax related behaviour debates and conversations can take place within parts of the academy in which the participants may be talking at cross purposes.

As Hanlon et al. (2010) indicates the meaning of the term "tax avoidance" and how it is identified and measured in a corporate context can vary significantly. Hanlon et al. (2010) acknowledges *"... that there is no universally accepted definition of, or constructs for, tax avoidance or tax aggressiveness; the terms mean different things to different people."*

[91] In a case heard by the Supreme Court in the UK concerning the tax residence status of an individual, Mr Gaines-Cooper had been in dispute with HMRC for thirteen years as to whether he was liable to UK taxation, see Gaines-Cooper v The Commissioners for Her Majesty's Revenue and Customs [2011] UKSC 47

[92] BBC news announced that Sir Elton John was suing the Times newspaper for linking his name with a tax avoidance ...*"The allegations are particularly damaging to the claimant's reputation in the sphere of charity fundraising."*

The description of tax avoidance offered in Hanlon et al. (2010), although not directed at a context within which the rights, powers, duties and responsibilities of a limited company are to be considered is as follows:

> *" ....we define tax avoidance very broadly. If tax avoidance represents a continuum of tax planning strategies where something like municipal bond investments are at one end (lower explicit tax, perfectly legal), then terms such as "noncompliance," "evasion," "aggressiveness," and "sheltering" would be closer to the other end of the continuum. A tax planning activity or a tax strategy could be anywhere along the continuum depending upon how aggressive the activity is in reducing taxes. However, much like art, the degree of aggressiveness (beauty) is in the eye of the beholder; different people will often have different opinions about the aggressiveness of a transaction. The individual studies we discuss often use different terms to describe the tax reporting behavior ("aggressiveness," "sheltering," "evasion," "noncompliance," etc.). Clearly, most interest, both for research and for tax policy, is in intentional actions at the aggressive end of the continuum (e.g., evasion)."*

Although the definition is written by American academics, it is worth noting that there is a link made between "aggressiveness" and "evasion" and an acknowledgement that the application of the word "aggressiveness" is very user dependent. This is not a particularly helpful approach if a choice has to be made between two alternatives.

Reference has already been made to Weisbach's understanding of tax avoidance and how there might be little need to distinguish between tax avoidance and tax evasion (Weisbach (2002). In part Weisbach's position reflects the view of many economists; tax avoidance would include all legal activities the consequence of which is a fall in the amount of tax paid. This would include substituting leisure time for work when marginal tax rates increase (see for example Brooks et al. (1997)). It is not difficult to see how

illegal tax evasion behaviour can also be included in the same category of behaviour as tax avoidance as tax evasion also results in a reduction in the amount of tax paid.

In the area of business ethics and CSR which considers tax related behaviour there also exists a lack of agreement and common understanding on the meaning of various terms that fall within tax related behaviour. (see for example Lanis et al. (2012), Sikka (2010b), Watson (2011), KPMG (2007),). This can result in conclusions being reached that are not justified by the reasoning provided (see Sikka (2010b) and the comments in Hasseldine et al. (2013)).

In addition, it is possible to argue that some academic research on corporate tax avoidance is carried out in circumstances which suggest that inappropriate and possibly inadequate proxies might be being used to identify tax avoidance behaviour (Hanlon et al. (2010)).

4.3: Consequences for tax authorities

This very practical nature of the importance of understanding the nature of tax evasion and related concepts can be illustrated by the response of the UK tax authorities to behaviour that has traditionally been considered by many commentators to be "perfectly legal".

As indicated previously, until recently it had generally been accepted that there was a more or less clear distinction between tax avoidance and tax evasion. On this view, tax avoidance is illegal and as a result unacceptable. By definition, if an arrangement, event or state of affairs was not illegal it is legal in the UK, it therefore would fall under the heading of "tax avoidance" which is thereby legal and acceptable. This distinction between what is legal and what is illegal is recognised by many to provide an inadequate taxonomy give the wide range of tax related behaviour that exists (McBarnet (2003), Hanlon et al. (2010)).

However even if the distinction is not overly helpful, it is possible to demonstrate that in more recent times any movement towards a consensus of understanding on the relationship between tax avoidance, tax compliance and tax evasion that probably did exist between the tax authorities and tax payers is being diluted by the behaviour of HMRC and other tax authorities (see for example McClaren 2008), even by the OECD.

Certainly HMRC now appear to take a different view on the relationship between tax avoidance and tax evasion (Hagger (2012), Gauke (2012), Timms (2008)[93]) and the approach taken by HMRC might be seen as encouraging a number of participants both in the tax avoidance and CSR debate, politicians, the government, certain NGOs, UK trade unions elements of the media and other lobbyists to take and defend positions that may be based on inappropriate and uncritically accepted assumptions (HMRC (2009b).

This approach of HMRC can be illustrated by reference to a recently published "charter" which sets out what taxpayers are entitled to receive from HMRC and what HMRC expect to receive from taxpayers.

In this charter it is instructive to note for example, that HMRC make clear this it will *"....challenge those that engage in avoidance ..."* (HMRC (2009a). This position taken by HMRC appears to stand in contrast to the widely held but perhaps too simple view that tax avoidance is legal.

As a consequence of the approach being taken by, for example HMRC it is possible that tax payers, both corporations and individuals could end up paying more tax than is required by law (Goldberg (2008), Gauke (2012) and HMRC (2009b)).

In summary therefore, to have a clearer understanding of the meaning of such terms as "tax avoidance", "tax planning" and "tax evasion" is not only a requirement when answering the research question but is also important

[93] It is interesting to note that though Timms and Gauke are members of different UK Governments and from different political parties their approach is very similar.

generally in seeking to understand and discuss the role of the state, taxation and citizens.

The next chapter introduces a proposed analytic and conceptual framework, the construction of which, it is argued, is necessary in order to answer the research question.

PART B:

Chapter Five: An analytic and conceptual framework

5.1: Introduction

As has been indicated previously, tax related behaviour is discussed and considered by academics from various different disciplines and by other commentators. Such discussions have resulted in various different types of tax related behaviour being identified.

In respect of such types of tax related behaviour one category has become the focus of a considerable amount of discussion and debate, namely, tax avoidance. Chapter 3 has demonstrated that the meaning and denotation of the term "tax avoidance", particularly when prefixed by one or more adjectives is subject to considerable dispute and uncertainty.

There have been a number of attempts to identify and describe the characteristics, qualities and attributes associated with type of the tax related behaviour that is identified as tax avoidance (see for example Stiglitz (1985) and Walker (2004)). In so doing, such attempts are seeking an understanding of the relationship between a number of matters including:

- how a country's tax code is to be applied to the arrangements, situations and states of affairs that can occur;
- the intentions and motivations associated with a person or persons entering into an arrangement and the bringing about of a set of circumstances and/or states of affairs; and,
- the tax consequences of such arrangements, circumstances and states of affairs.

The work of the OECD referred to above (OECD 2008) was in part to identify certain specific characteristics, qualities and attributes of a type of tax related behaviour where such a type consists of behaviour that is in some manner

unacceptable[94]. Following such identification, one of the purposes of the OECD (2008) report was to make recommendations whereby the incidence of such tax related behaviour would be reduced (see Chapter 10 of OECD (2008). As indicated in Section 3.7 the final OECD (2008) report admits to the difficulty of defining or if not defining, simply identifying, the characteristics, qualities and attributes that are relevant when trying to identify types of behaviour referred to as "unacceptable tax minimisation arrangements" that fall under the general heading of tax related behaviour.

Even though difficulties existed, OECD (2008) does identify the characteristics and attributes of two types of behaviour in respect of which concern was expressed (see pages 10 and 11 of OECD (2008)).

In defining aggressive tax planning by reference to certain identified characteristics, qualities or attributes the OECD has, albeit in a limited and maybe not wholly acceptable manner offered a reasoned alternative to a rather simplistic and possibly misleading dichotomous understanding of tax related behaviour. An understanding abandoned by the OECD was one that suggested that a defining characteristic of tax avoidance that could be used to distinguish between what many consider to be the only two types of tax related behaviour, that is tax evasion and tax avoidance[95], is based only on a distinction between what is illegal and what is legal.

In a manner which is similar to the approach taken by the OECD, this Chapter seeks to identify the conditions, characteristics and attributes that are

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[94] The nature of this unacceptability is not explored in this thesis. It can be presumed that such behaviour is unacceptable to national tax authorities given the aims and objectives that such authorities have in collecting tax revenue. However such behaviour may also be unacceptable, at least in part, to many other commercial and non commercial organisations insofar as an instance of such behaviour that resulted in a more advantageous tax position obtaining for a person might depend upon that potential payer being economical with the truth and/or making less than full disclosure and being less than honest with a tax authority. Other commercial and non commercial organisations might consider this to be an instance of being a "free rider".

[95] With such an understanding of tax related behaviour where the only distinguishing characteristic that is necessary is whether an arrangement is illegal or not would have the consequence that there are only two categories of tax related behaviour (i) tax evasion and (ii) everything else.

relevant when seeking to understand different types of tax related behaviour. The intention is to provide an understanding of the meaning or denotation of such terms as "tax avoidance", "tax evasion", "tax compliance" etc through the identification and consideration of a number of conditions, attributes and characteristics. These conditions, attributes and characteristics, taken together will constitute an analytic and conceptual framework for tax related behaviour and provide a means for identifying the various types of behaviour that fall within this general term.

The analytic and conceptual framework will provide a means whereby various types of behaviour that fall within this general term of tax related behaviour can be understood and the relationship between them "mapped".

Where the approach of this thesis differs from the approach taken by the OECD is that this Chapter identifies and discusses a number of characteristics of a tax code that appears not to have been considered in detail by the OECD. In particular this Chapter discusses four aspects of a tax code (see below), that are important when considering potential tax payer behaviour.

As has been previously indicated and for the reasons there set out, for the purposes of considering and discussing a suggested analytic and conceptual framework, rather than refer to terms such as "tax avoidance", "tax evasion", "tax compliance" etc and compare and contrast the various meanings and denotations of these terms that are used in possibly different ways by different commentators, this Chapter will simply refer as necessary to "tax related behaviour".

Given the lack of agreed meaning to such a term as "tax avoidance", to use such a term at the stage in the thesis which is intending to provide an analytic and conceptual framework of tax related behaviour would almost certainly be counterproductive. As Chapter 3 strongly suggests, the meaning and denotation of the term "tax avoidance" and the various connotations that different parties attach and/or impose on such term mean that the term

possesses various meanings and is used in different ways. As a consequence there is a lack of clarity associated with the term.

To employ a metaphor, an understanding and explanation of the different types of tax related behaviour will be provided in this Chapter through a "top down" approach rather than a "bottom up" approach. An analytic and conceptual framework will be constructed within which such terms as "tax planning", "tax evasion" and "tax compliance" can each be given a distinct meaning and denotation. This is to be contrasted with a "bottom up" approach that would, for example, seek to compare and contrast the various different uses made of a term such as "tax avoidance" by the different commentators with a view to finding a meaning of the term that is acceptable to all.

In a "bottom up" approach consideration would have to be given as to whether it is possible to obtain a sufficient and adequate understanding of what types of tax related behaviour there are and in particular what type of tax related behaviour is referred to by the term "tax avoidance" and related terms by simply gathering empirical evidence. For example, could an understanding of tax avoidance be obtained by asking people, by asking tax advisors, tax authorities, or the man in the street? (Kirchler et al. (2003))

A partial answer is "yes". However it is considered that given the wide disparity of understanding between academics, tax authorities, commentators and other interested parties, the answers received would not be overly useful, being based on a combination of misunderstandings, uncertainty, assumed axioms and/or vested interests. Because of the endemic lack of clarity and the confusion that exists regarding the taxonomy of tax related behaviour and in the particular the meaning and denotation of the term "tax avoidance", it is believed that the approach adopted in this Chapter is necessary, in particular that it is necessary firstly to craft an analytic and conceptual framework which can then be tested for usefulness and explanatory effectiveness.

It is not just lack of clarity and the existence of confusion that argues for the approach adopted in this Chapter. There is a tendency for commentators to fail to address in a convincing manner certain aspects of the categorisation or taxonomy of tax related behaviour. Section 3.6 discusses the use of certain adjectives in combination with the term "tax avoidance". Often when so used, little explanation is offered as to how such nuances of categorisation are to be applied. For example the president of the ICAEW recently posted a blog on tax avoidance (Izza (2012)) which was responding to Gauke (2012).

Members of the ICAEW play a major role in advising in the area of tax related behaviour. It might have been expected that the President of such an Institute, many members of which are actively engaged in the area of taxation would have something to say on the matter of tax related behaviour which was informative and useful.

The blog post contained the following:

> *"Today's speech by Treasury Minister David Gauke is the next stage in ratcheting up the pressure on those tax payers and their advisors who engage in* ***aggressive*** *tax avoidance*[96].
>
> *As readers of this blog will have seen, this is an issue where as a profession, we don't necessarily agree on what the boundaries are or indeed where the line should be drawn between* ***legitimate*** *tax planning and* ***aggressive*** *avoidance. Today's consultation should help to define those* ***boundaries*** *and provide greater certainty, an essential requirement of reasonable and responsible tax planning that our members undertake for their clients."* (emphasis added).

Although the words "aggressive", "legitimate" and "boundaries" are used there is nothing provided by Izza to explain those words. Indeed, the

[96] HMRC use the term "tax avoidance" in a very specific manner. Izza's blog does not acknowledge this distinctive meaning which in itself suggests that Izza assumes that when HMRC use the term it is being used in a manner that is similar to the way Izza understands that the term should be used.

guidance offered by the ICAEW on aggressive tax avoidance schemes (ICAEW 2012) although it also uses words such as "aggressive" and "artificial" offers little in the way of explanation of such words.

Izza's blog actually prompted the appearance of an article in The Tax Journal (Goodall (2012)) in which it was noted that one commentator responding to the blog entry:

> *"claimed that Izza did not have 'the intellect to distinguish between acceptable tax avoidance and the unacceptable'"*

The blog, ICAEW (2012) and many of the responses that have been made to the blog echo the publication some 30 years ago by the Institute of Economic Affairs a slim book (Seldon (1979)) which offered the term "avoision" to refer to type of tax related behaviour in respect of which it was difficult to decide whether such behaviour was acceptable and could be condoned or not acceptable.

In respect of how commentators respond to and categorise tax related behaviour not much appears to have changed in more than 30 years (Freedman (2004)). When identifying and referring to different types of tax related behaviour rather than justify distinctions (or even justify why there are no such distinctions), resort is had to adjectives such as "aggressive", "artificial" and "illegitimate" or to labels such as "circular" or "schemes", the meaning of which in the context of tax related behaviour is not offered or explained.

As explained by Lord Justice Mummery in the case often known as "Ships 2"[97]:

> *"18. The relevant transactions may, for forensic purposes, be rudely labelled as "schemes" or "devices" or "dodges" or may be analysed less crudely as "circular" or self-cancelling" or "pre-ordained" or "artificial" or be paraded in the more presentable garb of legitimate "tax efficient*

[97] Commissioners for HMRC v David Mayes [2011] EWCA Civ 407

arrangements". However the transactions are labelled, analysed or presented, the question that the court has to decide in the contest between the state and the citizen is mainly mundane: do the tax-shy transactions actually succeed in reducing the size of the tax bill under appeal?"

Instead of seeking empirical evidence as to what people understand by the terms "tax avoidance", "tax evasion", "tax compliance" etc, this Chapter will identify and discuss various characteristics, qualities and attributes of tax related behaviour and the overall context within which such behaviour occurs. These characteristics, qualities and attributes are then used to identify different types of tax related behaviour. As part of this process tax evasion behaviour and tax avoidance behaviour will be identified. The analytic and conceptual framework will also provide an insight into understanding how various qualifying adjectives (such as unacceptable or abusive) can be attached to various types of tax avoidance behaviour.

In turn, once presented, the suggested analytic and conceptual framework can be subject to criticism and/or refinement and/or replacement.

In the context of providing an analytic and conceptual framework, although such terms are mentioned, this Chapter does not consider in detail such terms as "preordained transaction" or "circular transaction". The concepts to which the terms "preordained transaction" and "circular transaction" refer have been used by the UK courts in an attempt to develop a judicial method of identifying certain types of arrangements that might not be effective in achieving an expected and beneficial tax position (see for example, Tiley (1988), Tiley (2001), Tiley (2004a), Tiley (2004b), Tiley (2005)). In more recent years it has been argued by a number of senior judges (for example Hoffman 2005), that these ideas which have been entertained by the UK courts over the last thirty years or so are, in essence, expressions of how firstly, an arrangement together with a resulting state of affairs and the context in

which and from which the state of affairs obtains is to be understood and secondly, how the UK tax code is to be applied to such a state of affairs.

Writing in academic journals Hoffman (2005) and Walker (2004) argue that the concepts of "preordained transaction" or "circular transaction" are not a unique judge made tax anti-avoidance principle but a means of assessing the relationship between an arrangement, the resulting state of affairs that obtains and the relevant part of the UK tax code (Templeman 1997)[98].

For these reasons, although the two concepts of "preordained transaction" and "circular transaction" are taken to be of great interest when seeking to understand a number of UK court decisions and also taken to be of great interest when considering the meaning and application of certain parts of the existing UK tax code to a particular state of affairs which might have to be at some stage considered by the court, the purpose of this Chapter 5 is not to discuss the two concepts in any great detail[99].

5.2: Requirements for an analytic and conceptual framework

The characteristics, qualities and attributes that are to be identified and discussed in this Chapter require the use of a number of key defined terms and an explanation of four key aspects of a tax code. The identification of the characteristics, qualities and attributes and discussion of these will take place in the context of the UK tax code.

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[98] Many of the tax anti avoidance cases in recent years have also emphasised the importance of these principles as principles of construction rather than as "judge made law". See for example, Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] HKCFA 66, Barclays Mercantile v Mawson [2004] UKHL 51 (2004) 76 TC 446, (HL) and MacNiven v Westmoreland Investments Ltd [2001] UKHL 6 (HL).

[99] The position in the UK can be contrasted with the position in the USA where judicial principles of tax avoidance have been developed. See Tiley (1987a), Grewel (2007) and Tiley (1987b). To quote from Tiley *"The United States courts have been much more willing than United Kingdom courts to develop some general tax jurisprudence or overriding principles that can be plucked from the sky to solve problems. The development of such doctrines has not been part of the United Kingdom tax tradition but there is far more of it than is generally admitted."* Tiley (1987a) p188

This section of the thesis makes use of the following key terms: "person", "critical tax point", "sub category of the UK tax code" and an "arrangement". It also discusses the following four important aspects of a tax code:

- the distinction on the one hand between (i) tax liabilities and on the other hand (ii) tax reliefs or tax credits; and,
- the distinction on the one hand between what may be referred to as the (iii) limits of a tax code and on the other hand (iv) the vagueness or uncertainty that is inherent in a tax code.

Each of these key terms and the four aspects of a tax code will be considered in turn. Each one of the key terms discussed is not considered to be controversial. The terms are introduced to make subsequent explanation and discussion of the various types of tax related behaviour more effective.

As indicated, in discussing such matters the primary focus will be upon the UK tax code as currently or previously enacted.

5.2.1: Person

The term "person" is used in many different ways and the use of such term might depend upon the context.

The UK Interpretation Act 1978 defines person as:

> *""Person" includes a body of persons corporate or unincorporated"*[100]

For the purposes of this thesis such a definition is not adequate. In this thesis the term "person" shall mean an individual (a human being), or an artificial legal person (such as a limited company) or any other type of entity (for example a university) that can be responsible for bearing a liability to taxation[101] or can be entitled to the benefit from a form of tax relief[102]. As

[100] Interpretation Act 1978 Schedule 1
[101] See Section 6.2.
[102] See Section 6.3.

with the definition found in IA 1978, in certain circumstances a "person" can mean more than one person.

This thesis will follow the practice in English law using the word "person" to refer to a human being and any other type of entity that is recognised as a person in law. A human being will be referred to as an individual if it is necessary to distinguish between an artificial legal person (such as a limited company) and a non artificial legal person (such as a human being).

It is possible to identify one or more characteristics, qualities and attributes that are the same (or sufficiently similar), which can be possessed by or ascribed to one or more persons. As a consequence of the possession or ascription of such a common characteristic, attribute or quality, such persons can be said to constitute a specific class or group of persons. The condition of class or group membership for any particular person is based on the possession of the identified characteristic, quality or attribute.

For example, for those persons that are individuals (human beings), there exists the possible characteristic of being in an employment relationship and each person who is a human being and is in an employment relationship is within the class of employed persons. A limited company, at present under the UK tax code can never possess the characteristic of being in an employment relationship and therefore cannot be within the class of employees.

The possession of one or more characteristics, qualities or attributes by one or more persons is relevant when considering the application or non application of many parts of the UK tax code. It is the possession of the relevant characteristic, quality or attribute which makes a person a member of a particular class.

It is possible for a person to be a member of more than one class of persons where the membership of each particular class depends upon the possession of the class defining characteristic, quality or attribute. For example, a person

who is an individual could be a member of the class of employed persons and could also have an entitlement to receive a dividend from a company in his or her capacity as a shareholder. In such a case the person would be a member of two classes:

- the class of employed persons: and,
- the class of persons who are entitled to receive a dividend.

Different parts of the UK tax code might apply to each different class of person.

5.2.2: Arrangement and resulting state of affairs

The term "arrangement" is a convenient umbrella term that is used in this thesis to refer to the actions, transactions, events, omissions, occurrences or other behaviour that result in the obtaining of a particular state of affairs when any such action, transaction, event, omission, occurrence or other behaviour is undertaken by or entered into or allowed to occur by a person. More than one action, transaction, event, omission, occurrence or other instance of behaviour taken together may also constitute an arrangement.

For example, continued ownership of property, disposal of property, trading activities over a period of time, entering into one or more contracts or other agreements, engaging in employment activities would all be instances of arrangements.

It should be noted that an omission also falls within this understanding of an arrangement. In the context of the explanation of tax related behaviour that is being offered in this thesis when a person omits to do one thing that person is selecting to do something else even if the something else is nothing more than maintaining the status quo.

Even the death of an individual will be an arrangement in the sense used in this thesis. There is an event, the death of an individual which brings about a

state of affairs in which the individual is dead. Such a state of affairs might have tax consequences under the UK tax code.

Used in this manner an arrangement may sometimes consist of a mixture of law and fact[103]. For example in the UK an arrangement (as the term is used in this thesis) which consists in the disposal of a property on a particular day is usually given effect by a contract of sale (a matter of law) being completed on a certain day in respect of a specific property (matters of fact).

Direct taxation in the UK (as in many countries) can be charged as a result of a particular transaction, such as the disposal of a property in which case, in the UK, capital gains tax and a form of stamp duty may be payable[104]. In such a circumstance it is reasonably easy to identify the arrangement that gives rise to a liability to tax, the event is the disposal of a property which results in a person ceasing to own an interest in a property.

However tax may also be charged by reference to a set or collection of activities[105] which takes place over a period of time. For example UK resident companies[106] are subject to corporation tax on the accounting profits (as adjusted for tax purposes) made during an accounting period (as defined for tax purposes). In such circumstances there be many hundreds or indeed millions of activities entered into or undertaken during the accounting period which taken together generate an accounting profit for that accounting period. For the purposes of this thesis all of the trading activities undertaken during the accounting period would constitute an arrangement.

When considering the nature of an arrangement this thesis assumes that in respect of any such arrangement, the arrangement entered into is real and is

[103] Identifying the distinction between fact and law can be difficult. The distinction raises issues that are discussed in jurisprudence. This thesis takes a practical approach and assumes that in most cases the distinction is clear.

[104] In this thesis the application of the value added tax part of the UK tax code is not considered.

[105] In the UK there might only be one activity within the set, such as an adventure in the nature of a trade consisting of the purchase and sale of one asset. See CIR v Fraser [1942] 24TC 498.

[106] See footnote 43.

not a sham[107]. If a purported arrangement was a sham, then the characteristics, qualities and attributes of the purported arrangement in contrast to the characteristics, qualities and attributes of the actual arrangement(s) undertaken may be more difficult to identify, understand, describe and verify. It is generally accepted that there is some form of relationship between sham transactions and certain types of tax related behaviour.

The concept of an arrangement as used in this Chapter is not synonymous with that of a legal contract. The term "arrangement" as used in this Chapter refers to something occurring, happening or existing in the world that is far wider in scope than a contract. In the case of a UK contract being executed on one day and completed on a later day, although there is only one contract, for the purposes of this thesis, at least two arrangements might be in issue. For example a tax liability to capital gains tax might crystallise on the date on which the contract was exchanged (the first arrangement) and a liability to stamp duty land tax might crystallise on the date the contract is completed (a second arrangement).

An arrangement and the resulting state of affairs that obtains as a consequence of the arrangement having been selected are capable of being described. However it is usually possible to ascribe more than one description to the combination of an arrangement and the resulting state of affairs[108]. This is the case generally, not just for matters associated with taxation.

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[107] "Sham" is a concept in UK law and refers to the non existence of rights and obligations that are purported to have been created through the arrangement but in fact have not been created. The classic definition of a sham is to be found in Snook v London and West Riding Investments Ltd [1967] 2 QB 786 (CA): in the judgement of which Lord Diplock states that a sham exists when "acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights or obligations different from the actual legal rights and obligations (if any) which the party intended to create. (at page 802). Other jurisdictions will have similar concepts.

[108] The relationship between a state of affairs (including the arrangement that gave rise to the state of affairs) and the description that is accorded the said state of affairs is complicated. There will be circumstances in which a description of the arrangement and resulting state of

This possibility arises because any selection of a description of the "bare facts"[109] with which an interested party might be confronted following the occurrence of an arrangement is likely to be influenced by the background, attitudes and concerns of the party providing the description.

An illuminating and useful discussion which does not arise in a tax context, on the relationship between various descriptions that can be ascribed to the "bare facts" is found in Anscombe (1958) in her description of "[a] man pumping water into the cistern which supplies the drinking water of a house.", (page 37). Anscombe asks "What is *the* description of his action?" *(emphasis in original).*

Many answers are possible. "He is being paid to pump water", "He is exercising his arm", "The action is an art installation"[110]. But of all the possible answers to this question, of all the possible descriptions of the arrangement and resulting state of affairs, some of the descriptions are more relevant in the context that is identified and within which the action occurs than other descriptions.

Although relevant generally, given the differences the application of part of a tax code can have to a set of circumstances, the appropriate description of the arrangement and resulting state of affairs that obtain can be particularly relevant in the context of taxation.

In the context of the application of a country's tax code to an arrangement and resulting state of affairs, the use of part of a much quoted phrase of

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affairs which is required for tax purposes cannot be agreed between the potential tax payer and the tax authority.

[109] Understanding and describing the existence of the "bare facts" of an arrangement and the resulting state of affairs can be a difficult and contentious matter that remains the subject of considerable debate. A discussion of such matters is beyond the scope of this thesis although it should be noted that the very existence of "bare facts" is disputed. It is assumed that when an arrangement occurs and a resulting state of affairs obtains, in the context of taxation, it is possible to identify the elements of such circumstances which are relevant (even if the description of such elements are subject to disagreement) to the determination of any liability to taxation or any entitlement to a tax relief or tax credit. This is what judges in court are asked to do and indeed do whenever a judgement is given.

[110] These are my suggested answers; they are not Anscombe's suggested answers.

Ribeiro P.J. (Arrowtown[111] paragraph 35) is apt. Referred to by Lord Justice Mummery in Ships 2[112]:

> *"19 ....Ribeiro PJ neatly extracted the essence of the legal techniques in [Arrowtown[113]]: "... the ultimate question is whether the relevant statutory provision construed purposively, were intended to apply to the transaction viewed realistically.""*

In the terms being used in this thesis, the arrangement and resulting state of affairs is referred to as a transaction by Ribeiro PJ. The term "viewed realistically" requires the description of the arrangement and resulting state of affairs to be one that is appropriate to the purpose and the context of the *"relevant statutory provision"*.

As previously indicated, when undertaking this search for a description of the arrangement together with the resulting state of affairs, the UK courts, if considered necessary will make reference to and make use of the concepts of "circular transactions" and "preordained transaction"[114], amongst others, in an attempt to settle on or select a description of the arrangement and resulting state of affairs that is considered to be appropriate in the context of the relevant part of the UK tax code.

This approach of the courts when seeking a description of an arrangement and resulting state of affairs is summarised by Lady Justice Hallett in the Schofield case[115]

> *"43. The relevant transaction here is plainly the scheme as a whole: namely a series of interdependent and linked transactions, with a guaranteed outcome. Under the scheme as a whole, the options were*

[111] Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] HKCFA 66.
[112] Commissioners for HMRC v David Mayes [2011] EWCA Civ 407
[113] Collector of Stamp Revenue v Arrowtown Assets Ltd [2003] HKCFA 66
[114] See Section 5.1.
[115] Howard Peter Schofield v The Commissioners for Her Majesty's Revenue and Customs [2012] EWCA Civ 927

created merely to be destroyed. They were self cancelling. Thus, for capital gains purposes, there was no asset and no disposal. There was no real loss and certainly no loss to which the TCGA applies. There is in truth no significant difference between this scheme and the scheme in ***Ramsay,*** *other than the nature of the "asset". A consideration of the scheme "asset by asset" (or step by step) as urged upon us by Mr Scholfield ignores the reality of the scheme, the findings of the First Tier Tribunal and the* ***Ramsay*** *principle."*

The reference to "Ramsey" is a reference to Ramsey (W.T.) v IRC [1982] AC 300 (HL).

In this extract Lady Justice Hallett is describing a rather complicated set of cross option arrangements that were intended to create a loss which could be used to set off against a previously crystallised gain. Although the taxpayer's barrister argued that the options consisted of a set of independent arrangements, the principle associated with Ramsey was applied and what was claimed to be a set of independent arrangements was viewed as one arrangement. The description of what had occurred was identified by applying methods of how tax legislation is to be understood and applied that have been developed over the last forty years or so.

It is reasonable to accept that at times it can be difficult to settle on or select an appropriate description of an arrangement and resulting state of affairs. Not unexpectedly interested parties might differ as to the description of the arrangement that is offered by each party[116].

Differences in the description of the arrangement that are acceptable can also occur between different judges who are being called upon to decide whether

[116] The differences that can arise in describing an arrangement sometimes give rise to disputes between a tax authority and a tax payer. Examples of this occurring are too numerous to cite in this thesis. Two very recent cases in which judgement has been given are illustrative of this issue. In Mayes the tax payer was successful (Commissioners for HMRC v David Mayes [2011] EWCA Civ 407). In Schofield the tax payer was not successful (Howard Peter Schofield v The Commissioners for Her Majesty's Revenue and Customs [2012] EWCA Civ 927).

or not and in what manner the tax code of a country might apply to the arrangement and resulting state of affairs, that is being considered. The difficulty is evidenced by the different decisions on the same arrangement and resulting state of affairs reached by different judges in the different levels of UK court. The possibility of a number of different descriptions being viable is an important matter when considering the research question.

5.2.3: Critical tax point

The term "critical tax point" refers to the identification of the point in time at which an arrangement and resulting state of affairs obtains.

There are two aspects of a critical tax point that are relevant to the explanatory and descriptive framework that is being offered in this Chapter.

The first is that an arrangement is entered into and a resulting state of affairs obtains.

The second is that it can be ascertained whether or not a sub category of the UK tax code applies to the arrangement and resulting state of affairs. If a sub category of the UK tax code does apply to the arrangement then the arrangement and the resulting state of affairs can be said to have tax consequences.

The concept of a critical tax point makes an assumption about the nature of a tax code and how the relevant parts of a tax code might have to be applied to a specific arrangement and the resulting state of affairs.

When a judge makes a decision regarding the applicability or otherwise of part of the UK law to the occurrence of a specific arrangement and the resulting state of affairs, the judge is declaring what that particular part of the UK law states. The judge is not extending the law, making the law or modifying the law. A judge is ascertaining how a particular part of the tax code is to be applied to the set of circumstances being considered.

This theory has been subject to criticism within common law jurisdictions with the suggestion being that as a matter of fact judges do extend, make and modify the law. This assumption is a topic that is considered within the field of jurisprudence. The assumption is criticised as being no more than a fiction in many areas of law, for example in tort[117].

Whereas in the development of the law of tort it is possible to accept that judges do make law, for the reasons set out below, in the case of the application of the UK tax code, the fiction, if it is a fiction would appear to be robust.

It is suggested that this assumption in the context of the UK tax code is a reasonable description of (i) how the tax code is applied to arrangements and resulting state of affairs that obtain and (ii) how interested parties[118] behave towards the UK tax code and assess tax related behaviour.

Interested parties act as if once an arrangement has occurred the tax consequences of that occurrence have been fixed. Discovering what the tax consequences are, in certain circumstances, might not however be straightforward.

There are a number of reasons why for practical purposes, it is reasonable to accept this assumption.

Firstly, as Morris (2012) indicates:

"The Bill of Rights of 1689 lays down the principle that only Parliament has the right to raise taxes:

[117] The well known "snail in the bottle case" of Donaghue v Stevenson [1932] HL is a case in point. Did Stevenson owe a duty of care to Donaghue in 1928 when she drank the ginger beer? Or did the House of Lords decide in 1932 that Stevenson should have a duty of care and ruled accordingly?

[118] In this context the interested parties will be potential tax payers, HMRC and judges.

"Levying of money for and to the use of the crown, [.....], for other time, and in other manner, than the same was granted by Parliament is illegal"

Although this legislation is over 300 years old, it is still relevant and was referred to in a case as recently as 1992[119]*."*

Given this principle of authority, it is difficult to accept that judges have any authority to impose taxation[120].

In addition as far as the judges themselves are concerned, senior judges when deciding whether a specific arrangement and resulting state of affairs falls within the provisions of a particular part of the UK tax code have consistently made clear, both in written judgements (see below) and in published writings[121] that when making such decisions, the judiciary do not have any authority to "make" tax law.

For example, in this lengthy extract from the judgement of Lord Justice Mummery in Ships 2[122] a description is offered of the role of the judges when considering certain instances of tax related behaviour:

"18. .....However the transactions are labelled, analysed or presented, the question that the court has to decide in the contest between the state and the citizen is mainly mundane: do the tax-shy transactions actually succeed in reducing the size of the tax bill under appeal?

19. The answer to that question depends entirely on the language of the legislation, properly constructed according to its purpose and

[119] Woolwich Building Society case [1992], Simons Tax Cases 657,677.
[120] See for example Walker (2004), a paper which reflects on the role of senior judges in tax avoidance cases and Hoffman (2005).
[121] Ibid.
[122] Commissioners for HMRC v David Mayes [2011] EWCA Civ 407

context, and its application to the transactions, properly analysed according to their terms and context. .....

20. If the taxpayer succeeds and HMRC and Parliament do not like the result, the law can be re-adjusted for the future in a Finance Act preceded by public debate and passed by democratic legislative processes. Even if the courts do not like the result, they have no means at their disposal to amend a law enacted by Parliament. Their sole function is to decide the case on their best understanding of the relevant transactions and the applicable law, whatever they may be. Whether or not the courts approve of the outcome is beside the point. ***It is not for judges to shoulder the law-making responsibilities of Parliament."*** (emphasis added)

Thirdly, Article 1 of the First Protocol of the UK Human Rights Act 1998 states:

"ARTICLE 1

PROTECTION OF PROPERTY

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

This suggests that an arrangement and resulting state of affairs that obtains at a particular point in time will be subject to taxation or not subject to taxation

at that point in time[123]. If taxation is to be imposed upon an arrangement, then in order for the actions of the UK Government to be compliant with the provisions of the HRA 1998 it is necessary that the crystallisation of a liability to taxation arises because of the existence and application of a sub category of the UK tax code that is in existence and is effective at that critical tax point[124].

It is difficult to envisage how the tax code could operate in the UK and be consistent with the HRA 1998 as required by section 6 HRA 1998[125] if UK judges were able to decide that at the relevant point in time, the critical tax point, although no liability to taxation crystallised under the relevant sub category of the UK tax code in respect of an arrangement that is being considered, the judges decided that it is appropriate that a liability to taxation should have crystallised and the judges take it upon themselves to "extend", or otherwise change the remit of that part of the tax code or impose a charge to tax in any event.

Based on the three factors which are summarised above it is a reasonable assumption which will be accepted in this thesis that at least in respect of the application of parts of the UK tax code, the UK tax administration, tax advisors and judges assume that at a critical tax point, the provision of the relevant sub category of the UK tax code does or does not apply to an arrangement and resulting state of affairs.

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[123] This alternative ignores the possibility of retrospective legislation which does occasionally occur in the UK. However the use of retrospective legislation might tend to support the view that for tax purposes the assumption that once an arrangement and resulting state of affairs obtains, the tax consequences, even if not yet know, have crystallised is in practice an acceptable assumption as to how the UK tax code operates.

[124] In certain circumstances, as a consequence of the timing of the announcement of changes to the UK tax code and subsequent enactment of legislation there might arise a critical tax point in respect of which no legislation has been enacted but the arrangement and resulting state of affairs will be subject to taxation.

[125] Part of section 6 reads as follows: "It is unlawful for a public authority to act in a way which is incompatible with a Convention right." and "public authority" will include the courts.

This is the case even if in respect of a particular arrangement, although there is a consensus of understanding between tax advisors and HMRC as to what the tax consequence of the arrangement actually is, a subsequent judgement of the court declares the tax consequences to be otherwise.[126]

If an identifiable part of the tax code does apply then a liability to taxation is crystallised or an entitlement to a tax relief or tax credit[127] arises even if it is some time after the critical tax point when agreement is reached in respect of the tax consequences or such a position is finally determined[128].

A consequence of introducing the concept of a critical tax point into the construction of an analytic and conceptual framework is that it is possible to identify ex ante behaviour and ex post behaviour where the reference point in time is the critical tax point.

5.2.4: Sub category of the UK tax code

Although the system of direct tax in the UK can be considered to consist of all of the UK tax legislation enacted at any one time[129], it is also possible to consider all of such UK tax legislation as consisting of a number of different and distinct sub categories of the UK tax code.

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[126] See for example the UK case of Mansworth v Jelley in which a potential tax payer challenged the generally accepted view which was held concerning the consequences of the exercise of a share option and subsequent disposal of the shares acquired following such exercise. The court accepted the view of the potential tax payer which was different from the consensual view that had been held by HMRC, the majority of tax advisors and other commentators.

[127] See Chapter 6 for a discussion about the crystallisation of a liability to taxation and the existence of an entitlement to a tax relief or a tax credit.

[128] It is possible that HMRC and a potential tax payer will reach an agreement as to the amount of taxation that is due or the amount of tax relief to which the potential tax payer is entitled without paying too much detailed attention to the relevant sub category of the UK tax code. A form of "horse trading" does take place between potential tax payers and HMRC and such "agreements" are within the powers available to HMRC under the UK tax code (see section 5 Commissioners for Revenue and Customs Act 2005).

[129] Tax legislation in the UK is often effective from a specified date, for example from the date on which the annual budget is presented to the UK Parliament, even though the legislation might not be enacted until many months after the specified date. It is also possible that there will be various versions of the draft tax legislation produced between the specified date from which the new legislation is effective and the date on which it is enacted. During this period there might be no certainty as to what the taxation consequence of a particular transaction is because there is no final legislation. See Section 7.2.1 for a discussion on this matter.

Different sub categories of the UK tax code are not only identified by the existence of different named taxes in the UK, for example "capital gains tax" and "inheritance tax" but also within a "named" tax such as income tax there can be considered to be different sub categories of the UK tax code where each different sub category addresses one or more class of person and/or one or more types of specific arrangement and resulting states of affairs.

In addition, a sub category of the UK tax code does not only have to be a part of the UK tax code that is intended to impose a charge to taxation or provide an entitlement to a tax relief or tax credit. There are sub categories of the UK tax code that are, for example, administrative provisions, disclosure provisions or deal with the powers of HMRC.

Each different sub category of the UK tax code will apply to (i) a class of persons each member of which possesses one or more defining characteristics, qualities or attributes the possession of which is a necessary condition for the application of that part of the UK tax code that constitutes a particular and identifiable sub category of tax together with (ii) a class of arrangements and resulting states of affairs falling under one or more specific descriptions, again each member of such class possesses certain defining characteristics.

For example, employment income tax applies to those persons who are individuals and fall within the definition of employed persons (i.e. possess the characteristic of being employed) and receive income as a consequence of the existence of an arrangement which is constituted by an employment relationship. But within the part of the UK employment income tax legislation which is relevant to this class of persons and class of arrangements, different sub categories of the UK tax code can be further identified. For example the benefit in kind tax legislation[130] is different from the employment related

[130] See Part 3 Income Tax (Earnings and Pensions) Act 2003.

security tax legislation[131]. Each of these can be considered to be a sub category of the UK tax code.

5.2.5: Application base

Based on the key terms introduced and discussed above it is possible to provide in general terms a description of what is referred to in this thesis as an application base for a sub category of the UK tax code.

The application base for a sub category of the UK tax code will consist of the following elements:

- a class of persons who possess one or more of the characteristics, qualities or attributes that defines a class of person and where such class is identified by the relevant sub category of the UK tax code;

in combination with

- a class of arrangements together with the resulting state of affairs that obtains on the occurrence of any one of the said arrangements where such a class of arrangements is identified by the relevant sub category of the UK tax code;

A construction of the application base is represented pictorially in Figure 1.

In this context a reference to an application base for a sub category of the UK tax code is not a reference to only those parts of the UK tax code that are enacted with the purpose of imposing a liability to tax on a potential tax payer or an entitlement to a tax relief or a tax credit. The reference to an application base will include a reference to the class of persons and class of arrangements (together with resulting states of affairs) to which any sub category of the UK tax code can possibly apply. It will include administrative

[131] See Part 7 Income Tax (Earnings and Pensions) Act 2003.

provisions, disclosure provisions, filing provision, relieving provisions as well at tax charging provisions.

In respect of the sub categories of the UK tax code that are intended to impose a liability to taxation or to provide an entitlement to a tax relief or a tax credit of some type it is possible to construct what can be referred to as a tax base. A tax base is an application base that is intended to impose a liability to taxation or to provide an entitlement to relief if a person within the relevant class of persons enters into an arrangement of a particular type.

Every tax base within the UK tax code will also be an application base but not every application base will be a tax base.

Figure 1 below can also represent a tax base if the term "tax base" is substituted for "application base" and if Note 1 reads as follows: "Note 1: the sub category of the UK tax code exists as an identifiable set of statutes and regulations which is intended to impose a charge to taxation or provide an entitlement to a tax relief or a tax credit.".

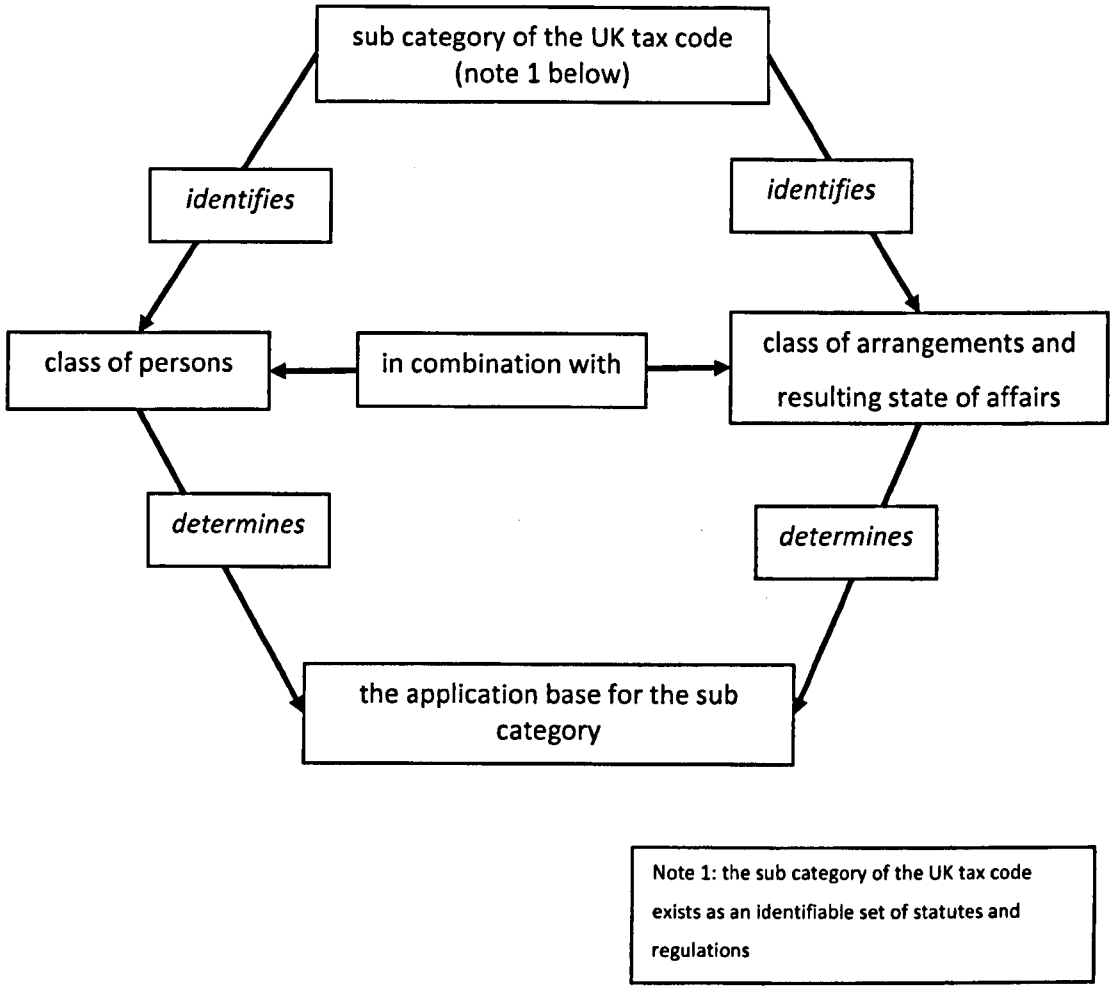

Figure 1: a sub category of the UK tax code and its application base

Such a characterisation of a tax base for a sub category of the UK tax code only requires that a member of the identified class of persons (first bullet point above) is capable of entering into an arrangement falling within the class of arrangements (second bullet point above). This analysis is consistent with the description set out in (Shaw et al. (2010).

It is considered that there is no requirement to identify all of the sub categories of the UK tax code that exist at any one time. The use of the concept of a class of persons and a class of arrangements constituting a tax base for a sub category of the UK tax code is an analytic and explanatory mechanism for understanding how tax legislation relates to the arrangements and resulting state of affairs entered into by a person or persons. The

application of the term "sub category of the UK tax code" to existing tax legislation is to be applied in a flexible and pragmatic manner.

The next chapter continues the analysis of tax related behaviour by exploring the distinction between tax liabilities and tax reliefs.

PART B:

Chapter Six: Tax liabilities and tax reliefs: introduction

6.1: Introduction

Many different sub categories of the UK tax code have been introduced by the UK Parliament and remain in existence. In addition, various sub categories of the UK tax code have been introduced and subsequently amended or even repealed[132] Such introduction, amendment and repealing will continue as the tax code of the UK changes due to the decisions of the UK Government in power at a particular time.

Changes may result from responses to political and economic trends and the various circumstances and events, some of which may be very unexpected, that arise during the tenure of such Government. In addition the fundamental policies and priorities that are adopted by or at a minimum associated with a Government will impact upon the sub categories of the UK tax code that are introduced, amended and/or repealed. Changes to the UK tax code may also occur as a consequence of sentiments that are perceived to operate within a society[133] and to the relationship that exists between the various types of commercial activity that exist and are encouraged to exist within the UK and the tax regime that applies or is chosen to apply to such activities[134].

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[132] See Section 7.2 for an example of the taxation of mobile phones provided to employees.
[133] The government proposed as part of the tax changes for 2012 that an upper limit restriction should be imposed on donations to charity. But for the proposed change any donation to charity resulted in a tax relief for the donor. An amount of income equal to the charitable donation was not subject to tax. As a result of significant lobbying by various interested parties the proposal to limit the tax relief on charitable donations was withdrawn. See http://www.bbc.co.uk/news/uk-politics-18278253 (last accessed 27 September 2012).
[134] In order to make the UK a more attractive place from which to do business a number of changes have been made to the corporate tax regime. By way of illustration, one of the changes is to the way in which patents held outside the UK are to be taxed. Details of the Patent Box arrangement which offers a 10% tax rate on certain income can be found at http://www.hmrc.gov.uk/budget2012/tiin-0726.htm (last accessed27 September 2012).

Each such sub category of the UK tax code will be introduced for one or more reasons and following its introduction will probably have an impact on the behaviour of at least some potential tax payers[135].

However, to state the obvious and as previously indicated, not all sub categories of the UK tax code impose a liability to taxation or make available some form of tax relief or tax credit. A particular sub category of the UK tax code can require potential tax payers to act in a certain manner, for example require disclosure of the details of certain sets of arrangement entered into[136] or require the making of a self assessment return to HMRC[137]. Other sub categories of the UK tax code could provide HMRC with additional powers, for example powers of investigation[138].

Among the various effects that the introduction of additional provisions within the UK tax code or indeed the existing UK tax code can have, two aspects in particular will be addressed in this Chapter. In order to construct an analytic and conceptual framework of tax related behaviour which is to be used to address the research question of this thesis it is considered useful to understand these two aspects of the UK tax code.

A sub category of the UK tax code can be introduced or has been introduced in order to create a tax base. The existence of a tax base, which is the combination of (i) a class of persons together with (ii) a class of arrangements, has the consequence that should a person enter into an arrangement and the person and the arrangement (together with the resulting state of affairs that obtain), fall within the tax base of this sub category of the UK tax code then, in

[135] A sub category of the UK tax code may be introduced not only to counter tax related behaviour that seeks to reduce the amount of liability to taxation that crystallises (for example see Part 6 (sections 231 to 259) Taxation (International and Other Provisions) Act 2010 which seeks to deny a deduction for interest payments in certain circumstances, but also to encourage or modify certain types of behaviour. See for example Chapter 6, Part 3 Income Tax (Earnings and Pensions) Act 2003 which assesses a benefit in kind value on cars provided to employees and the lower the CO2 emissions the lower the value of the taxable benefit.

[136] See sections 309ff Finance Act 2004 as supplemented and amended.

[137] See sections 8 and 9 Taxes Management Act 1970.

[138] See for example section 20 Taxes Management Act (Power to call for documents of taxpayers and others).

accordance with the presumptions that operate as to the application of the UK tax code, this will result in the crystallisation of a liability to taxation at the critical tax point[139].

Secondly, a sub category of the UK tax code can be introduced or has been introduced in order to provide relief in some manner from what would otherwise be a liability to taxation. A relevant liability to taxation has crystallised or will crystallise as a result of a person entering into an arrangement and the resulting state of affairs obtaining. As a consequence of the utilisation or application of the tax relief or tax credit the amount of what would otherwise have been or will be the liability to tax, is reduced or otherwise mitigated.

As suggested, this distinction between what is referred to in this thesis as on the one hand tax liabilities and on the other hand tax reliefs or tax credits is a distinction that can be very useful in understanding the nature of tax related behaviour and the various sub categories of behaviour. The distinction will also assist in understanding the use of such terms as "tax avoidance", "tax planning", "tax evasion" and "tax compliance", terms commonly used in any discussion and debate that is focussed on the relationship between tax related behaviour and CSR.

The distinction between on the one hand a liability to taxation and on the other hand an entitlement to a tax relief or credit when used as part of an analytic and conceptual framework is also useful in understanding and subjecting to criticism certain of the approaches advocated by a number of tax authorities (including HMRC) and a number of other commentators that offer an explanation of and comment on the nature of tax related behaviour.

[139] On occasion rather than a potential tax payer and a tax authority seeking to determine the actual amount of liability to taxation that has crystallised at the critical tax point, an agreement is reached as to the amount of taxation that must be paid. See footnote 128 for the reference to HMRC's authority for such agreements.

It might be argued that such a distinction between a liability to taxation and a tax relief or tax credit is not as clear cut as the previous paragraphs would suggest. Parts of the UK tax code can be messy and complex. Parts of the legislation that are intended to impose a charge to taxation can provide that the charge to taxation is "subject to" exceptions that are contained in the same set of legislation. Alternatively legislation intended to restrict a relief can contain provisions that dilute the effect of the restriction[140].

Rather than consider that a particular sub category of the UK tax code provides an opportunity for an entitlement to a tax credit or a tax relief to arise[141], what such a sub category of the UK tax code is actually doing is providing a "safe harbour" from the crystallisation of a liability to taxation. The term "safe harbour" refers to an exclusion from the crystallisation of a liability to taxation if particular and identifiable conditions are satisfied.

This distinction between liabilities to taxation and the availability of an entitlement to a tax relief or tax credit will be explored further.

A sub category of the UK tax code that is intended to impose a liability to taxation can be represented as follows[142]:

[140] See for example the "arbitrage provisions" of Part 6 (sections 231 to 259) Taxation (International and Other Provisions) Act 2010. If certain conditions are satisfied, sections within this Part 6 have the effect of denying a corporation tax deduction in respect of interest paid by a UK company. The sections operate so as to impose a restriction on a relief (the relief being the tax deductibility of interest paid). However within Part 6 there are also restrictions that apply to the restrictions. Interest paid is not deductible if certain conditions are satisfied but the identified conditions will not be satisfied if certain other conditions are satisfied. The legislation is complex.

[141] Such an entitlement will only arise if certain conditions set out in the relevant sub category of the UK tax code are satisfied.

[142] The representation is simplified in that it assumes that there are a limited number of arrangements that fall within a particular sub category of the UK tax base.

representation 1

if a person is within the class of persons that constitutes the class for the tax base for the relevant sub category of the UK tax code

enters into

an arrangement which together with the resulting state of affairs falls under Description "A" or "B" or "C" or "D" which together consist of the class of descriptions that constitutes the tax base for the relevant sub category of the UK tax code

then

a liability to tax will crystallise at the critical tax point

A sub category of the UK tax code that is intended to provide an entitlement to a tax relief or tax credit can be represented as follows:

representation 2

if a person is within the class of persons that constitutes the class for the tax base for the relevant sub category of the UK tax code

enters into

an arrangement which together with the resulting state of affairs falls under Description "G" or "H" or "J" or "K" which together consist of the class of descriptions that contribute towards the identification of the tax base for the relevant sub category of the UK tax code

then

an entitlement to a tax relief or tax credit will arise at the critical tax point

Some parts of the UK tax code can be identified as a sub category of the UK tax code that are intended to impose a liability to taxation and these will be of the general form set out in representation 1.

In a similar manner other parts of the UK tax code can be readily identified as a sub category of the UK tax code that can provide an entitlement to a tax relief or tax credit and these will be of the general form set out in representation 2.

However parts of the UK tax code[143] are complicated and in addition to containing provisions under which a liability to taxation can crystallise, the same part of the UK tax code will contain provisions under which no such liability to taxation will crystallise.

To continue with the method of representing a sub category of the UK tax code as used above, consider the tax base in representation 1 above which contains an additional provision:

[143] In this context "parts of the UK tax code" refers to the legislation and/or regulations that can be identified as forming a set or collection of such legislation and/or regulations relating to a particular set of arrangements together with the resulting state of affairs.

representation 3

if a person is within the class of persons that constitutes the class for tax base for the relevant sub category of the UK tax code

enters into

an arrangement which together with the resulting state of affairs falls under Description "A" or "B" or "C" or "D" which together consist of the class of descriptions that contribute towards the identification of the tax base for the relevant sub category of the UK tax code

then

a liability to tax will crystallise at the critical tax point

but

if an arrangement and the resulting state of affairs falls under the Description "D" and condition "M" is satisfied

then

no liability to tax will crystallise at the critical tax point

The questions that arise when considering the distinction between the different sub categories of the UK tax code, one type of which can impose a liability to taxation and the other type of which can provide an entitlement to a tax relief or credit are, using the representations set out above, as follows:

Question (i): does the tax base which imposes a charge to taxation for the sub category of the UK tax code set out in representation 3 above include all arrangements and resulting states of affairs that fall under Descriptions "A" or "B" or "C" or "D"

AND

Separately there is a sub category of the UK tax code that provides an entitlement to a tax relief or tax credit if the arrangement and resulting state of affairs is one that falls under Description "D" and condition "M" is satisfied?

or, alternatively,

Question (ii): does the tax base for the sub category of the UK tax code set out in representation 3 above include all arrangements and resulting states of affairs that fall under Descriptions "A" or "B" or "C" together with those arrangements that fall under Description D when condition M is not satisfied but only consists of the arrangements falling under Descriptions "A" or "B" or "C" when condition M is satisfied?

In other words does the tax base for the sub category of the UK tax code set out in Representation 1 include within the class of arrangements that constitute the tax base more arrangements (Arrangements "A", "B" "C" and "D") than the class of arrangements that constitute the tax base for the sub category of the UK tax code set out in Representation 3?

Or, alternatively, are the tax bases the same and the satisfaction of condition "M" provides a tax relief or credit?

Why might these questions be important?

This thesis argues that when providing a taxonomy of tax related behaviour there is an important and significant difference between:

i. tax related behaviour that seeks not to be within the tax base of a particular sub category of the UK tax code that is enacted with a view to imposing a liability to taxation; and,
ii. tax related behaviour that seeks to be within a particular tax base that is enacted in order to provide an entitlement to a tax relief or credit.

The difference, it is argued, arises as a consequence of the conditions that must be satisfied before on the one hand a liability to taxation crystallises and on the other hand an entitlement to a tax relief or credit arises.

In the main, the sub categories of the UK tax code that can impose a liability to taxation will apply to arrangements that occur that result in or are associated with the creation, realisation or recognition of an amount of value[144]. Such value is capable of being identified for the purposes of the relevant tax code.

Sub categories of the UK tax code that impose a liability to tax are intended to identify a category of value and take part of the value away from the person who has ownership of the value[145]. The value taken is transferred to the state and is referred to as taxation[146].

In contrast where a sub category of the UK tax code is enacted in order to provide an entitlement to a tax credit or relief, Parliament has decided to limit its right to impose a charge to taxation on a type of value that has been identified as existing for the purposes of a particular sub category of the UK tax code.

A necessary condition for the imposition of a liability to taxation is an accrual or a receipt or entitlement to receive or the possession of value. The value

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[144] Reference is made in this paragraph to "value". This is being used as a general term identifying that which is subject to taxation. It will include income that is created or is received in the form of trading income, employment income and investment income. It will also include capital gains and wealth. Defining the meaning of "value" is difficult. For a discussion of the meaning of income (which would be included within the concept of value) see Holmes (2001), a book that identifies and discusses many of the issues that arise when considering the nature of income.

[145] See Section Section 11.11.1 for a discussion concerning the protection afforded to property by The Human Rights Act 1998. In what might appear to be in contrast Murphy (2002) discusses the relationship between property ownership, the role of a State and taxation. Taxation is not taking away a person's property rather that which a person considers to be owned only exists because of the State and the system of law that operates.

[146] Some interesting issues arise in this area. Parts of the tax code impose an entitlement to value that accrues but has not been received in a form out of which the liability to taxation can be satisfied. "Dry income" of this nature is to be avoided if possible.

that is to be taxed must be identified within relevant sub category of the UK tax code.

Such a necessary condition does not exist in the case of an entitlement to a tax relief or credit. Rather in respect of a tax relief or credit Parliament can identify and describe the relief or credit as it sees fit and impose whatever conditions on the entitlement to receive such tax credit or relief as is considered appropriate.

If it is accepted that Parliament, and only Parliament, is empowered to enact law which imposes a liability to taxation then to the extent that no such law is enacted in respect of a class of particular arrangements and resulting state of affairs then the failure to impose a tax liability on any such arrangement should not be considered, classified or described as a tax relief or credit provided by Parliament. Rather it can be described as an absence of a sub category of the UK tax code that imposes a liability to taxation on that class of arrangements.

A tax relief or credit is a benefit, the possibility of which is provided by Parliament to mitigate the effect of what would be, but for such tax relief or credit a liability to taxation.

Based on the above analysis, in representation 3 above, an arrangement that falls under the description "D" is only within the relevant tax base if condition "M" is not satisfied. If an arrangement of description "D" does obtain **AND** condition "M" is satisfied then on that occasion that arrangement of description "D" does not fall within the tax base of that sub category of the UK tax code.

This analysis also means that condition "M" is not a tax relief or tax credit because if condition "M" is satisfied the occurrence of arrangement "D" does not give rise to a liability to tax. If there is no liability to tax crystallised (because arrangement "D" together with condition "M" are not within the relevant tax base) then there is no tax liability to be relieved or credited.

Each of the concepts of (i) a liability to taxation and (ii) a tax relief or credit will be considered in turn.

6.2: Liability to taxation

Using the key concepts introduced above, a class of persons together with a class of arrangements (and the state of affairs that result from each such possible arrangement) constitute the tax base for a sub category of the UK tax code (see Figure 1) that is enacted by Parliament in order to impose a liability to taxation.

A liability to tax will arise when a person within the class of persons forming part of the tax base for a sub category of the UK tax code enters into an arrangement which forms part of the tax base for that sub category of the UK tax code. At the critical tax point that occurs when the relevant arrangement and resulting state of affairs obtains, if the sub category of the UK tax code so provides, a liability to taxation crystallises. A liability to taxation can be said to crystallise at the relevant critical tax point as a consequence of the existence of that sub category of the UK tax code together with a person who is a member of the relevant class entering into an arrangement that is also within the relevant class of arrangements.

6.3: Entitlement to a tax relief

In contrast, a tax relief or tax credit has the effect that if an arrangement and resulting state of affairs obtain and as a consequence of the existence of a sub category of the UK tax code an entitlement to a tax relief or tax credit arises, a liability to taxation that has crystallised or potentially has crystallised is possibly capable of being mitigated.

The mitigation takes the form of a reduction in the quantum of the liability to tax or a postponement of the date of payment of the liability to tax or a combination of these two elements.

There are many different types of tax relief and of tax credits within the UK tax code but for the purposes of this thesis they will all be referred to as "tax reliefs".

If an arrangement and the resulting state of affairs that obtains give rise to an entitlement to a tax relief then the benefit of the tax relief can be taken in a number of different ways, for example:

- the effect of the benefit of the tax relief can be automatic and the potential tax payer has to do nothing further to realise or to receive such benefit:
- the effect of the benefit of the tax relief can be automatic but the potential tax payer can elect not to realise or receive all or part of such benefit[147]; or,
- the benefit of the tax relief is not available automatically, instead the potential tax payer has to choose to exercise his/her entitlement to such relief.

Examples of how a tax relief would provide a benefit include the following situations:

6.3.1: Tax relief type A

An arrangement is selected and the resulting state of affairs that obtains at the critical tax point would give rise to a liability to tax under a sub category of the UK tax code **but** for the existence and application of an identifiable and different sub category of the UK tax code which provides an entitlement to a tax relief. As a result of the provisions within this sub category of the UK tax code that provides such an entitlement, no liability or a reduced liability to tax

[147] Under the UK tax code different reliefs will have different rules on whether a potential tax payer can elect not to realise or accept all or only part of the relevant relief. For example under TCGA 1992 s162A if an election is made not to realise or accept a relief none of the relief is realised or accepted but under TGCA 1992 s171A it is possible to elect to realise or accept only part of the relevant relief.

crystallises (such provisions are commonly referred to as "relieving provisions").

Relieving provisions of this type are found in many parts of the UK capital gains tax legislation. Such relieving provisions postpone the crystallisation of a liability to tax until some other arrangement occurs in the future. Examples would include, "share for share" relief for certain corporate reorganisations under which the shares in a company are transferred to a second company and the consideration provided by the purchasing company takes the form of the issue of new purchasing company shares to the seller[148] . Provided certain conditions which are specified in the relevant sub category of the UK tax code are satisfied, although a disposal of a capital asset has occurred (the shares in the company being disposed of), no liability to taxation crystallises on the disposal because of an entitlement to the relief.

In a similar fashion, "rollover relief" is available in certain types of capital asset reinvestment arrangements. If a capital asset which falls within a specified category of capital assets is disposed of for a capital profit (calculated in accordance with the relevant part of the UK tax code), it is possible to prevent the crystallisation of a liability to taxation or reduce the quantum of the liability to taxation that would otherwise arise on such a disposal by using all or part of the proceeds arising on the sale of the capital asset to invest in one or more assets that fall within a set of specified categories of capital assets[149]

6.3.2: Tax relief Type B

An arrangement obtains and as a result of the provisions of a sub category of the UK tax code the amount of taxable profit, for example, that would otherwise be brought into charge to tax, is reduced (maybe to nil) by utilising an available relief which provides a benefit by reducing the amount of taxable profit that is actually brought into charge to taxation.

[148] See section 135ff TGCA 1992.
[149] See section 152ff TGCA 1992.

Examples of this type of relief would include a claim for capital allowances following the acquisition of qualifying capital assets[150] or the offset of trading losses brought forward against current year trading profits[151].

6.3.3: Tax relief Type C

An arrangement obtains and a liability to taxation arises but an entitlement to a tax relief arises. The benefit of the tax relief is that the amount of taxation that would otherwise be due is reduced because an amount of taxation has already been paid.

A common example of this type of relief is a potential tax payer being entitled to benefit of taxation paid in another country on profits that have been subject to taxation in the other country but are also subject to tax in the UK[152].

In respect of such tax reliefs, the sub category of the UK tax code under which a tax relief will possibly be available to a potential tax payer will almost certainly contain the various conditions that must be satisfied before the relevant tax relief is available.

This chapter has argued for a distinction between tax liabilities and tax reliefs and has also argued for the existence of different types of tax relief. The importance of these distinctions will be made clear in Chapter Eight.

[150] See for example sections 11ff Capital Allowances Act 2001.
[151] See for example sections 60ff Income Tax Act 2007.
[152] See for example section 18ff Taxation (International and Other Provisions) Act 2010

PART B:

Chapter Seven: The limits and the uncertainty of tax law

7.1: Introduction

In exploring the nature of tax related behaviour a number of concepts have been introduced and explained and a number of distinctions have been drawn (see Chapter Six and Chapter Seven). This chapter considers two important aspects of the UK tax code without an understanding of which any understanding of tax related behaviour will be inadequate.

The OECD's work on intermediaries OECD (2008) which has been referred to above in Section 3.7, identified two categories of behaviour as falling under the heading "aggressive tax planning". The first is *"[p]lanning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences"*. The second is a potential tax payer *"[t]aking a position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law"*.

These two descriptions of what is identified by the OECD as aggressive tax planning are used in this thesis as a prompt for the identification of the final two aspects of the tax code that are to be discussed in this Chapter.

The two aspects that are the subject of this section are:

- the limited nature of a sub category of the UK tax code; and,
- the uncertainty or vagueness that can be associated with a sub category of the UK tax code.

These two aspects will be considered firstly in the context of the crystallisation of a liability to taxation (see Section 6.2 above). Then, secondly, consideration will be given as to how these two aspects apply to an entitlement to a relief arising (see Section 6.3 above).

7.2: The limits of a sub category of the UK tax code

Using the key terms previously discussed (see Chapter 6), a liability to taxation arises at a critical tax point if and only if there is a sub category of the UK tax code which imposes such a liability to tax as a result of a person within the class of persons that constitutes the tax base enters into an arrangement that is within the class of arrangements that constitute the tax base. It is necessary that both the arrangement (and the resulting state of affairs that obtains), and the person under consideration to be is within the tax base for that sub category of the UK tax code for any liability to taxation to crystallise.

It follows from this understanding of a tax base for a sub category of the UK tax code, that a specific tax base will not impose a liability to taxation on all possible arrangements (and the resulting states of affairs that obtain) and all persons. Rather for each sub category of the UK tax code, and hence for the tax base for that sub category of the UK tax code, there will be a specified category of arrangements and a limited number of persons that could possibly give rise to a liability to tax.

This can be represented diagrammatically as follows:

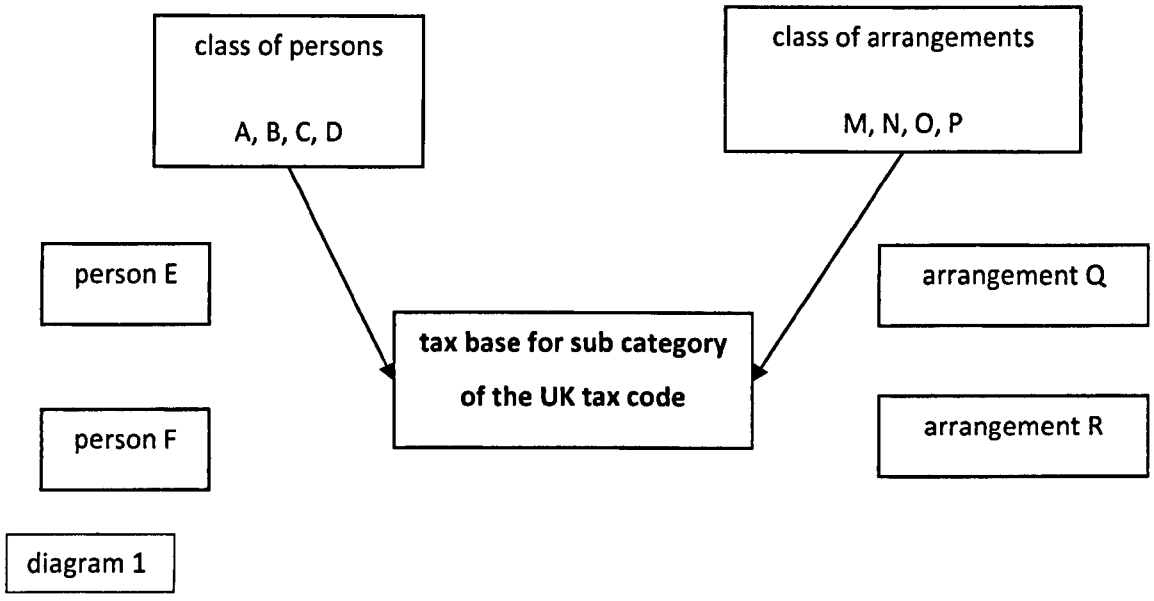

diagram 1

In the diagram, persons A, B, C and D are within the class of persons that constitute the tax base for the relevant sub category of the UK tax code. Arrangements falling under descriptions M, N, O and P are in the class of arrangements that constitute the tax base for the relevant sub category of the UK tax code.

Persons E and F are not with the relevant class of persons and cannot fall within the tax base. In a similar manner arrangements Q and R are not within the relevant class of arrangement and cannot fall within the tax base. If person E entered into an arrangement of type M then such a combination would not be within the tax base. Similarly if person A entered into an arrangement of type Q such a combination would not be within the tax base.

However person E entering into an arrangement of type M might be within the tax base for a different sub category of the UK tax code and person A entering into an arrangement of type Q might also be within a different tax base.

In the words used in Shaw et al. (2010), *"...every tax system involves the creation of boundaries of one sort or another between what is taxed and what is not, between tax payers with different tax characteristics..."* (Shaw, et al. (2010), paragraph 12.3.3)

It can therefore be concluded that in respect of any sub category of the UK tax code, the tax law which gives effect to that sub category of the UK tax code is limited in its application. That is, there will be:

- arrangements that are not within the class of arrangements that partly constitute the existence of the relevant tax base; and,
- persons that are not within the class of persons that partly constitutes the existence of the tax base for that sub category of the UK tax code.

However, as noted, this does not mean that because an arrangement and/or a person is not within the tax base for a particular sub category of the UK tax code, a person entering into an arrangement which is not within the tax base for that sub category of the UK tax code would necessarily not crystallise a liability to taxation. The arrangement (and the resulting state of affairs that obtains) that is entered into by that person might fall within the tax base for another sub category of the UK tax code.

For example the disposal of a capital asset will usually not fall within the tax base for the income tax sub category of the UK tax code but may possibly fall within the tax base of capital gains tax sub category of the UK tax code. [153]

[153] Such an example of an arrangement provides and illustration of the importance of the description that is ascribed to the arrangement and resulting state of affairs that obtains. At first blush it would appear reasonably straightforward to identify a capital asset, for example a commercial office building. If such an asset is disposed of and the description "capital asset" attached for tax purposes then the disposal would fall within a tax base which is part of the UK capital gains tax regime (see for example TGCA 1992). However the same asset could be disposed of but the description ascribed for tax purposes might be such that the disposal fell to be treated as a trading transaction (in contrast to a capital transaction). A trading transaction would be taxed under part of the income tax sub category of the UK tax code. Although the "bare facts" are the same in each case (the disposal of a commercial building), the description ascribed to the arrangement and resulting state of affairs will determine whether the transaction is taxed as capital or income.

It follows that any particular sub category of the UK tax code will only impose a liability to taxation on certain persons in combination with certain arrangements. This conclusion has the consequence that not all potential tax payers and not all possible arrangements will fall within the each tax base for a specific sub category of the UK tax code. Any tax base for a sub category of the UK tax code can be said to be limited as it does not apply to every person and/or to every arrangement.

It is possible therefore that the complete collection of tax bases which taken together constitute all of the existing sub categories of the UK tax code that can possibly imposes a liability to taxation can be considered not to contain either all possible arrangements or all possible potential tax payers.

To state the obvious, this means that there will be boundaries to the whole of the UK direct tax system. In this manner the UK tax system which is to be found in the enacted UK tax law can be said to be limited in nature as can every sub category of the UK tax code.

There will be possible arrangements (which are to be taken together with the relevant resulting state of affairs), undertaken by persons that do not give rise to a liability to tax. An example of this would be a UK tax resident but non UK domiciled individual who has income and capital gains arising outside the UK and does not remit any part of the income or gain so arising to the UK. Provided the individual has paid the annual charge that is due by reason of being a non UK domiciled individual[154], for such an individual there will be no exposure to any liability to taxation in the UK on such income or gain.

Another example which illustrates the relationship between an arrangement, a sub category of the UK tax code and the crystallisation of a liability to taxation is that of a mobile phone which can be used for private purposes which is provided to an individual who is an employee, where the provision of the phone only occurs because the individual is an employee. Almost

[154] See Schedule 12 Finance Act 2012 amending sections 809Bff Income Tax Act 2007.

certainly a mobile phone received in such circumstances if a benefit in kind received by reason of employment.

When mobile phones were first made available there was no income tax exposure for the employee. Legislation was then introduced to charge the benefit in kind to income tax. Subsequently this legislation was repealed. The current situation is that in certain circumstances a mobile phone received as a benefit by reason of employment is charged to tax but in most circumstances there is no charge. This example also demonstrates the limited nature of a sub category of the UK tax code. The benefit of an employee receiving a mobile phone was originally not taxed, then the benefit was taxed and now such benefit might or might not be taxed.

As a result of the incomplete nature of each sub category of the UK tax code, opportunities may be presented ex ante a critical tax point which offer a person a choice between more than one arrangement (together with its resulting state of affairs) and in respect of the arrangements (together with its resulting state of affairs) that are being considered each arrangement falls within the tax base for a different sub category of the UK tax code (or perhaps fall within no tax base at all).

Selecting one arrangement rather than another would crystallise at the critical tax point an amount of liability to taxation that is different from the amount of liability to taxation that would have been crystallised had a different arrangement been selected from the arrangements that were available[155].

The existence of a different tax base for each different sub category of the UK tax code provides an opportunity for a person to choose between different sub categories of the UK tax code. It is even possible that a person would enter into an arrangement (which together with the resulting state of affairs) is not with the tax base of any sub category of the UK tax code.

[155] For these purposes a different quantum of liability to tax would include the postponement of payment of a liability to tax.

Before capital gains tax was introduced in the UK[156], arrangements were entered into which, (together with the resulting state of affairs that obtained), fell outside the tax base of the income tax legislation. Such arrangements were not therefore subject to any form of taxation. Even following the introduction of the capital gains tax legislation, arbitrage opportunities[157] are available in the UK and a potential tax payer can still, in certain circumstances, enter into arrangements that fall outside the tax base of income tax (even though the relevant person is within the class of persons that fall within the tax base of a particular sub category of the UK tax code) because such a potential tax payer chooses to fall within the tax base of capital gains tax[158].

The introduction of a new sub category of the UK tax code can also be considered the cause or may act as a prompt for considering or even crafting a number of possible arrangements that were not considered or did not even exist before the introduction of the new legislation.

For example, certain types of arrangement (and the resulting state of affairs that obtain), the possibility of which existed before the introduction of a particular sub category of the UK tax code, might become more likely to be selected after a new sub category of the UK tax code is introduced. In other words, the introduction of a sub category of the UK tax code might be said to ***engender*** the coming into existence of a certain specific arrangement with the consequences that although the possibility of such arrangement existed before the introduction of the relevant sub category of the UK tax code it was unlikely that an arrangement would actually be identified and selected as there was no obvious reason or pressing need to consider entering into such an arrangement.

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[156] Capital gains tax was introduced in the UK in the Finance Act 1965.

[157] In this context the term "arbitrage opportunities" refers to the choice that is available between two or more possible arrangements in circumstances such that the liability to taxation that would crystallise following selection of the one of the arrangements is less than the liability to taxation that would crystallise if a different arrangement had been selected.

[158] See Section 8.2.1 for an explanation and description of an arrangement intended to fall within the capital gains tax base.

An example of behaviour being prompted by the introduction of a sub category of the UK tax code is provided by what happened following the introduction of a tax on windows in the UK[159]. It is reasonable to accept that before the introduction of the window tax in the UK householders could have bricked up windows. But the introduction of a tax on the number of windows in a house provided what proved to be for many households a compelling reason to brick up one or more windows.

As a consequence, given that the introduction of a sub category of the UK tax code might on occasion be said to **engender** certain arrangements, in such circumstances an engendered arrangement only comes into existence following the introduction of a certain type of tax legislation. The engendered arrangement is crafted because it falls outside the class of arrangements that constitute the tax base of the new sub category of the UK tax code.

Even if it is the case that the engendered arrangement selected falls within the tax base of another sub category of the UK tax code then the amount of the liability to tax that crystallises under the other sub category of the UK tax code might be less than the amount of tax that would otherwise have crystallised under the newly introduced sub category of the UK tax code[160].

7.2.1: Illustration of limits of a tax base

An illustration of the limited nature of a sub category of the UK tax code is to be found in the Finance Bill 2003 ("FB 2003") as originally published, which as amended became the Finance Act 2003. FB 2003 introduced new and wide

[159] The window tax was first introduced at the end of the seventeenth century and levied a tax charge on the number of windows in a house. The reasoning being that the more windows a house has, then the larger the house and the larger the house the wealthier the landowner. See http://www.historyhouse.co.uk/articles/window_tax.html for more information.

[160] See Section 8.2.1.

ranging legislation which was intended to tax certain kinds of employment related securities[161].

One sub category of the UK tax code included within the provisions of the FB 2003 as originally published applied to "convertible securities". The tax base for this new sub category of the UK tax code would have been constituted by persons in an employment relationship entering into an arrangement[162] with an asset that fell within the class of assets referred to in FB 2003 as "convertible securities". The original draft legislation was aimed at ensuring that any value or benefit received by the person or by an "associated person" falling within the tax base following a change in the rights (and possibly the class name) associated with the "convertible securities" would be taxed as employment income and not as a capital gain which before the legislation would have been the case.

FB 2003 originally defined "convertible securities" as share or securities in respect of which either (i) the employee (or associated person) had an **entitlement** to convert them into a different and more valuable type of share or security or (ii) the employee (or associated person) had **a right to acquire** such an entitlement.

> *"Finance Bill*
>
> *Schedule 22 — Employee securities and options*
>
> ***436 "Convertible securities"***
>
> *For the purposes of this Chapter securities are convertible securities if—*

[161] See Part Seven Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003"). All legislation is to enacted legislation as included in ITEPA 2003 unless quoted in text of Section 7.2.1.

[162] In the relevant legislation the "arrangement" consisted of the ownership of a convertible security by a person where the ownership only occurred because of an employment relationship. The ownership did not have to be by the person who was employed. See section 436ff ITEPA 2003.

(a) they confer on the holder an immediate or conditional entitlement to convert them into securities of a different description, or

(b) a contract, agreement, arrangement or condition authorises or requires the grant of such an entitlement to the holder if certain circumstances arise, or do not arise."

If an arrangement occurred as a consequence of which shares or securities of a particular type were acquired and an employee had (i) such an entitlement to convert or (ii) a right to acquire such entitlement to convert, then the shares or securities so acquired would constitute "convertible securities" and the employee would fall within the tax base for this sub category of the UK tax code.

In accordance with the originally published draft legislation if the right to convert was subsequently exercised or the right to convert was acquired and subsequently exercised and the shares or securities increased in value because of the exercise of such right then an amount equal to the increase was treated as employment income (as opposed to a capital gain arising as a result of an increase in the value of the shares or securities). The increase was taxed accordingly under the provisions of the new sub category of the UK tax code.

On considering the provisions of FB 2003 as originally published, it was clear that the class of arrangements that constituted part of the proposed tax base for this new sub category of the UK tax code had the consequence that an arrangement under which an employee held shares or securities which ***automatically*** converted into shares or securities of another type and as a consequence increased in value, that is the employee did not have (i) a right to convert or have (ii) an entitlement to acquire such a right, would not be within the tax base for the new proposed sub category of the UK tax code.

This understanding of the limit of the tax base of the proposed convertible securities legislation was discussed by a tax partner at a large international

law firm with the Inspector of Taxes at HMRC who was responsible for helping to facilitate the adoption of the draft legislation. In particular the discussion centred on the nature of the arrangements falling within the tax base of the proposed new sub category of the UK tax code was discussed.

Within days of the conversation Amendment 176 was made to FB 2003 and a new draft paragraph inserted which referred to automatic conversion of shares or other securities. The amendment was included in the Finance Act 2003.

"(c) a contract, agreement, arrangement or condition makes provision for the conversion of the securities (otherwise than by the holder) into securities of a different description."

The consequences of the amendment was that the class of arrangements that contributed to the tax base for the new convertible securities legislation now included an arrangement which entailed the automatic conversion of such securities.

7.2.2: Lessons from illustration

This example of new legislation creating an additional tax base within the UK tax code illustrates two matters in particular.

Firstly, when considering a sub category of the UK tax code that is intended to impose a liability to taxation, a careful consideration of the legislation may result in an appraisal or assessment being undertaken of the description of the arrangements and expected resulting state of affairs together with the description of the persons that fall within the tax base for the said sub category of the UK tax code in order to ascertain what the tax base actually is for that sub category of the UK tax code.

This will on occasion result in the recognition that there are one or more arrangements (together with resulting state of affairs) that are not within the

class of arrangements that constitute the tax base for the relevant sub category of the UK tax code[163]. The new legislation can engender a type of arrangement.

Secondly, the tax base for a sub category of the UK tax code might be different from what HMRC believes the tax base to be[164]. In respect of a sub category of the UK tax code that is intended to impose a liability to taxation, it might be possible to enter into an arrangement which has a description that does not fall within the descriptions of the arrangements that constitute the tax base for that sub category of taxation.

It is understood that until the conversation with the Inland Revenue (as it was then) referred to on the previous page, the Inland Revenue believed that the tax base for this new sub category of the UK tax code included more arrangements (and resulting states of affairs) that would be classified and described as instances of the conversion of shares or securities than the draft legislation in FB 2003 actually included. The Inland Revenue, at the time the draft FB 2003 legislation was first published, believed that the tax base for this sub category of the UK tax code included within the class of arrangements constituting the tax base more types of arrangements than was actually the case.

The limits that exist for a sub category of the UK tax code means that a person can enter into an arrangement, and the description of the arrangement (together with the resulting state of affairs) will not be within the relevant tax base for that sub category of the UK tax code.

This does not mean that the person having entered into an arrangement will not crystallise a liability to tax. Within the overall system of the UK tax code

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[163] Such a consideration of a sub category of the UK tax code will often identify what are commonly referred to as "loopholes" in the legislation. Identifying a type of arrangement that is not within the class of arrangements and entering into such an arrangement is an example of what can be referred to as the exploitation of a loophole.

[164] In addition to the example discussed from FB 2003, see also the case of Ingram v IRC [2000] 1 AC 293 discussed below in Section 7.4.2.

there will be different sub categories of the UK tax code and the arrangement might fall within the tax base for a different sub category of the UK tax code.

A person choosing between possible arrangements is an example of what has been previously referred to as taking advantage of an "arbitrage" opportunity between different types of taxation. This is recognised by Stiglitz (1985) who identifies one type of tax related behaviour as consisting in an arrangement being selected by that person because the amount or timing of the taxation applying to the selected arrangement is preferred by the potential tax payer when compared to known alternative arrangements.

7.3: Uncertainty of the tax base for a sub category of the UK tax code

The second ***aspect*** of a sub category of the UK tax code that is being considered in this part of the thesis is that although the tax base for a sub category of the UK tax code will consist of the members of the class of persons (each of which possesses the class defining characteristic or characteristics), in combination with the class of arrangements, whether a particular person is within the relevant class of persons or whether a particular arrangement (together with the resulting state of affairs) is with the relevant class of arrangement, might not be certain.

That is, in respect of any particular person and/or any particular arrangement it might not be certain as to whether such a person and/or such an arrangement is within the tax base for relevant sub category of the UK tax code.

As a consequence it will be uncertain as to whether a liability to taxation will crystallise at the critical tax point for a person entering into such an arrangement.

This means that in respect of a sub category of the UK tax code that is intended to impose a liability to taxation, it is possible to enter into an arrangement that might or might not fall within the class of arrangements

that constitute the tax base for that sub category of the UK tax code. Or, it might not be certain that the person who has entered into the arrangement is within the tax base.

It has been argued that this aspect of uncertainty is a characteristic of law in general, not just tax law. That there is a relationship of uncertainty or vagueness between the meaning of the written legislation as understood by courts, advisors, tax authorities etc (perhaps differently in each case) and the application of such legislation to arrangements that obtain in the world (see Endicott (2000),Chen et al (2004), Burton (2007), D'Amoto (1983) and Endicott (2001)).

Detailed discussion of the nature of the uncertainty or vagueness that appears to be a persistent characteristic of a system of law and of a tax code is complicated and lies in the area of jurisprudence. Such a discussion is not addressed in this thesis.

As will be argued later in this thesis in Chapter 7, the existence of uncertainty in the tax code, in certain circumstances, is a feature that should be taken into account when considering tax related behaviour in the context of the research questions of this thesis.

What can be noted however, is that if uncertainty exists in respect of:

> (i) the characteristics, qualities or attributes the possession of which is/are necessary for any person to be considered to be within the class of persons that are a constituent part of the tax base for a sub category of the UK tax code; or,
>
> (ii) the description that identifies the characteristics, qualities or attributes of an arrangement (and resulting state of affairs), the possession of which is/are necessary in order for any arrangement to be considered to be within the class of arrangements that together

with the class of persons constitute the tax base for that sub category of the UK tax code;

it might be possible to identify, describe and explain the reasons for such uncertainty.

For example, it is possible to identify characteristics, qualities and attributes which having been identified are used to define a set of persons or a set of arrangements. One or more of the identified characteristics, qualities or attributes might give rise to uncertainty as to its application[165].

In respect of tax related behaviour there will be two aspects to the uncertainty that is a characteristic of the UK tax code.

As indicated above, the first is associated with the meaning of the relevant part of the UK tax code and to what arrangements and persons the relevant sub category of the UK tax code is intended to apply.

The second is associated with the description of the arrangement that is being considered and the description of the person who has entered into that arrangement[166].

In crude terms this is difference between:

- what is the law and what does it say?
- what are the "facts" to which the law is to be applied?

When seeking to identify, describe and perhaps even assess[167] uncertainty there are a number of key questions that are important to consider.

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[165] An obvious example would be: "is this individual in an employment relationship or not?". The answer to such a question depends upon two matters, the description of the facts and the meaning of the legislation. Firstly it depends upon the characteristics, qualities and attributes of what the person actually does. It also depends upon the identified characteristics, qualities and attributes that are used to define the meaning of the term "employment relationship". What does this term mean within the relevant sub category of the UK tax code.

[166] See extract from speech of Lord Justice Mummery in Section 5.1.

These questions are to be asked about the person and the arrangement which has been entered into and also about the UK tax code.

In respect of the UK tax code key questions include:

- what is the sub category of the UK tax code that is being considered and as a consequence might result in a liability to taxation crystallising (or even an entitlement to a tax relief arising)?
- what is the description for the purposes of the relevant sub category of the UK tax code that is relevant when seeking to determine whether a person is within the class of persons to which this sub category of the UK tax code applies?
- what is the description for the purposes of the relevant sub category of the UK tax code that are relevant when seeking to determine whether an arrangement and resulting state of affairs is within the class of arrangements (and resulting state of affairs) to which this sub category of the UK tax code applies?

As previously noted, the issues associated with the vagueness or uncertainty of law, including tax law, are matters that has been the subject of considerable debate and discussion for many years. The issues that arise are not just of theoretical interest but do have practical implications In connection with the operation, application and administration of the tax code of a country.

For example the existence of a measure of uncertainty or vagueness in a sub category of the UK tax code, taken together with what might be considered to

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[167] In some cases having identified and described matters that give rise to uncertainty it is possible to assess possible responses to such uncertainty and also to assess the likely consequences of such uncertainty. For example, in the USA it is a requirement that in certain circumstances, tax advisors to a tax payer must identify and assess uncertain tax positions. Having identified an uncertain tax position the tax advisor must provide an opinion as to whether the expected tax position "is more likely than not" to crystallise. See http://www.irs.gov/Businesses/Corporations/Frequently-Asked-Questions-about-FIN-48 for further information.

be zeal on behalf of a tax authority in collecting tax revenues (Timms (2009), Gauke (2012)) can lead to situations where it becomes appropriate to raise questions about the relationship between the actions of a tax administration and the rule of law (Goldberg 2008). An illustration of this can be found in the Banking Code (HMRC (2009b) introduced in 2009 which sought to restrict the behaviour of banks operating in the UK by reference to the views of HMRC on how certain parts of the UK tax code were to be applied (see FMLC (2009) for a response to the consultation document that was published).[168]

7.4: Responses to uncertainty

Uncertainty has an impact on how a person responds to a sub category of the UK tax code and the arrangements that are to be considered.

Responses to a sub category of the UK tax code in part depend upon the knowledge and experience of the person who is seeking to understand the meaning of the particular sub category of the UK tax code under consideration and how it is to be applied to the persons and arrangements in issue.

When an individual considers a sub category of the UK tax code, it is necessary to distinguish between (i) any vagueness and uncertainty associated by the individual with the relevant sub category of the UK tax code, its tax base and the application of that tax base that arises or exists as a result of what may be termed relevant remedial characteristics[169] of the individual and (ii) any vagueness and uncertainty that is associated by the individual with the relevant sub category of the UK tax code, tax base and the application of the tax base that arises or exists as a result of the actual wording of the legislation and not as a result of remedial characteristics of the individual.

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[168] See Evans et al. (2011) for a collection of papers that address the issue of the rule of law and the discretion available to a tax authority.

[169] Remedial characteristics of an individual are those aspects of an individual that can change. The use of the term in this context refers to the lack of knowledge, experience and understanding of the relevant part of the UK tax code that is possessed by the individual. The individual does not understand or know enough about the relevant part of the tax code. Other individuals might know and understand more.

Descriptions of two such different responses to a sub category of the UK tax code are described below. These descriptions are intended to illustrate the opposite ends of a range of responses to uncertainty.

7.4.1: "subjective uncertainty" (or ignorance)

The uncertainty as to whether a particular sub category of the UK tax code being considered by a tax advisor applies or not to a proposed arrangement and to a person may arise as a result of the level of ignorance and/or lack of understanding possessed by that tax advisor. The ignorance and/or lack of uncertainty might be in respect of a failure to understand how the relevant sub category of the UK tax code is to identify and apply to persons and/or arrangements. Or the ignorance and/or uncertainty might be in respect of the description that is to be applied to the person and/or the arrangement under consideration. It is even possible for the tax advisor to fail to understand both the legislation and inadequately describe the person and the arrangement.

The more knowledgeable and experienced tax advisor would be aware of such matters as the meaning and purpose of the legislation, how it is to be applied, the context within which the legislation exists, the views of commentators, the views of HMRC and the previous rulings of the courts.

A more knowledgeable, experienced tax advisor would not be uncertain in such a situation. In such circumstances the uncertainty experienced by a less experienced tax advisor can be said to be subjective uncertainty. The ignorance and/or lack of understanding is a relevant remedial characteristic of the tax advisor. The tax advisor by learning and understanding more would be less subjectively uncertain.

7.4.2: "objective uncertainty"

Difficulties may also arise because different interested parties, for example, a tax advisor and a representative of a tax authority each of whom is very experienced and knowledgeable and has a considerable amount of

understanding in connection with the relevant sub category of the UK tax code, might still have different views on the persons and arrangements that are within a particular tax base. The type of uncertainty exhibited by expert tax advisors and tax authorities can be termed "objective uncertainty"[170].

There is no clear dividing line between subjective uncertainty and objective uncertainty, rather the number of matters or issues that are capable of being identified as uncertain will change as knowledge and/or experience increases.

Subjective uncertainty that exists can usually be reduced by selecting a more experienced and knowledgeable tax advisor or employee at the tax administration. In contrast objective uncertainty that exists in respect of the extent of a particular tax base and its content will have a bearing on the ex ante assessment of potential arrangements by a particular potential tax payer[171].

At times disagreement between a tax payer/tax advisor and a tax authority can arise because the tax authority is wedded to what it considers to be the content of the tax base of part of the tax code.

This can be illustrated by an inheritance dispute that arose between the tax payer/tax advisor and the Inland Revenue (as it was then). The inheritance tax legislation contains provisions that treat an asset that has been given away but in respect of which the donor retains an interest to remain within the estate of the donor. However the courts over many decades have decided that there is a distinction *"... between retaining an interest in the donated property and dividing property into separate interests, giving one away and retaining the other. In the latter case, no interest in the donated property was reserved."* (Hoffmann (2005)).

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[170] Many of the well known tax anti avoidance cases in the UK arise as a consequence of what might be termed "objective uncertainty". The tax authority takes on view on the application of the tax base the tax payer/tax advisor takes a different view.

[171] In practice many potential tax payers are advised by professional tax advisors, see Goldberg (2002).

In Ingram v IRC[172], Lady Ingram structured the gift of her house in such a manner that she continued to live in the house. There was a disagreement between the tax payer and the Inland Revenue (as it was then) as to how the relevant sub category of the UK tax code was to apply to such a person and to such an arrangement. The Revenue considered that such a transaction should be taxable, the House of Lords ruled otherwise. The judgement of the House of Lords was based on the principle that it was possible to have separate interests in a house, a freehold interest and a leasehold interest. In such a case, the Revenue would have classified the uncertainty as to the application of tax code as being one falling under the heading "objective uncertainty". In fact it was ignorance on the part of the Revenue ("subjective uncertainty") that prompted the dispute.

What is taken to be of relevance when considering whether a person and/or arrangement is within the tax base of a sub category of the UK tax code will almost certainly differ depending upon whether:

- one or more of the other possible arrangements being assessed ex ante will possibly give rise to a liability to tax which differs as to quantum of liability between the arrangements being considered; or,
- whether, on the other hand, one or more of the arrangements being assessed might possibly give rise to an entitlement to a relief.

This difference arises because, as has been suggested, for a liability to taxation to crystallise there must be some form of value falling under a particular description that can be identified.

In contrast, the characteristics, qualities and/or attributes of an arrangement and/or a person that can possibly give rise to an entitlement to benefit from a tax relief depends upon what Parliament has decided. The conditions that must be satisfied before some tax reliefs are available can be very straightforward and easily identifiable. For example an entitlement to an

[172] Ingram v IRC [2000] 1 AC 293

interest deduction depends upon the satisfaction of a liability to pay interest (see McNiven[173]). In contrast the benefit of a share for share exchange relief requires less obvious and apparent conditions to be satisfied (see Furniss v Dawson[174]).

7.4.3: Parliament and uncertainty

There is an assumption that applies when considering the UK tax code. When Parliament enacts any sub category of the UK tax code (usually enacted as part of the adoption of a larger set of tax legislation), Parliament intends that the tax base for that type of tax legislation will be capable of being understood and applied. Accordingly it will be possible to ascertain whether a person and/or arrangement are within the tax base.

Given the principles underlying tax legislation (clarity, equity and certainty for example)[175] it makes little sense to assume that Parliament would enact a sub category of the UK tax code the tax base of which is not capable of being understood and applied even if at the time the legislation is enacted it is not possible to list, for example, all of the arrangements falling within the tax base[176].

The assumption that the tax base for a sub category of the UK tax code is capable of being understood and applied enables the courts to determine whether a particular person entering into a particular arrangement is within or outside a particular tax base of a specific sub category of the UK tax code.

> *"The only way in which Parliament can express an intention to impose a tax is by a statute which means that such a tax is to be imposed. If that is what Parliament means, the courts should be trusted to give effect to its intention."* (Hoffmann (2005))

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[173] MacNiven v Westmoreland Investments Ltd [2001] UKHL 6 (HL)
[174] Furniss v Dawson [1984] AC 474 (HL)
[175] The characteristics of an appropriate tax system are those identified in Smith (2008) which have been referred to many writers since
[176] For example see footnote 165.

As indicated, when making such a determination, the courts are not considered to be making law but rather the courts are stating or declaring what the law has always been. Until the appropriate court has so decided, the class of persons and class of arrangements that together constitute the tax base of a sub category of the UK tax code exist, but whether a particular person and/or arrangement is within the tax base for the relevant sub category of taxation, might not be certain.

7.4.4: Practicality and uncertainty

There will of course be many sub categories of the UK tax code where in respect of a particular person and a particular arrangement there is little or no uncertainty associated with deciding whether the person and arrangement is within the tax base. It will be clear whether a person possessing one or more specific characteristics entering into an arrangement of a particular type is within the tax base for a sub category of the UK tax code.

However there will also be instances where a matter is objectively uncertain (in the sense used in this Chapter).

As indicated, this uncertainty can arise as a result of firstly a difficulty in identifying the tax base (the arrangements and the persons) and the application of the tax base. The factors which contribute to the uncertainty of the application of the relevant sub category of the UK tax code will include factors such as:

- the identification and description of the characteristic, quality or attribute that must be possessed by a person before the person is included within the tax base; and,
- the identification and description of the characteristics, qualities or attributes that must be possessed by an arrangement and resulting state of affairs for an arrangement to be included in the tax base.

The second set of reasons for "objective uncertainty" arises because of the difficulty in ascertaining an appropriate description of any one or more of a number of characteristics, qualities or attributes of either the person and/or the arrangement that the person has selected. A description of the person and the arrangement undertaken also has to be identified before it can be decided that the person and arrangement are within or not within the relevant tax base.

In practice the identification of the tax base for a sub category of the UK tax code does not always occur before the identification of an appropriate description of the person and the arrangement. A more reflexive process can occur. As the committee of the House of Lords agrees in Mawson[177]

> *32. The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description.* ***Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts.*** *It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found.* (emphasis added)

Two examples will be used to illustrate the type of situation which can give rise to uncertainty.

[177] Barclays Mercantile v Mawson [2004] UKHL 51 (2004) 76 TC 446, (HL)

Firstly, the income tax sub category of the UK tax code applies to many classes of arrangements and many classes of persons. It applies to income derived from employment.

On the basis of the simple explication immediately above, inclusion in the class of persons and arrangements which comprised the tax base for this sub category of the UK tax code will impose a liability to taxation on any income derived from employment. The tax base would include all those arrangements that consist of a person in an employment relationship providing services under an employment contract.

But there might be objective uncertainty as to the meaning of "employment" and "employee" as used within the relevant sub category of the UK tax base[178]. The words "employment" and "employee" are not defined terms and therefore of necessity will be tainted by some measure of vagueness (Endicott (2000)). If so, for a tax advisor and/or a tax authority[179], the constituent parts of the tax base of this type of legislation will not be completely certain.

In practice, the courts have, over time, developed an understanding of what "employee" and "employment" mean when used in this sub category of the UK tax code. This understanding provides a set of characteristics, qualities and attributes that can be identified and if there is a measure of correlation between the characteristics, qualities and attributes possessed by an individual and those identified by the courts then the individual might fall to be classified as an employee.

This means that even though there may be situations in which there remains a measure of "objective uncertainty" as to whether an individual is an employee for the purposes of a sub category of the UK tax code, the understanding as developed by the UK courts of what constitutes an employment and

[178] There will be a separate issue as to whether a particular individual is to be classified as an employee.

[179] Hall v Lorimer [1993] EWCA Civ 25 (a case in which the individual was not an employee) which can be contrasted with Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance [1968] 2QB497 (a case in which the individual was an employee).

employee is available to those in the UK such as tax advisors and HMRC who are trying to ascertain whether a particular individual is an employee.

The second illustration relates to CGT. UK capital gains tax applies to assets. Uncertainty has existed (and will no doubt continue to exist as different types of arrangements are invented[180]) as to whether a particular arrangement involved an asset that falls within the tax base of CGT[181]. What constitutes a capital asset for the purposes of the CGT tax base? In such circumstances whether a particular arrangement was within the class of arrangements that contribute to the tax base for CGT, might be uncertain. In considering the relevant sub category of the UK tax code, in this example CGT, the UK courts have and will continue to realise a greater understanding of the concept of a capital asset and in so doing identify as capital assets for CGT purposes assets that previously might not have been considered as being capital assets.

However in so doing the courts are not extending or reducing the tax base of CGT. Rather in identifying an asset that falls within the remit of the CGT tax base the UK court is declaring the characteristics, qualities and attributes of the arrangement (which will involve the capital asset) that partly constitute the relevant tax base.

It is only in what may be termed the "borderline" cases that should the constituent parts of the relevant tax base still be objectively uncertain (as understood by this Chapter), there is a mechanism (through the courts) which can be considered by potential tax payers and by the tax authority as a means of reaching a determined position.

[180] The demand for derivative instruments and other complex financial instruments has increased considerably over the last thirty years or so. Tax legislation has on occasion struggled to adapt to the changes and innovations in commercial practice that have occurred.
[181] See for example the case of Zim Properties Ltd v Proctor Ch D 1984, 58 TC 371; [1985] STC 90. The tax payer, Zim was held to have disposed of a capital asset when it successfully sued its solicitors for negligence. The right to sue was a chose in action, a capital asset.

7.5: Tax reliefs

The distinction between what has been referred to as:

- the limited nature of the tax base of a sub category of the UK tax code; and,
- the uncertainty of a sub category of the UK tax code

are both important when considering whether a liability to taxation arises.

The limited nature of the tax base of a sub category of the UK tax code provides opportunities for a choice to be made, where one of the reasons for choosing one arrangement rather than another arrangement is the reduction in the liability to taxation that is expected. But the identification and description of these opportunities has to take into account the uncertainty that might exist as to what constitutes the tax base for a sub category of the UK tax code and the description of the person and/or arrangement that is the appropriate description given the purpose of the tax base.

In a similar manner, the distinction between the limited nature of the tax base of a sub category of the UK tax code and the uncertainty of what class of persons and what class of arrangements is included within the tax base are both relevant when choosing, ex ante the critical tax point, between arrangements one or more of which are expected to give rise to an entitlement to a tax relief.

It has been argued in this Chapter that tax reliefs are introduced by Parliament to mitigate what would otherwise be a liability to taxation. It has also been argued that before a person is entitled to a tax relief the conditions associated with the sub category of the UK tax code which creates the tax relief must be satisfied.

These conditions will include both the clear conditions set out in the legislation which comprises the sub category of the UK tax code and also

include the implied conditions which are discerned by the courts as being those relevant conditions intended by Parliament even if not obvious from a reading of the words in the legislation.

For example the courts have decided in a number of examples of tax related behaviour that were entered into with a view to creating an entitlement to a tax relief in the form of a loss that the loss so created was not the type of loss intended by Parliament to benefit from the tax relief.[182] Identification of the implied conditions have an important role to play in determining whether a particular combination of a person together with an arrangement which obtains will be entitled to a tax relief as a consequence of that combination falling within the tax base for that relief.

The approach of the UK courts to understanding and applying tax legislation to a particular set of circumstances which is to be found in the Ramsey[183], Furniss[184] and subsequent cases, demonstrates that the UK courts seek a description of the person and the arrangement which together constitute the tax base with a view to identifying more clearly what the implied conditions associated with a sub category of the UK tax code consist of in order to decide whether or not all of the conditions have been satisfied.

7.6: Tax related behaviour: liabilities to tax and entitlement to tax reliefs

Based on the preceding analysis, there is a significant difference between:

- tax related behaviour which seeks a tax reduction through entering into an arrangement that either does not crystallise a liability to taxation or which crystallises a liability to taxation which is less than

[182] See Her Majesty's Commissioners of Inland Revenue v. Scottish Provident Institution ([2004] UKHL 52) and Howard Peter Schofield v The Commissioners for Her Majesty's Revenue and Customs [2012] EWCA Civ 927 and Ramsey (W.T.) v IRC [1982] AC 300 (HL) as a selection of cases in which the taxpayer has not established an entitlement to a tax relief on the grounds that the loss to which the taxpayer claimed entitlement was not a "real loss" for the purposes of the relevant sub category of the UK tax code.

[183] Ibid footnote above.

[184] Furniss v Dawson [1984] AC 474 (HL)

the liability to tax that would have crystallised if a different arrangement had been entered into; and

- tax related behaviour which seeks a tax reduction by receiving an entitlement to a tax relief.

In the former case the potential tax payer seeks to fall **outside** the tax base for a sub category of the UK tax code. This is possible because of the limited nature of the tax base for each sub category of the UK tax code. A tax base that seeks to impose a liability to taxation does so by identifying value which can be described. The existence of value (of some type) is required before tax can be charged.

In the latter situation the potential tax payer seeks to fall **within** the tax base of a sub category of the UK tax code. The tax base for a relief does not require the identification of value before an entitlement to relief can arise. Instead, for various reasons[185] Parliament provides tax reliefs. It is through seeking to ascertain what are to be discerned as the reasons for a tax relief that the courts are able to identify the overt and implied conditions that must be satisfied before the entitlement to the relief arises.

The next chapter, Chapter Eight, uses the analysis of tax related behaviour that has been provided in Chapters Five, Six and Seven to distinguish different types of tax related behaviour.

[185] There are many reasons why tax reliefs are enacted. To nudge behaviour in one direction rather than another is a significant reason.

PART B:

Chapter Eight: Distinguishing different types of tax related behaviour

8.1: Introduction

When seeking to answer the research questions, it is necessary to distinguish various different types of tax related behaviour.

This section is based on the preceding analysis, in particular the discussion that centred on what were identified as the four aspects of a tax code:

- tax bases under which a liability to taxation can crystallise;
- tax bases under which an entitlement to a tax relief can arise;
- the limited nature of a tax base for a sub category of the UK tax code; and,
- the uncertainty associated with the application of a tax base.

In this section the opportunities for tax related behaviour will be discussed briefly.

Then an analytic and conceptual framework will be introduced and discussed.

Finally a taxonomy of tax related behaviour will be offered.

8.2: Opportunities for choice

Before a critical tax point, a person might have an opportunity to choose between one or more different arrangements. As previously explained the choice might be between retaining the status quo and entering into an arrangement.

If the person is seeking to reduce the overall level of a tax liability as a result of a specifically selected arrangement obtaining at the critical tax point then the person can achieve such a result either by (i) choosing an arrangement that crystallises a liability to tax which is less than the amount of tax that

would have arisen if another arrangement had been selected or (ii) choosing an arrangement which provides an entitlement to a relief which can then be used to mitigate an existing or future liability to tax.

8.2.1: UK opportunities for choice

Given the extent and sophistication of the UK tax code the opportunities in the UK to reduce a tax liability by selecting one arrangement rather than another are limited (category (i) above). This is the case for both UK tax resident companies and UK tax resident individuals.

Some possibilities do remain. In the UK the possibilities of selecting between different tax bases each of which is associated with a different sub category of the UK tax code arise because of, for example, the differences that exist in the UK tax system between:

- income taxation and capital taxation;
- different types of income taxation; and,
- accounting treatment and tax treatment.

The differences that exist between rates of taxation within the different sub categories of the UK tax code enable beneficial tax positions to be selected.

Three examples will illustrate the type of choices that do exist in the UK.

The first is in the area of employee incentive arrangements (particularly senior employee incentive arrangements). Many of these arrangements are share or equity based and often take the form of an option arrangement. The employee is given the opportunity (in the form of an option) to acquire a specified number of shares at a specified price with the opportunity to exercise the option being at some time in the future. The exercise of the option is often subject to commercial performance conditions.

Subject to the conditions being satisfied, if the shares over which the option has been granted have increased in value by the time of the exercise of the

option, then the difference between the market value of the shares when the shares are acquired by the option holder at the time of option exercise and the price paid for the shares (the price paid is usually set when the option is granted) will be an amount of value which is subject to income tax.

The tax rate will be the employee's marginal rate. In certain cases (when the shares acquired as a result of the exercise of the option are listed or can be sold) in addition to income tax being payable, employer's and employee's social security costs are also payable (known as national insurance contributions ("NIC") in the UK). This means that the employee could pay 52% of the value received on the exercise of the option to HMRC.

In contrast, the highest rate of capital gains tax rates for individuals is 28%. An employee would prefer to benefit from the growth in value of any shares offered as part of an incentive arrangement on capital account rather than income account[186].

When the FA 2003 was introduced arrangements that had been available for use as an alternative to an option arrangement (the benefit of which was subject to income tax) and had been taxable on capital account were under the new legislation now to be taxed on income account.

FA 2003 engendered a new type of arrangement. Instead of providing an employee with a right to acquire shares (an option) with the hope and expectation that the shares would increase in value the employee was given the opportunity to acquire an interest in shares which amounted to a capital asset and was owned by the employee from the date on which the option would have been granted.

In effect the interest in a share acquired by the executive was an interest that was equal to any growth in value of the share. By owning such an interest

[186] The situation is complicated by the existence of UK legislation that in certain circumstances the employing company is provided with a relief which is deductable against taxable profits equal in amount to the value that is charged to income tax when an employee exercises an option.

any growth in value of the share belonged to the holder of that interest, the employee. On the disposal of that interest, a capital asset was being disposed of (the interest in the share) and the gain on disposal would be taxed at capital gains tax rates and not income tax rates.

This example illustrates how an arrangement can be crafted (the creation of an interest in a share that was equal to the growth in value of the share), how the existence of such an arrangement can be engendered by new legislation and how once the possibility of such an arrangement has been created a person may be presented with a choice between alternatives.

The second illustration relies on the tax consequences of entering into a salary sacrifice arrangement in the UK. It is possible for an employer to contract with his employee that the employee will sacrifice part of his salary and give up his contractual entitlement to be paid an amount equal to the sum sacrificed. In exchange for sacrificing part of the salary that would otherwise be payable to the employee, the employee will receive some other form of benefit. The advantage of making such a choice and entering into a salary sacrifice arrangement is that the national insurance contributions or NIC[187] consequences of receiving a benefit (rather than employment income in the form of cash) are that no NICs, either employee's or employer's, will be payable. Many employees in the UK use salary sacrifice arrangements to make additional contributions to their pension plans. The employer and the employee each benefit from the salary sacrifice. The Government collects less tax (in the form of NICs) than it would have done if the salary sacrifice had not occurred.

[187] NICs are a form of employment tax or social security contribution payable by employers and employees and calculated by reference to specified levels of employment earnings.

The third example is a common example of tax related behaviour. In simple terms an investment can take the form of an equity investment or financial investment by providing loan capital.[188]

If equity finance is provided, the return to the tax payer is by way of a distribution from the company, often in the form of a dividend which will probably be subject to income tax in the hands of the recipient. The paying company does not receive a deduction against taxable profits for the dividend paid.

The return on loan capital will be interest which will almost certainly be taxable to income tax in the hands of the recipient. Subject to any restricting legislation (see footnote 188), the interest paid by the company will be deductible against taxable profits.

The rates of tax for the recipient of a dividend and the recipient of interest are likely to be different. The company's tax position will be different depending on whether a dividend or interest is paid.

The choice between funding a company with equity debt provides an opportunity to reduce the amount of tax that is paid.

8.2.2: Non UK opportunities for choice

For a UK tax resident individual, the opportunities to mitigate tax by venturing overseas or entering into overseas based arrangements are also rather limited. Subject to certain specific exceptions[189], UK tax resident individuals are subject to tax on worldwide income and gains.

[188] There is legislation in the UK which restricts the amount of interest that can be treated as tax deductable in certain circumstances, the "thin capitalisation legislation", see section 146ff Taxation (International and Other Provisions) Act 2010.

[189] There are special provisions within the UK tax code that apply to UK tax resident individuals who are non UK domiciled.

In contrast a UK tax resident company[190] is able to take advantage of opportunities that can be engineered by using other limited companies with which it is associated. These other companies can be based outside the UK and will not be UK tax resident companies.

When the tax code adopted and operating in another jurisdiction is considered the opportunities to reduce a liability to taxation that crystallises may be increased. This is primarily because the tax code of an overseas jurisdiction will have a different set of tax bases than the set of tax bases that constitute the UK tax code.

As a consequence the characteristics, qualities and attributes that are relevant to the description of a class of persons and/or a class of arrangements for each tax base in the overseas jurisdiction can be considered and compared with the tax base of various sub categories of the UK tax code.

Such comparison enables the tax consequences of falling within one tax base rather than another to be compared. If the possibility of a reduction in taxation exists then arrangements can sometimes be crafted which take advantage of the consequences of falling within one tax base rather than a different tax base.

Given that the tax code of each jurisdiction will be different one for the other then an overseas tax code has the possibility of providing further or more opportunity for choice.

8.3: An analytic and conceptual framework

8.3.1: Introduction

It is now possible to use the previous analysis to construct an analytic and conceptual framework that will assist in understanding tax related behaviour

[190] The classification of a company as UK tax resident is different from the classification of a company as UK incorporated.

and the different categories of tax related behaviour. The analytic and conceptual framework can be used to answer the first research question.

The first research question is as follows:

> **"What are the different qualities, characteristics and/or attributes of tax related behaviour that can be identified and described and can then be used to create a taxonomy of the different types or categories of tax related behaviour?"**

Under the definition of tax related behaviour the person undertaking such behaviour must:

- intentionally undertake the action that constitutes the behaviour; and,
- believe that the action undertaken will result in a tax reduction which will benefit somebody.

These two conditions mean that it is possible to ask the question: "Why are you undertaking the action?"

The answer has to be along the following lines: "I am undertaking the action because it is believed that the tax consequence for me (or somebody with whom I am associated) of undertaking the selected action is better than the consequence that would follow the undertaking of at least one other action."

In the suggested answer, "better than" bears a neutral meaning along the lines of "retain more value". As will be suggested, whether such a belief is true or not depends on a number of matters.

An important part of tax related behaviour is the belief held about the consequences of the action undertaken. As in this thesis all tax related behaviour is intentional[191] before selecting the tax related behaviour the

[191] There are types of behaviour that can occur in a tax context which are not intentional. For example an individual who occasionally selling items on an internet auction site might give no thought as to whether or not any profit he makes is taxable. In such circumstances although

person must, in some manner have appraised the consequences of such behaviour. The appraisal might have been cursory or a more diligent appraisal might have been undertaken. The nature of the appraisal will have, it is argued an impact on the taxonomy of tax related behaviour.

8.3.2: Critical tax point

The concept of the critical tax point is important when seeking to understand tax related behaviour.

8.3.2.1: Tax positions

At the critical tax point a tax position will obtain. The following list identifies all of the tax positions that can obtain at a critical tax point.

(i) a liability to taxation crystallises;

(ii) no liability to taxation crystallises;

(iii) an entitlement to a relief arises; or,

(iv) no entitlement to a relief arises.

8.3.2.2: Known tax position

In many situations the tax position can be said to be known and there will be agreement of mind between the tax payer and HMRC as to the tax position without any need to discuss either the sub category of the UK tax code that is relevant or the arrangement undertaken.

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the individual might be considered negligent his position is understandable as whether he is making a taxable profit or not depends upon the details of his activities. This is to be contrasted with a market trader who every day trades from a stall and never pays tax on his profit. In the second case the activities undertaken are commonly recognised as generating a trading profit and the market trader should know that this is the case.

Whether or not the arrangement undertaken arises from tax related behaviour or not, most of the arrangements undertaken in the UK will be within this description.

8.3.2.3: Unknown tax positions

However, an aspect of the tax code that has been discussed is the possibility of there being uncertainty as to the application of tax base of a sub category of the UK tax code. The uncertainty of the tax base together with any uncertainty that exists concerning the appropriate description of the arrangement (and resulting state of affairs) and/or the person undertaking the arrangement could mean that either the tax payer or HMRC or both do not know what the tax position is that has obtained at the critical tax point.

If the tax position is uncertain then either the tax payer knows that the tax position is uncertain or he does not know (see "mistaken tax position" and "misleading tax position" below).

If the tax position is uncertain and this is known to the tax payer then the tax payer has a choice:

- he continues to act ex post the critical tax point knowing that the tax position is uncertain; or,
- he seeks to remove the uncertainty by discussing the matter with HMRC.

In those cases of uncertainty in which there is a desire to settle the position as to what tax position has actually obtained at the tax point one of three processes can take place.

1. The tax payer and HMRC discuss the application of part of the tax code to the person and/or arrangement and reach agreement as to how the tax code applies. The tax position is agreed and is then known.

2. The tax payer and HMRC do not or cannot agree on how the tax code is to apply to the person and/or arrangement and instead a position is reached on the tax consequences of the critical tax point. The tax position might or might not be known but the tax payer and HMRC have put an end to any tax uncertainty. This can be referred to as "doing a deal" and such actions are within the powers of HMRC and often take place[192].

3. The tax payer and HMRC do not or cannot agree on how the tax code is to apply to the person and/or arrangement and instead the courts determine how the sub category of the tax code is to be applied to the person and/or arrangement. The tax position is then certain, known and agreed.

8.3.2.4: Misleading tax positions

It is possible that whatever the tax position that has actually obtained and whether or not such a tax position is uncertain a tax payer adopts and offers a description of a tax position that is intentionally misleading.

The tax payer might or might not know the actual tax position and might or might not know whether the tax position is uncertain. It is unlikely that as a result of pure happenstance the misleading tax position that is offered is a description of the tax position that actually obtained.

8.3.2.5: Mistaken tax positions

In addition to the positions summarised above, the possibility also exists that the tax payer might believe that the tax position is known and yet this belief may be incorrect. Such a belief might be held in good faith[193] .

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[192] A widely reported example of doing such a deal is the Vodafone case. HMRC contended that tax was payable in the UK by Vodafone on an acquisition that had taken place in Germany. Vodafone disputed that tax was due. Vodafone agreed to pay HMRC an amount which is reported to have been significantly less than the amount of tax that HMRC claimed was payable. The deal meant that the dispute as to whether a sub category of the UK tax code applied to the arrangement was put to one side.

[193] An example of such a mistaken tax position might be the one that a well known UK based entertainer, Jimmy Carr, entered into which received a great deal of publicity in the media.

On the other hand a mistaken tax position might be held to be true and the tax payer does not care whether he is mistaken or not. In such circumstances the tax payer might be held culpable or negligent in holding such a belief.

At issue in such circumstances is whether:

- the actual liability to taxation that has crystallised is greater than the liability to tax that the tax payer believes has crystallised; or,
- the amount of tax relief to which the tax payer believes he is entitled is greater than the amount of tax relief to which he is actually entitled.

Even under a system of self assessment, in the case of a belief about a tax position that relates to an entitlement to a tax relief then, depending upon the nature of the tax relief to which the tax payer believes he is entitled, HMRC might have an opportunity to consider such entitlement because some form of claim has to be made.

In other situations, as a result of self assessment, HMRC will in the main, only become aware of such mistaken tax positions if the tax payer is within a group of tax payers that are subject to scrutiny. High net worth individuals, individuals with complex tax affairs, larger more complex groups of companies and tax payers involved in certain types of trades are more likely to be subject to scrutiny.

Although the discussion above has been framed in terms of the tax payer, in many circumstances a tax payer will only act on advice from one or more tax advisors. Tax advisors will not only use their knowledge of the tax code, the practice of HMRC and decisions of the courts to advise on the nature of the

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From reports in the media it would appear that the promoters of the arrangement encouraged Mr Carr to believe that he would receive loans from an offshore arrangement while at the same time strongly suggesting that such loans would never be repaid. In such circumstances it is doubtful whether such amounts advanced to Mr Carr from the offshore arrangement were in fact loans. Mr Carr probably believed in good faith that his tax position was one of "no liability to taxation has crystallised", and yet his belief was possibly mistaken (see for example: Telegraph (2012b), Telegraph (2012c), Guardian (2012d) and Guardian (2012e)).

tax position that obtains at a critical tax point but will also act tactically when disclosing matters and/or agreeing matters with HMRC. When the various possibilities concerning tax positions are discussed above the tactics of disclosure and agreement are assumed to be those of the tax payer.

In summary, at a critical tax point a tax position will obtain.

The tax position can be:

- known
- unknown and remains unknown
- unknown and a form of agreement as to the tax position is reached
- ignored and irrelevant to the tax payer
- mistaken.

Each of the above positions is important when considering tax related behaviour.

8.3.3: Ex ante or ex post tax related behaviour

When seeking to identify different types of tax related behaviour an important distinction to discuss is that between tax related behaviour that occurs ex ante a critical tax point and tax related behaviour that occurs ex post a critical tax point.

The above discussion has centred on tax positions that obtain at a critical tax point. Given the definition of tax related behaviour, tax related behaviour can be a response to the obtaining of a tax position at a critical tax point or be in anticipation of a critical tax point and the tax position that will result.

8.3.3.1: Ex ante appraisal

Before a critical tax point, a tax payer may identify two or more sub categories of the UK tax code. In respect of the identified sub categories of the UK tax code the tax payer may consider the possibility of undertaking tax related

behaviour with a view to entering into an arrangement that is within one sub category rather than any other.

The tax payer will appraise the following:

- the description of the person and arrangements that together constitute the tax base for the sub categories of the UK tax code being considered; and,
- the description of the person and the arrangement that would constitute the tax related behaviour; and,
- whether or not the tax related behaviour would be within the tax base of a sub category of the UK tax code.

There is a range of possibilities for the quality of the appraisal undertaken.

It is not considered possible to measure the quality of appraisal but it would appear that diligence, honesty, good faith, truth and integrity are characteristics that would be associated with an appraisal that is to be classified as appropriate.

In the context of tax related behaviour it is suggested that diligence, honesty, good faith, truth and integrity are fundamental characteristics. As fundamental characteristics it is not possible to justify their existence by reference to anything else. It is suggested that these characteristics are the foundations on which tax related behaviour rests.

If these characteristics are not recognised as part of the relationship that exists between the tax payer and the state to which tax is paid then such non recognition will be part of the taxonomy of tax related behaviour as understood in this thesis.

A position that does not accept the importance of such characteristics in behaviour when appraising a tax base would have to maintain that such characteristics are in some manner not foundational. It is suggested that

maintaining such a position in the context of a tax code is not consistent with other positions that would be maintained by such an advocate within society. For example a scheme of property law and contract law would also appear to require such characteristics whenever dealing occurs. Further justification of these characteristics is difficult and unfortunately is not pursued further in this thesis[194].

An appraisal that is to be classified as not appropriate or even no appraisal of the tax base at all would lack one or more of the characteristics of diligence, honesty, good faith, truth and integrity.

Such an understanding of appraisal is related to the method used to establish whether a tax base is, what has been termed, "objective uncertainty"[195].

Objective uncertainty exists in respect of the tax base of a sub category of the UK tax code if there exists uncertainty or vagueness concerning the description of the persons or the arrangements that together constitute the tax base. Objective uncertainty exists when tax payers, tax advisors and a tax authority have considered the tax base, have taken into account the legislation, commentaries, previous judgements of the courts and concluded that some aspect of the legislation is vague.

Subjective uncertainty lacks such a methodology.

In the context of appropriate appraisal a similar methodology should be adopted. The tax payer/tax advisor should consider the legislation, commentaries and previous judgements of the courts and in so doing exhibit the characteristics identified earlier. Such appraisal will result in a belief that can be justified as to what the tax position will be if tax related behaviour is undertaken. Such appraisal might conclude that the tax position is uncertain.

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[194] It would be interesting to explore further these foundational characteristic in the context of work carried out by Eabrasu (2012). His defence of private property against the taxation claims of the state will still possibly require foundation characteristics such as diligence, honesty, good faith, truth and integrity to justify property ownership.

[195] See Section 7.4.2.

Following such ex ante appraisal tax related behaviour may follow.

Ex ante appraisal will apply to both a tax base that is intended to crystallise a tax liability and a tax base that provides for a tax relief should certain conditions obtain.

8.3.3.2: Ex post disclosure

After a critical tax point a tax position will obtain.

Whether under a self assessment system or not, a tax payer then has to make disclosure of the arrangements that obtained and the tax position that has resulted.

The relationship between the beliefs of the tax payer, the behaviour of the tax payer and the actual tax position has been discussed above in connection with a tax position.

In a similar manner to an appraisal by a tax payer ex ante of a tax base, there exists a range of possibilities for the disclosure undertaken.

Appropriate disclosure will possess the characteristics of diligence, honesty, good faith, truth and integrity. Inappropriate disclosure will lack one or more of these characteristics.

Again it is considered that these characteristics are foundational in the context of tax related behaviour.

Ex post disclosure will be relevant in connection with;

- a tax base that is intended to crystallise a tax liability; or,
- a tax base that provides for a tax relief should certain conditions obtain.

8.3.4: Compliance

Compliance occurs ex post a critical tax point.

Compliance is usually limited to circumstances that require the satisfaction of a liability to taxation. This understanding is notionally extended in this thesis to apply to both:

- the satisfaction of liability to taxation that has crystallised at a critical tax point; and,
- satisfying the conditions that are required to be satisfied before an entitlement to a tax relief arises.

This notional extension of an understanding of the meaning of compliance is justified on the basis that a tax relief as understood in this thesis is to be used in some manner to mitigate a liability to tax that has crystallised or would have crystallised but for such tax relief being available. Indeed a liability to taxation that has crystallised as a result of tax related behaviour might be satisfied by the utilisation of tax relief to which a tax payer is entitled as a result of different tax related behaviour.

8.3.5: The compliance diamond and flowchart

A diagram (Diagram 1) of what is called the compliance diamond is below. The compliance diamond is a pictorial representation of the relationship between the following:

- ex ante appraisal of a tax base
- arrangement selected
- tax position that obtains
- critical tax point
- ex post disclosure and compliance.

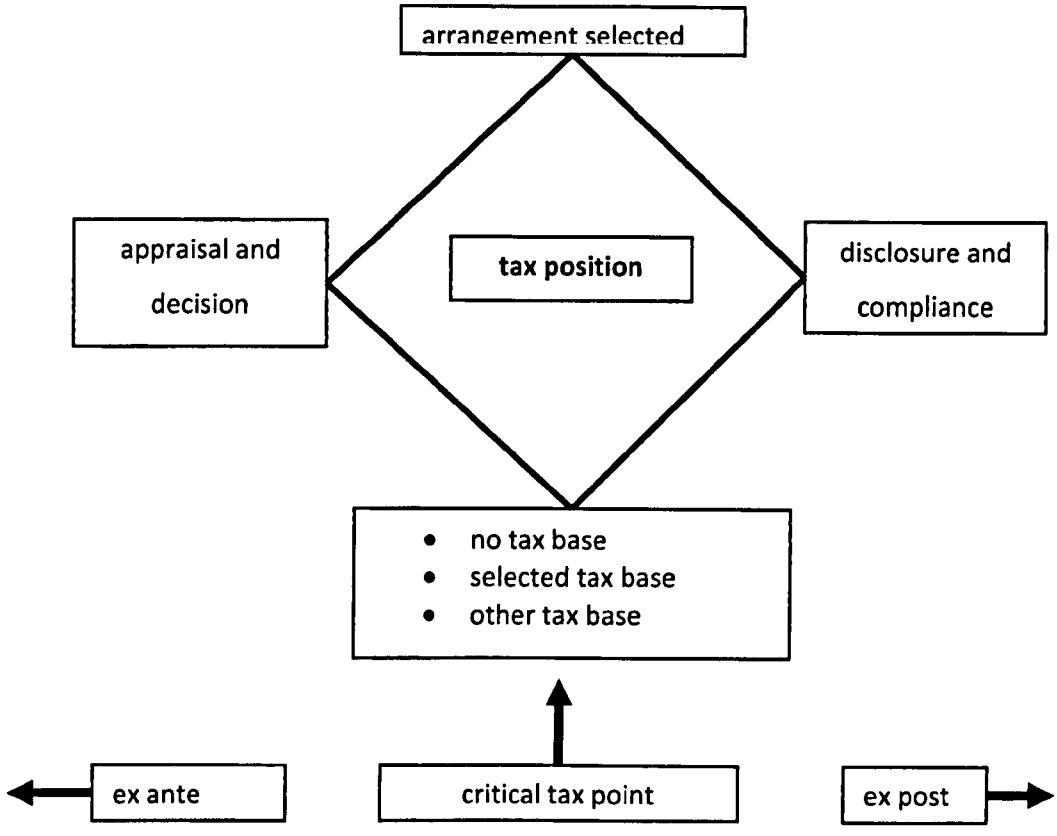


Diagram 1: compliance diamond

The Diagram 1: compliance diamond is a diagram that applies to tax related behaviour that occurs before the critical tax point.

In the Diagram 1: compliance diamond, time is represented moving from left to right. Before a critical tax point an appraisal is made of the choices available, a decision is made and an arrangement selected[196].

[196] A possibility exists that an appropriate appraisal will have been made of selected tax bases, an arrangement has been identified which is expected to be within the selected tax base and the arrangement is entered into. Mistakes have been known to occur as a consequence of which the description of the arrangement actually entered into is different from the description of the arrangement that it was intended to enter into. In such circumstances the tax position that obtains at the critical tax point is different from the tax position that was expected to obtain. For the purpose of this thesis such mistakes will not be considered further. It will be assumed that if an arrangement is selected, it is that arrangement that will be entered into.

The purpose of the tax related behaviour is to fall:

- within no tax base; or,
- within a selected tax base.

The possibility also exists, not as a result of mistakes made in implementing the arrangement[197] but as a result of not adequately appraising the tax bases being considered that at the critical tax point the arrangement actually falls within a tax base that is not expected.

Finally in the Diagram 1: compliance diamond, ex post the critical tax point disclosure and compliance are identified.

The Diagram 1: compliance diamond emphasises the importance of compliance when tax related behaviour is undertaken.

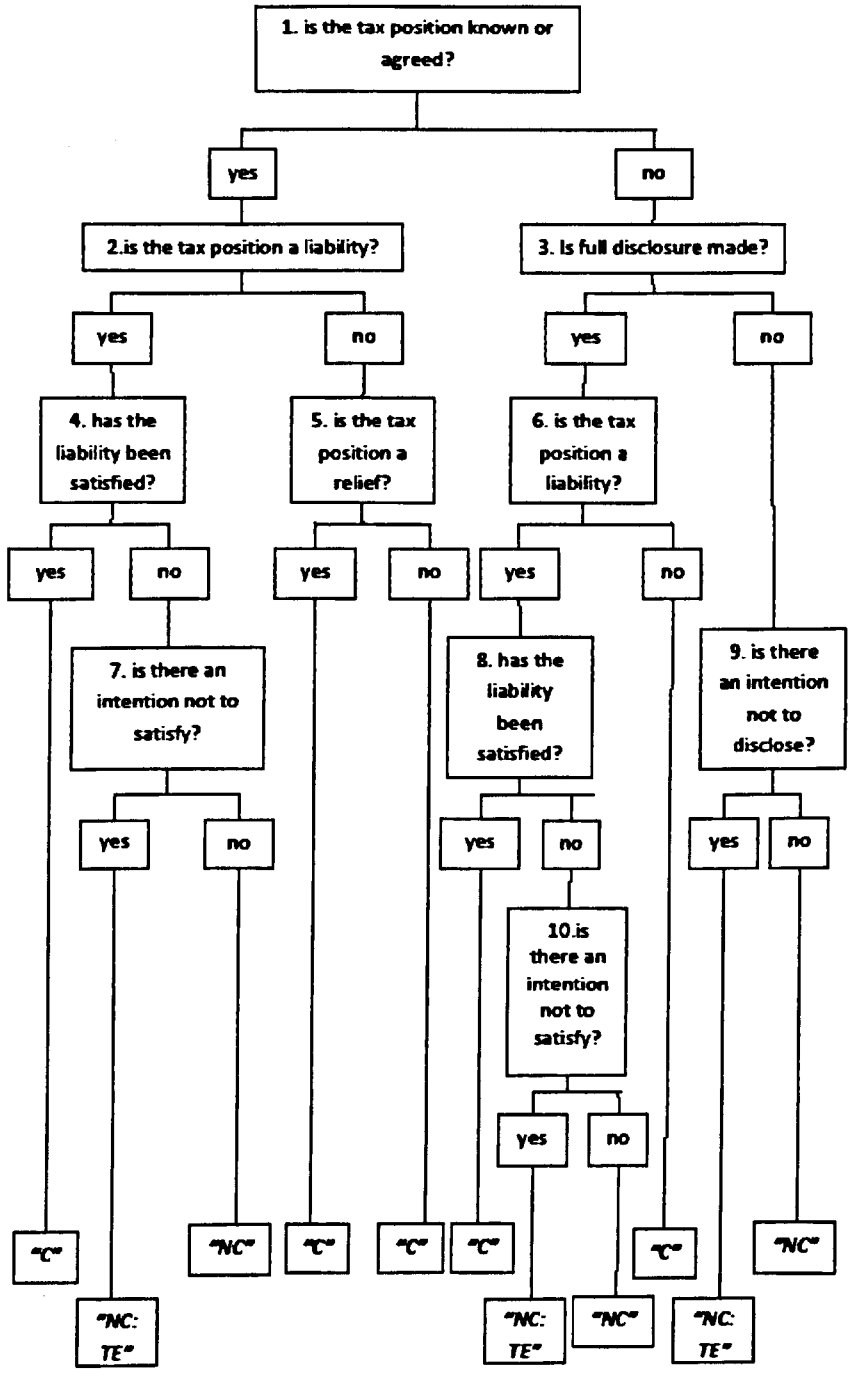
The compliance diamond is to be understood together with the flowchart set out below (Flowchart 1). As indicated the starting point for Flowchart 1 is a tax position that obtains at a critical tax point. The flowchart then sets out the possible decisions that a tax payer can make.

The key for the flowchart is as follows:

- "C" = compliant behaviour;
- "NC:TE" = non compliant "tax evasion"; and,
- "NC" = non compliant.

Compliant behaviour is when (i) any liability to taxation that crystallises at the critical tax point is satisfied and (ii) any claim to an entitlement to a tax relief is justified.

[197] See above.



Flowchart 1: the compliance/non compliance flow chart.

Non compliant "tax evasion" is when a liability to taxation that has crystallised and has not been mitigated by the utilisation of a compliant tax relief is intentionally not satisfied. Tax evasion is marked in quotation marks because there is a criminal offence that is commonly identified as tax evasion. However for the offence of tax evasion to be successfully attached to non compliant behaviour the tax payer must be charged and either plead guilty or be found guilty in a court.

Non compliant "tax evasion" will include examples of tax payer behaviour in which the tax payer is aware of a liability to taxation and intentionally does not satisfy all of that liability. The category of non compliant "tax evasion" does not depend upon being prosecuted. Non compliant "tax evasion" will apply to persons operating in the "shadow economy" as well as those that are investigated by HMRC and reach some form of settlement with HMRC in respect of the tax that is unpaid.

Non compliant behaviour is not compliant behaviour and is not non compliant "tax evasion" behaviour. Non compliant behaviour occurs when a tax payer does not satisfy a liability to taxation but does not have an intention not to satisfy such liability.

The consequence of non compliant behaviour and non compliant "tax evasion" behaviour is similar; both result in the non satisfaction of a liability to taxation. The difference between the two types of behaviour is in the intention of the tax payer. The tax payer in non compliant "tax evasion" does not intend to satisfy that liability to taxation that has crystallised. In the case of non compliant behaviour there is in principle no intention not to satisfy, rather, the tax payer can be described as ignorant or the liability to taxation or negligent as regards his tax affairs.

Establishing intention to not satisfy a liability to taxation can be very difficult[198] and to try to do so in the context of tax related behaviour is almost

[198] Compare the behaviour of Lester Piggot and Ken Dodd at footnote 90.

certainly not worthwhile. What is of more significance when seeking to understand tax related behaviour is that it leads to compliance or non compliance and that there may well be different categories of non compliance.

As indicated, the flowchart together with compliance diagram and the analysis of taxation provided earlier has been used to construct an analytic and conceptual framework which can be used to provide a taxonomy of tax related behaviour.

8.3.6: Taxonomy of tax related behaviour

Based on the previous analysis there are two types of tax related behaviour.

8.3.6.1: Type A

This type of behaviour consists of tax related behaviour that occurs after a critical tax point and seeks a tax reduction in respect of a tax position that has already obtained. Type A tax related behaviour is an ex post response to a tax position that has obtained.

If the purpose of the tax related behaviour is to obtain a tax reduction by not satisfying a liability that obtained at the tax critical point then such tax related behaviour is non compliant "tax evasion".

If the purpose of the tax related behaviour is to obtain a tax reduction by entering into an arrangement that is intended to provide the tax payer with an entitlement to a tax relief then:

- If the tax relief that is expected to be available obtains at the tax point the tax payer is compliant[199];
- If the tax relief that is expected to be available does not obtain at the tax point and the tax payer does not satisfy the original liability to

[199] In order to establish the tax position at the critical tax point the tax payer will almost certainly have to disclose and comply ex post as shown on the compliance diamond.

taxation then the tax payer is either (i) non compliant is (ii) within the category of non compliant "tax evasion".

8.3.6.2: Type B

This type of behaviour consists of tax related behaviour that occurs before a critical tax point and seeks a tax reduction through a tax position that has not yet obtained. Type B tax related behaviour is an ex ante anticipation of a tax position that is expected to obtain.

Type B tax related behaviour has to be considered within the framework provided by the compliance diamond. Ex ante appraisal and ex ante decisions have to be taken together with ex post disclosure and ex post compliance. The categories of ex ante Type B tax related behaviour are informed by and given content by ex post disclosure and compliance.

Based on the relationship between ex ante behaviour and ex post behaviour there are four possible categories of Type B tax related behaviour:

i. an ex ante intention to comply and appropriate ex post compliance;
ii. an ex ante intention to comply and inappropriate ex post compliance;
iii. an ex ante intention not to comply and inappropriate ex post compliance; and,
iv. an ex ante intention not to comply and appropriate ex post compliance.

Category (i) is compliance behaviour. Category (ii) is non compliant behaviour (and might be categorised as non compliant "tax evasion" behaviour depending upon the ex post behaviour undertaken and intentions exhibited. Category (iii) is non compliance "tax evasion" and category (iv) is compliance behaviour although this categorisation is only possible ex post.

What is of significance in this taxonomy is the aspect of uncertainty or vagueness that may be a feature of a tax base does not feature in the

description of the taxonomy. This is because, in the case of compliance behaviour the characteristics of (i) ex ante appraisal and (ii) ex post disclosure and compliance[200] facilitate the attaining of a position of certainty. Behaviour that is not compliant does not seek to attain such a position.

8.4: Tax related behaviour that "fails"

The purpose of tax related behaviour as defined in this thesis (Section 1.2.1) is to achieve a reduction in a liability to taxation.

This purpose can be assisted when seeking to crystallise a liability to taxation that is less than would be the case if a different arrangement (with the resulting state of affairs) had been selected. Such tax related behaviour can be effective because of the limitations that are inherent in any tax base of a sub category of the UK tax code.

Identifying a tax base and the person and arrangements that constitute the tax base can also assist in obtaining an entitlement to a tax relief[201] .

However another aspect of the UK tax code can frustrate the purpose of tax related behaviour when seeking a reduction in a liability to taxation. This aspect of the UK tax code is its uncertainty or vagueness (see Section 7.3).

The compliance diamond and flowchart (see Section 8.3.5) identify and explain the characteristics of different types of tax related behaviour.

What the compliance diamond and flowchart demonstrate is that it is possible ex ante for a person to have appraised relevant sub categories of the UK tax code and decided to engage in tax related behaviour and enter into an arrangement with an expectation of the tax position that will obtain at the critical tax point.

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[200] The characteristics are those of diligence, honesty, good faith, truth and integrity.
[201] See Commissioners for HMRC v David Mayes [2011] EWCA Civ 407 for a notorious example of being within the tax base of relief.

Following the critical tax point as part of the disclosure exercise the purpose of which is compliance, the tax payer discovers that the tax position that obtained is not as it was expected to be.

In such circumstances provided the tax payer complies with any obligations that arise at the critical tax point (see Section 8.3.4) then the tax payer has not engaged in behaviour that falls to be classified as either non compliant or non compliant "tax evasion".

In more traditional terms; failed tax planning/mitigation/avoidance is not necessarily the same as tax evasion and provided the tax payer complies with all obligations it will not be tax evasion.

8.5: Summary

The analytic and conceptual framework has argued for a taxonomy of tax related behaviour in which the term "tax avoidance", "tax planning", "tax mitigation" and similar terms are not required to describe ex ante tax related behaviour.

Instead, as has been argued, the description and assessment of ex ante tax related behaviour relies upon:

- a propensity to comply; and,
- the exhibition of the characteristics of diligence, honesty, good faith, truth and integrity when appraising possible alternative arrangements, the application of different tax bases and the decision to enter into an arrangement.

Ex ante tax related behaviour that does not exhibit a propensity to comply and exhibit the identified characteristics can be described as such but the categorisation of any tax related behaviour selected ex ante a critical tax point can only be labelled ex post.

The compliance diamond diagrammatically represents the relationship between ex ante tax related behaviour and ex post compliance. The flowchart categorises tax related behaviour on the basis of ex post behaviour.

Further consideration of the analytic and conceptual framework is to be found in Chapter Twelve: Discussion and conclusion.

Part C:

Chapter Nine: Rights, duties and responsibilities

9.1: Introduction

As part of the process of answering the research questions, it is necessary to understand more fully what is meant by "rights, duties and responsibilities". This chapter explores these concepts.

Consider the following:

> *"We define CSR as the **duty** of the companies (sic) to the development of its stakeholders, and to the avoidance and correction of any negative consequences caused by business activities."* (Muthuri et al. 2010) (emphasis added)
>
> *"... there is one and only one social **responsibility** of business–to use it[s] resources and engage in activities designed to increase its profits so long as it stays within the rules of the game ...."* (Freidman 1970) (emphasis added)
>
> *"Every natural or legal person is **entitled** to the peaceful enjoyment of his possessions"* (Human Rights Act 1998) (emphasis added)
>
> *"A director of a company **must** act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole"* (s172 CA 2006) (emphasis added)

The first quotation from the Muthuri et al. (2010) paper provides a definition of CSR which uses a concept of duty. Muthuri et al. (2010) identifies those to whom the duty is owed (the "stakeholders") and sets out the nature and extent of such duty.

The second quotation is by Milton Friedman and is taken from his famous 1970 New York Times article which in turn refers to his book "Capitalism and Freedom"[202]. Freidman refers to the concept of responsibility and indicates the nature and extent of the responsibility he attributes to business. Again it is possible to discern those to whom such responsibility is owed (the shareholders) and the nature and extent of such responsibility.

The third quotation is from the UK's Human Rights Act 1998[203] ("HRA 1998") and refers to the entitlement of individuals and legal persons. The entitlement of a person can be understood as meaning that the person has a right to something[204].

The final quotation sets out part of section 172 of the UK corporate code (CA 2006). The section uses the word "must". In using this word the section states the primary duty or obligation[205] of a director of a UK company. The quotation identifies those to whom the duty is owed (the company for the benefit of the members)

Concepts such as those identified above; duty, responsibility, entitlement (or right) and must (or duty/obligation) play an important role in any discussion of the subject matter of this thesis, and are particularly important when addressing the second research question. Such concepts, the role and importance that are ascribed to them have a bearing on understanding the relationship between tax related behaviour and corporate activity.

However, it is not clear that all users of such concepts such as these have a clear understanding of the concept being used or of the possible relationship between various combinations of these concepts. It is also not clear that the

[202] Capitalism and Freedom published by Chicago University Press,1962, ISBN 0-226-26401-7.
[203] The HRA 1998 incorporates into UK law the Convention for the Protection of Human Rights and Fundamental Freedoms agreed by the Council of Europe on 4 November 1950 and the part quoted is to be found in the Convention.
[204] Included within the definitions of "entitlement" offered by the online version of the Oxford English Dictionary (OED") is "to give (a person or thing) a rightful claim *to* a possession, privilege, designation, mode of treatment"
[205] The online version of the OED defines "must" as "to express a command, obligation, or necessity; (hence) an obligation, a duty; a compulsion".

users of these concepts are clear as to who or what is the bearer or subject of such concepts.

In addition, in many instances, it is also not clear whether the users of such concepts are acknowledging or, if not acknowledging at least accepting, a distinction between the use of such concepts in a legal manner or in a moral, social or even pragmatic manner.

Finally it is not clear whether the use of such concepts is being used in an aspirational normative manner with a view to identifying and describing what should be the case. That is, behaviour that is undertaken in the world does not conform to a set of rules and principles which are being advocated as the appropriate set of rules and principles. This normative use of such concepts is aspirational in that it describes an alternative possible world that should obtain rather that the world that does obtain.

The alternative to an aspirational normative use of such concepts is what can be called an empirical normative use of the concepts. In such a use, the concepts are being used in a manner that is understood and commonly accepted as applying to behaviour in the world as it is now.

For example, when Muthuri and her co-author uses the concept of duty in connection with a company, are they using the concept of duty to define what CSR is or should be? In addition given that the type of company being referred to is an arrangement that exists within a set of legal rules commonly referred to as a corporate code, is the duty a legal duty or some other type of duty and what is the relationship between the duty referred to by Muthuri and other any other duties that might be imposed by the relevant corporate code or another part of the legal system or systems within which the relevant company operates? These questions are not answered in Muthuri et al. (2010).

It is suggested that it is only when questions such as those set out in the previous paragraph are asked and an answer sought can a useful assessment

be made of Muthuri's definition and of many of Muthuri's claims. In a similar manner, many other researchers and commentators addressing all of or part of the subject matter of this thesis fail to explain in a clear manner the meaning of and relationship between the concepts that are the subject of this chapter: that is, rights, duties and responsibilities.

9.2: Three types of rights and corresponding duties

For centuries, practitioners and commentators, particularly in the area of law, have used the words "rights", "duties" and "responsibilities" and as is argued in Hohfeld (2012) it is not clear that such terms had been used by lawyers and others in a coherent and consistent manner.

Hohfeld provided a conceptual analysis of the relationship between legal rights and duties[206]. This conceptual analysis is detailed and still referred to and responded to in the twenty first century (Harris (2004), Munzer (2006), Honore (2006)). In addition Hohfeld's analysis has been used in other areas of thought, for example ethics (Thompson (1992)).

Prompted by Hohfeld's analysis, Harris (2004) offers an analysis of rights which he used to discuss the nature of human rights.

Part of his analysis is as follows:

> *"1. A person, group, corporation, people or state is said to have a right when he, she or it is supposed to have standing (either as principle or through a representative) to insist on something.*
>
> *2. The assertion of a* ***strictly-correlative right*** *expresses the content of a duty from the point of view of the subject to whom the duty is owed.*

[206] See Hohfeld (1920) for a collection of his important papers on these topics.

3. The assertion of a ***domain right*** *refers to a liberty to act or not act, or a power to control or not to control acts of others, within a protected sphere of action.*

4. The assertion of a ***background right*** *conjoins the interest of a subject with measures that are taken to be warranted as ways of protecting or promoting that interest."* (Harris (2004)), (bold emphasis added).

In Harris (2004) there are two further propositions (numbered 5 and 6) but these other propositions refer to the application of propositions 1 through to 4 to human rights. These additional propositions are not considered in this thesis.

The three types of rights, (i) strictly correlative rights, (ii) domain rights and (iii) background rights together with related duties will be used to understand and explain rights, duties and responsibilities in the context of the second research question.

9.3: Fencing duties

Harris (2004) points out that in respect of domain rights which are a liberty to act or not act or a power to control or not control the acts of others, operate within a protected sphere of action.

The protected sphere of action is bounded by what metaphorically is referred to in Harris (2004) as "fencing duties". Fencing duties are the duties which provide constraints on domain rights. Hart as quoted in Harris (2004) expresses it thus:

"... the cruder forms of interference, such as those involving assault or trespass, will be criminal or civil offences or both, and the duties or obligations not to engage in such modes of interference constitute a

protective perimeter behind which liberties exist and may be exercised."

As will be argued later in this thesis, in addition to the three types of rights outlined above, fencing duties are important when seeking to answer the second research question.

9.4: Responsibility

Milton Freidman refers to responsibility and the term used to identify a wide area of study and practice "corporate social responsibility" uses the word. But what is responsibility?

Many definitions are offered by the Oxford English Dictionary online version. Three important meanings of "responsibility" are:

i. *"Capability of fulfilling an obligation or duty; the quality of being reliable or trustworthy"*
ii. *"The state or fact of being accountable; liability, accountability* for *something"*
iii. *"The fact of having a duty to do something"*

These three meanings can be summarised as

i. capacity;
ii. accountability; and,
iii. duty.

When used in speech or writing it is not always clear which meaning "responsibility" is to bear. In the case of the quotation from Friedman (above) it is reasonably clear that "responsibility" is used in the sense of duty.

As regards the phrase "corporate social responsibility" it is not at all clear what meaning is to be ascribed to the word. This might be intentional, as to quote again Votaw (1973):

"The term [social responsibility] is a brilliant one; it means something, but not always the same thing, to everybody."

However it is considered of use in this thesis to keep the different meanings of "responsibility" in view. In order to understand and distinguish the different meanings, applications and uses it is helpful to locate the different meanings along a time axis.

When this is done the following results:

- responsibility as capacity applies to the past and to the future, it is a state or quality of the person or thing that is responsible;
- responsibility as accountability tends to apply to the past, actions have been performed and/or events have occurred and a person and/or thing is held to have been a cause, wholly or partly of the action or event;
- responsibility as duty tends to apply to actions and events that should occur. Responsibility as duty is the:
    - duty that is owed to the possessor of a strictly correlative right; or
    - the duty that allows the exercise of a domain right; or
    - the duty that facilitates a background right.

In respect of a duty that should have been undertaken but has not been undertaken, then the person who had the duty had a responsibility to satisfy the duty. The failure to satisfy the duty now means that that person is accountable for not having satisfied the duty.

9.5: Law, ethics and other matters

Rights, duties and responsibilities do not exist only in the area of law. There are well recognised ethical and social rights, duties and responsibilities.

The relationship between for example law, ethics and the requirements and benefits of society are complex and difficult and a detailed consideration is beyond the scope of this thesis.

However because of the manner in which the second research question is intentionally framed[207], it is important to consider how a distinction can be made between the rights, duties and responsibilities that fall under these different areas of interest.

It is suggested that a practical manner to make such distinctions is to ask the following question:

"What reason do you[208] have for .....?"[209]

There is to be substituted in " ?" the action or event that is being consider or undertaken.

The answer to this question will refer to:

- a legal provision;
- an ethical provision;
- a social provision; or,
- more than one type of provision.

For example

Question 1: "What reason do you have for having your will signed by two witnesses?"

[207] The second research question is as follows: "When a UK incorporated company is provided with an opportunity to engage in tax related behaviour which is expected to result in a tax reduction and thereby contribute to the retention of value by that company, what rights, duties and/or responsibilities are to be or should be considered when deciding whether to refrain from or engage in such tax related behaviour?"

[208] The "you" can refer to a "*... person, group, corporation, people or state*" (Harris (2004)).

[209] A version of this question can be asked about past behaviour or future behaviour.

Answer 1: "It is a legal provision that for a will to be valid there must be two witnesses and I want a valid will."

Question 2: "Why reason do you have for taking your son to the rugby game?"

Answer 2: "I promised I would take him as part of his birthday present."

Question 3: What reason do you have for allowing your female colleague to enter the lift before you do?"

Answer 3: "It is a social convention of which I approve and to which I try to adhere."

Question 4: "What is the reason for not taking and keeping the garden statue that is readily accessible and located in a friend's garden?"

Answer 4: "It is illegal steal, it is immoral to steal and it is inappropriate to do such a thing to a friend."

Question 1 and Answer 1 fall within the domain of law, whereas Question 2 and Answer 2 fall within the domain of ethics. Question 3 and Answer 3 look to the domain of the social and Question 4 and Answer 4 look to all three domains.

As Question 4 and Answer 4 suggest in respect of certain actions there may be issues that have a bearing on such actions that can be framed within more than one of the domains of law, ethics and the social.

Notwithstanding such instances the form of question is helpful when seeking to identify the domain or domains of law, ethics and the social that are relevant to understanding whether rights, duties and/or responsibilities are legal, ethical, social or a mixture.

Part D:

Chapter Ten: What is a company?

10.1: Introduction

In Part A the background and purpose of this thesis was presented. The research questions of this thesis link three separately identifiable areas of research. Research in each of the identified areas is conducted in a number of academic disciplines. The three areas are:

i. tax related behaviour;
ii. the corporate form; and
iii. CSR.

It was further explained in Part A that what was of importance is the meaning and application of a number of related concepts that play a key role in answering the research question and provide a link between each of the three elements identified above. The related concepts are those of right, duty[210] and responsibility. As was summarised in Chapter 9 a fruitful way in which the relationship between these concepts can be considered is through the analysis of rights provided by Harris (2004).

As part of the process of critically considering the corporate form, this **Part D** will identify and provide a description and explanation of a number of the powers, rights, duties and responsibilities that exist[211] and in some manner attach to or are associated with the corporate form. Part D will also consider the actual manner in which such powers, rights, duties and responsibilities are understood to attach or be associated with the corporate form and the

[210] For the purpose of this thesis it is assumed that the concepts of duty and obligation are synonymous.
[211] It is not the purpose of this part of the thesis to consider all powers, rights, obligations and responsibilities that exist or attach in some manner to the corporate form. For example, there are many obligations that are associated with UK companies, such an obligation to file accounts with the Registrar of Companies section 441 CA 2006 that are not considered relevant in the context of the second research question.

consequences of such attachment or association. This consideration will contribute towards a framework within which the research questions are to be answered.

However before constructing such a framework it will be helpful to consider various aspects of companies and the corporate form.

10.2: The social importance and impact of the corporate form

It is undeniable that however they are to be understood, companies are important. Companies in the 21st century have, as they have had for many decades, a significant impact on the lives of billions of individuals

10.2.1: Developed World

In the developed world[212] the goods produced and services provided by companies are all too familiar. Reference is easily and readily made to companies making the cars, trains, buses, aeroplanes that are travelled in, providing a considerable part of the entertainment that is enjoyed in the form of television programmes, films, music etc, selling consumers much of the food that is bought and the clothes that are worn and, as has been shown to be of great importance in more recent years, providing the finance facilities that are necessary for everyday life.

Many of the brands that are recognised and which are part of the "mental furniture" of tens of millions of individuals, for example, Coca Cola, Nike, Virgin, Ford are bound up with what are recognised as companies and in turn such brands play a part in what choices individuals make and, to some extent, how they live their lives (Fournier (1998), Thompson (2002), Balmer et al. (2003)).

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[212] For the purposes of this thesis, references to the "developed world" or "developed countries" may be taken to be a reference to the group of countries classified by the IMF as "advanced economies". See, for example, page 187 (part of the Statistical Appendix) of the IMF report "World Economic Outlook" April 2011 at http://www.imf.org/external/pubs/ft/weo/2011/01/pdf/text.pdf (last accessed 6 July 2011).

In addition, many individuals in the UK and in other developed countries owe their livelihoods to companies as a result of the capacity of companies to be employers[213], sources of innovation and creativity, generators of income and the purchasers of goods and services. In the developed world companies have impact and are considered by many to be some form of actor and as such play a major role in commercial and economic activity and also in what can be termed social activity.

10.2.2: Developing World

But companies do not only have a significant impact in the developed world. In the countries classified as emerging or developing by the IMF[214], it is claimed by many that some companies that operate in such countries, in addition to supplying goods and services, providing employment and contributing to commercial activity, can and do have a significant and possibly detrimental effect on the country and its population (Christian Aid (2005), Cobham (2005), Christian Aid (2008), Palan et al. (2009), UNDP (2008), UNDP (2011)[215]. Reference need only be made to such events as the Bhopal disaster[216]to appreciate the effect that property falling within the ownership[217] and control of a company can have on the part of the population of a community within a country.

Although the lives of many (if not most) individuals and the activities of many other entities of any country will almost certainly be affected in some manner by the actions, arrangements and omissions that are associated with or attributed to companies, it is also thought by many commentators that the individuals living in and the entities active in emerging or developing countries

[213] Consideration of the manner in which a company can be an employer is not within the scope of this thesis.
[214] The reference to "emerging countries" and "developing countries" is based on the IMF classification. See, for example, page 188 (part of the Statistical Appendix) of the IMF report referred to in footnote 212 above.
[215] The Oxford Report reviews a considerable part of the literature in this area.
[216] A very readable description of the Bhopal disaster is to be found in pages 3-6 of Velasquez (1988).
[217] The nature of property and the nature of ownership is not considered in any great detail in this thesis. Chapter 11 includes a brief discussion which addresses these topics,

are likely to suffer adverse consequences to a greater extent from actions, arrangements and omissions of some companies than those living or active in developed countries (see references in previous paragraph). This is possibly because the more robustly developed legal framework[218] within which companies operate in the developed world plays a part in preventing the more detrimental consequences that occur more frequently in emerging and/or developing countries obtaining in developed countries[219].

10.2.3: Groups of companies

Identifying and understanding the impact that companies can have within various types of countries[220] and on the populations of those countries is made more difficult by the increase in the number of associations of companies which are often referred to as multinational corporations ("MNCs"), transnational corporations ("TNCs") or multinational enterprises ("MNEs"). MNCs/TNCs/MNEs tend to be referred to in a manner that is similar to the references made to one single company and yet such associations of companies can consist of many hundreds of companies and the ownership and contractual arrangements that exist within such

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[218] In this context the term "robustly developed legal framework" is closely associated with the extent to which individuals, businesses and other arrangements living and operating within a country or state are able to rely on and/or have confidence in the degree to which the rule of law operates within that country or state. For example the UK, USA and Australia are countries that are considered to have more robustly developed legal frameworks. Countries such as Afghanistan or Somalia will have significantly less robustly developed legal frameworks. Russia will be somewhere in between. There is probably a link between the extent to which corruption exists within a country or state and how robustly developed is the legal framework of that country. The organisation Transparency International each year produces an index that ranks countries in order of the corruption that is perceived to exist within each country. The index for 2011 is to be found at http://cpi.transparency.org/cpi2011/ (last accessed 18 April 2012). Although not impossible, it is more unlikely that an event similar to the Bhopal disaster would have occurred in the UK, USA or Australia because companies operating in those countries are subject to and the individuals working within those countries are influenced by the more robustly developed legal framework that exists in those countries.

[219] This is not to deny that the actions of companies can have a negative impact on individuals living in the developed world. Reference need only be made to the cases of Enron and WorldCom (Sikka 2010b) amongst others, to identify examples of what are described by many as the negative consequences of the actions of companies that have occurred in recent years in developed countries.

[220] The reference to various types of country is a reference to the classification of countries as developed or developing countries see previous footnotes.

associations can be very complicated (Muchlinnski (2007)). The number of such arrangements and the growth of such arrangements has increased significantly over the last fifty years (as previously) to the extent that it is claimed by some commentators that many MNCs/TNCs/MNEs are economically larger that some countries (UNCTAD (2002)[221].

Given the importance and significance of companies throughout the world, it is not altogether surprising that the ways of talking about and referring to companies, identifying the essential nature and purpose of companies and discussing the expectations of what actions, arrangements and omissions companies should and should not be associated with has changed and continues to change within many societies[222].

10.3: The peculiar nature of a company: its origins

Even though companies are ubiquitous in many societies and are often referred to as some form of entity that is analogous to a human being with an ability to act in the world, it is not easy to identify and describe the characteristics, qualities and attributes of a company which in some manner adequately capture the nature of a company and the actions with which a company should or should not be associated.

For example, in the context of this thesis, even though CSR when considered as an area of study, is still in a development stage (Lockett (2006), Prieto-

[221] A claim such as this has to be considered with care. The usual measure of the economic size of a country is by reference to some measure of economic value added. The size of a company or group of companies is often measured by reference to turnover. Like is not being compared with like.

[222] Although discussion about the nature and purpose of companies does take place in many societies and it is assumed that there are common themes present that can be addressed in those discussions, care might have to be taken when moving from a discussion which is focussed on these topics in one country to a discussion about the same topics that takes place in another country. A reason for the need to take care is that a company, when considered from a legal point of view, is a structure or arrangement that exists within the law code which is unique to a specific country or state. As will be demonstrated in this thesis there are differences between company law codes and these differences are of relevance when considering certain issues. For example the differences may be relevant when considering the duties of directors and the understanding of such duties if the country or state in which the company is incorporated has adopted in one form or another what might be referred to as human rights legislation.

Carron (2006)), the nature of a company and the actions a company undertakes and/or should undertake are of considerable interest for CSR. Yet the nature and purpose of a company are often assumed by those researching and writing in this area to be of a certain type and there exists very little criticism of the relevant assumptions made. Indeed care is required simply to ensure that it is understood to what the word "company" is referring[223].

10.4: Different types of company

The word "company" is used by commentators in many different circumstances and there are different types of company and there are therefore different uses for the term.

From a company of soldiers or company of actors, through a firm or business trading as "ABC and company" to the large limited companies the shares of which are listed on a recognised stock exchange and the shares of which are regularly bought and sold[224]. All of these types of "things" are companies.

Derived from the Latin word for body, "corpus" a company can be nothing more than a collection of persons. However, this thesis and the research questions are primarily concerned with a certain type of company, the limited company. In particular, the thesis is concerned with the type of limited company that is created or incorporated under the provisions of the corporate code of the UK in contrast to a limited company created under the corporate code of any other jurisdiction. Although in answering the second research question the thesis will contrast certain of the characteristics,

[223] See for example Anandajan et al. (2007), a paper which discusses companies and transfer pricing and yet uses a definition of a multinational corporation which refers to firms under common control with a common pool of resources. It is not clear that the writers of this paper have distinguished between the unique nature of company (see Section 10.9) and the idea of a collective commercial entity referred to as a "firm".

[224] The categorisation of companies is rather complicated. One categorisation applies to multi participant companies and distinguishes between companies can exist even if all of the participants that existed at a point in time have ceased to exist (for example a UK limited company) and those companies that cease to exist if all of the participants cease to be (for example a partnership). Another distinction would be used to distinguish a corporation aggregate with more than one participant (for example a partnership "ABC and company") and a corporation sole with only one participant (for example the Archbishop of Canterbury).

attributes and qualities of a UK limited company with other types of organisations, the existence or creation of which does not require a corporate code[225], the nature of such other types of organisations is not a major primary concern of this thesis. To that end, and as indicated in Chapter 1, when the word "company" is used it will refer to a limited company unless the context clearly states otherwise.

10.5: History of the limited company

Part of the key to understanding the nature and purpose of a company might be found if the history and development of the corporate form was appreciated. This thesis does not provide a detailed history of the changes that have taken place and the events that occurred over the last 160 years or so which have culminated in the form of the limited company that exists today. There are numerous such histories in existence that provide aspects of the history of the development of the limited company. Whether in the form of books, monographs or academic articles, many different aspects of the history of the corporate form have been researched and discussed.

A useful overview of the history of the UK limited company is to be found in Davies (1997), Chapter 2 (History of Company Law to 1825) and Chapter 3 (History of Company Law since 1825).

Although reference will be made to the content of these chapters, the contents will not be repeated or even summarised in any detail in this thesis.

Three matters associated with the history of the UK limited company will however be noted.

[225] A corporate code is a system or collection of laws that sets out the rules that apply to the formation, operation and distribution of the type of arrangement referred to as limited company and the various persons, such as directors, members and creditors that are associated with such an arrangement. A corporate code belongs to a particular jurisdiction and each corporate code will be different one from another.

The first is that legislation was required in order to allow the form of UK limited company which is the historical predecessor to the twenty first century company that is subject to the provisions of CA 2006 to exist and operate. Before the Joint Stock Companies Act of 1844 ("1844 Act"), in the UK, any company which was to exist and operate as a "legal person" had to be created by a special Act of Parliament or by charter (Davies (1997)). The 1844 Act enabled companies to be created and registered without such a time consuming and expensive process. However, even though an "incorporated" entity, the members of a company formed under the 1844 Act did not have what is now known as "limited liability".

The 1844 Act set in train a process of change and modification to company codes which continues today and not just in the UK. The reasons for such changes and modifications are many but a significant and recurring reason is to facilitate commercial activity. For example in March 1998 a fundamental review of the framework of core UK company law was announced and a consultation document was published[226]. The consultation document contained the following:

> *"Our current framework of company law is essentially constructed on foundations which were put in place by the Victorians in the middle of the last century. There have been numerous additions, amendments and consolidations since then, but they have created a patchwork of regulation that is immensely complex and seriously out of date."*
>
> *"The object of the review will be to bring forward proposals for a modern law for the modern world. The Government is determined that the nation should have an up-to-date framework which promotes the competitiveness of UK companies and so contributes to national competitiveness and increased prosperity. "*

[226] Modern Company Law for a Competitive Economy (accessed at http://www.bis.gov.uk/files/file23283.pdf.

This consultation eventually led to CA 2006.

As will be argued later in this thesis (see Section 11.11.2), in addition to direct changes and modifications that occur within the UK company code itself[227], there are changes made in other parts of the UK legal code which impact upon UK incorporated limited companies.

The second matter to note is that limited liability for the members of a company incorporated under the 1844 Act was first introduced in the UK through the Limited Liability Act of 1855 ("1855 Act"). The 1855 Act was replaced by the Joint Stock Companies Act 1856, in the words of Davies (1997), *"... the first of the modern Companies Acts."*.

The introduction of legislation which provided for the limited liability of the members of a UK limited company was of great significance. Although it is possible to include a limit on the liability of the parties to an agreement in the terms of the agreement itself, it requires negotiation, cost and time.

Again in the words of Davies (1997):

> *"Nevertheless it is clear that without the legislative intervention, limited liability could never have been attained in a satisfactory and clear-cut fashion, and that it was this intervention which finally established companies as the major instrument in economic development."*

The third matter to note is the importance of the role played by the UK courts in reaching an understanding of and in applying the various UK company codes to the arrangements and situations that came before the courts for judgement.

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[227] For example see the changes that were made to the financial assistance regime. A comparison of the provisions contained in Chapter VI Companies Act 1985 with the provisions contained in Part 18 of CA 2006 indicates a significant relaxation of the regime that applied to the giving of financial assistance for the purchase of a company's own shares under CA 1985. This is a relaxation that was, at least in part, intended to assist commercial activity.

This importance is exemplified by the land mark decision of Salomon v Salomon[228] ("Salomon"), a judgement which is known to most if not all UK lawyers and which has had far reaching consequences around the world for over the last one hundred years[229].

When the actual judgements of the various courts in Salomon are considered it is still possible to express surprise at the decision of the House of Lords given the reasoning contained in the judgement of the Lords as compared to that to be found in the judgement of the decision of the Court of Appeal[230].

The UK courts continue to have a significant impact on the understanding and explication of the UK corporate code and how it is to be applied. It is often in the judgements of the UK courts that rights, powers, obligations and responsibilities which are attributed to companies and persons associated with companies (such as directors or creditors or members) are identified.

For example in addition to the case of Salomon v Salomon UK courts have decided many other cases which contribute to understanding the corporate form its limitations and how it is to operate, the UK courts have decided:

- the extent to which the statutory contract expressed in the corporate code can be relied upon by a person who is not a member of the relevant company (Hickman v Kent or Romney Marsh Sheep-Breeders' Association [1915] 1 Ch 881);
- that the members of a company have no interest in the assets of the company of which they are members (Macaura v Northern Assurance Co Ltd [1925] AC 619; and,
- that a director of a company must avoid conflicts of interest Bhullar v Bhullar [2003] EWCA Civ 424.

[228]Salomon v A Salomon & Co Ltd [1897] AC 22 (HL).
[229]The impact of this case is still being discussed and considered. See for example Granthan et al. (1998) a book which contains a number of essays discussing the case and its implications.
[230]Broderip v Salmon [1895] 2 Ch 323.

These are just a very few of the cases that help to explain the UK corporate code and how the code is to be understood and applied.

What this very restricted and selective history of the UK limited company is intended to illustrate is that there exists an important and necessary link between the organisations and arrangements that are identified as UK limited companies and a collection of statutes, regulations and decisions of the UK courts. The statutes, regulations and decisions of the UK courts have an important role to play in understanding what a UK limited company can do and should do.

In part the statutes, regulations and decisions of the courts have the role of providing the "fencing duties" referred to earlier.

10.6 Characteristics and qualities of a company

Even so, it is without doubt that a company, any limited company, is a curious arrangement. In addition to having an existence or at a minimum, recognition only within a system of law, which in turn is a set of principles and practices created by a particular society[231], it is undeniable that characteristics and qualities are often attributed to a company and descriptions offered of a company which are similar to those commonly attributed to and offered of some human beings. Yet on occasion there is little consensus on whether such attributions and offerings are appropriate or justified, or if they are, in what manner are they appropriate or justified.

It is not just in respect of legal characteristics and qualities that this attribution and offering occurs. Certain moral or even spiritual

[231] It is beyond the scope of this thesis to discuss the issues that are associated with the nature of law. There continues to be considerable debate in the philosophy of law as to the relationship between law (in theory and practice) and morality. The literature is very rich. Seminal works include Hart, H.L.A. (1997), Dworkin, R. (1996), Finnis, J. (2011), Fuller, L. (1977) and Raz, J. (2009).

characteristics and qualities are sometimes associated or not associated with a company although little consensus exists in respect of such matters.

For example:

> *"Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked."* Edward, First Baron Thurlow 1731-1806[232].

> *"My aim is to take some small steps toward debunking the view that a corporate organization is some kind of ghostly moral agent, what some have called an "invisible person" and others have said is "no collective name for individuals, but a living organism and a real person, with body and members and a will of its own.".* Velasquez (2003).

> *"Extending this logic, French (1979) points to the fact that corporations possess an internal decision-making system and structures which are entirely independent of the people within the company. He argues that the corporation, and not just the people within it, are moral actors and thus the proper subject of ethical evaluation (French 1979)."* Crane et al. (2008a), page 31.

In seeking an answer to the research questions, the importance and relevance of considering the nature of a company is well illustrated by the use made by Crane et al. (2008a) of the work of Peter French (for example French 1979).

The extract from Crane et al. (2008a) above identifies an important assumption concerning the moral status of a company which underlies the thesis proposed in their book. The book itself advocates a view of the

[232] The quotation is often given as indicated, see Coffee (1980), however it would appear that what was actually said was different: "Corporations have neither bodies to be punished, nor souls to be condemned; they therefore do as they like." Quoted in John Poynder *Literary Extracts* (1844) vol. 1, p. 268 (see http://en.wikiquote.org/wiki/Edward_Thurlow,_1st_Baron_Thurlow). It is interesting to note that whatever was said, the limited company, which is the dominant form of corporation today, did not exist at the time Baron Thurlow was alive.

corporation which has provided and will continue to provide much academic debate in the area of CSR, (as widely understood to include such areas of interest as corporate citizenship and sustainability), and yet the thesis of their book at least in part, depends upon a premise that is contestable (the premise advocated by French and referred to in the quotation). If the premise relied upon is not an appropriate one upon which to rely when the nature of a corporation is to be considered, then a number of the conclusions reached and recommendations made are possibly ill-founded. In an analogous manner, an answer to the second research question which simply assumed that a company was a moral agent might be very different from an answer which arose out of a critical assessment of such an assumption.

One of the purposes of this thesis is to identify and consider the rights, duties and responsibilities that are associated with a type of arrangement that is commonly referred to as a company, a type of arrangement that is recognised as having some form of existence and also, as has been indicated[233] of operating in many societies[234]. When considering tax related behaviour together with the issues that arise in the area of CSR it will be necessary to identify whether there are any relevant rights, duties and responsibilities that a company possesses or to which it is subject. If there are any such duties, rights and responsibilities it will be necessary to identify them, describe them and offer an explanation of how such duties, rights and responsibilities are "linked to" a company. It will also be necessary to identify any rights, duties and responsibilities that any individual or other entity associated or connected or linked (in some manner) to such a company possess or to which they are subject.

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[233] See Chapter 10.

[234] As will be discussed later in this thesis the arrangements referred to as "companies" would appear to share a number of common characteristics wherever such companies are to be found. See Kraakman et al. (2009) for a discussion of a number of characteristics that can be identified a possessed by most companies.

10.7: The nature of a company

As has been hinted at in the above extracts there can be widely different views held as regards the description of the nature of a company, its possible purpose and its qualities and characteristics.

Undeniably, there is some agreement as regards of certain of the more obvious characteristics that are associated with the corporate form. For example, a company continues to exist over a period of time even if the original individuals who founded the company have died. A company also has the ability to own property and the ability to be able to contract with others (Kraakman et al. (2009)). These are characteristics or qualities of a company that few would dispute. Yet these characteristics or qualities have a decidedly legal edge to them. As noted, other, less markedly legal, characteristics or qualities that may be very different in kind from legal characteristics or qualities have also been associated with the corporate form (compare Velasquez (2003) with French (1979)). Such differences in turn raise questions about the relationship, if any, that exists between on the one hand what can be called legal characteristics and qualities which are to be contrasted with on the other hand, moral or ethical[235] characteristics and qualities.

In order to be able to identify any rights, duties and responsibilities that are to be considered when answering the second research question, it is necessary to consider in more detail the nature of a company. As indicated there are a number of different views of what type of arrangement is constituted by a company and it has been argued that the view taken of the nature of a company will colour the understanding of what powers, rights, duties and responsibilities are to be considered relevant when seeking to understand companies and their role in society. This in turn might help to illuminate and assess the various categories or types of tax related behaviour.

[235] This thesis assumes that the terms "morality" and "ethics" (and their cognates) are interchangeable.

> *"... deciding whether a corporation is a person helps us decide what its rights and duties are and how we can expect it to behave. It gives us a normative framework for how we should view corporations, how they should be treated, and how they should treat us."* (Ripken 2009)

It might be suggested that expressing any measure of concern about what could be referred to as the ontology or "true" or "real" nature of a company (Foster (2005)) is misguided or at least unnecessary. Given that a company exists and operates within a legal framework which is facilitated by the law making authority[236] operating within a society[237], even though there are different descriptions of a company the nature or ontology of a company is actually simple. As understood through the legal framework that constitutes a corporate code within a country, a company is treated as if it were a person, albeit an artificial person. There is nothing more to be said. Accordingly, based on the position suggested by Ripken (2009), as a company is such a person this will inform the identification and description of the *"rights and duties"* that are relevant to the research question.

10.8: Referring to companies

It is not just that a company is an artificial person created within a legal system. It might also be suggested that holding such a straightforward view of a company as a person is supported by the way in which common forms of speech refer to a company and the manner in which many individuals and organisations actually talk about and refer to a company.

In ordinary language is it easy and rather natural to reify companies or at the very least to speak of companies in a manner which suggests a form of

[236] In addition to a law making authority a legal system also requires structures which provide for legal enforcement, interpretation and administration of the legal framework. There exist a rich literature on the nature of legal systems. The literature can arise in many parts of the academy, sociology, politics and economics, For a seminal discussion of these matters see Hart (1997).

[237] One view of a company ("company" in this context is used in a neutral manner not a meaning a limited company which by definition requires a corporate code for its existence), is that a company is a real entity that in some manner exists in any event and does not require a corporate code for its existence (Avi Yonah (2005), Foster (2005)).

existence which assumes that the "entity" being referred to is real and has some form of substance. As has been noted, there is a tendency to refer to what is a rather abstract legal concept an "artificial person", as a type of actor which as such possesses types of qualities and characteristics that are similar to those possessed by many human beings (Crane (2008a), French (1979), Muthuri (2010)).

It is common to speak of companies as doing or deciding things; to speak of Nissan making further investment in a UK car plant (Reuters (2012) or to refer to a company called Bomabadier as considering its future in the UK[238]. However even if such references and uses abound, it is not obvious that a company is what might be called a "natural kind"[239].

Although the description of a company as an "artificial person" might be considered and accepted by some as an adequate and sufficient explanatory reason, if not accepted as the only reason required justifying the apparent reification of companies and acceptance of a company as a person, it is suggested that matters are not that simple. It would be unwise to assume some form of necessary connection between the many common ways that are used to refer to companies, the status in law of a company as an artificial person and the actual "nature" of a company.

> *"The corporation's personhood is woven into the fabric of our language, indicating the corporation's nature as a real and independent person, or at least our inevitable tendency to accept it as*

[238] Bombadier is a train manufacturer in the UK who failed to gain an order for the build and sale of new trains to UK train operators see http://www.thisisstaffordshire.co.uk/Manufacturer-review-UK-plants/story-12891051-detail/story.html (last accessed 7 July 2011).

[239] Although the subject of considerable debate as to whether natural kinds exist, it can be a useful term that is used to refer to things, groupings or orderings that do not depend upon humans for existence. There is a sense in which horses and trees would exist if there were no humans, companies would not exist.

such. This is the way we talk about and think about corporations, and that has to be relevant for something." (Schane (1987))[240]

The way of referring to and describing an entity that in the case of companies, suggests that a company is a type of actor, is not restricted to companies. It is also used when speaking about other types of entity such as when HMRC[241] makes an announcement (HMRC (2012a), charities such as CAFOD saving lives in East Africa[242] or a UK law firm such as Slaughter and May being renowned for its commitment to excellence[243] By itself the use of language in such a manner illuminates little about the *"corporations nature as a real and independent person."*.

That government departments, trusts, commercial partnerships and other types of entity can be discussed and be ascribed characteristics such as desires and intentions without there being any suggestion of a separate, identifiable entity that exists in legal terms (unlike the manner in which a company is said to exist as an "artificial person") suggests that the reification of such arrangements and organisations (or at the very least, the metaphorical use of language to suggest the existence of an actual entity of some type), has little to do with a sophisticated understanding or indeed any understanding of the legal nature of the actual arrangements and organisations that exist. Instead it has more to do with the convenience that language can provide when seeking to speak about certain types of arrangement and organisations. It is easier to talk about HMRC as if it were an "it" than to be possibly more precise and recognise it as a collection of individuals seeking to fulfil various tasks on behalf of the UK Government which in turn is in a contractual relationship with those individuals.

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[240] See also Buell (2006).

[241] The name of the tax administrators in the UK.

[242] CAFOD is a charity created by way of a trust arrangement. As such it is not considered to be a person in English law (unlike a company) and yet it is possible and commonplace to refer to the actions of CAFOD see http://www.cafod.org.uk/ (last accessed 7 July 2011)

[243] Slaughter and May is a partnership in the UK and is not considered to be a separate person in English law and yet is often spoken of as if it were such a separate person see http://www.slaughterandmay.com/ (last accessed 7 July 2011).

It is one matter to acknowledge and accept that language is being used in a convenient manner, what might be termed a pragmatic use of language. It is an entirely separate matter to conclude that such usage of itself necessarily determines the nature of the entity[244] to which reference is being made.

Before concluding that there is no connection between such a use of language and the "real" nature of the entity to which the language use refers and even though the pragmatic use of language may identify a number of arrangements that have no separate legal identity as some form of an entity it might still be the case in that respect of a company because a company does have a separate legal identity the pragmatic use of language reflects, in some manner, this underlying reality, a company is a legal person that is real and independent.

However it is considered that there is no justifiable or indeed interesting link between the legal status of an entity and the language which is used to refer to and describe such an entity. This conclusion is supported by the changes that have occurred in the practice and business form of UK law firms.

Before the Limited Liability Partnership Act ("LLPA") was enacted in 2001[245] solicitors together in practice would use the business form of a partnership to conduct business. In English law a partnership is not considered to be a person separate and distinct from its partners[246]. After the 6 April 2001 many firms of solicitors that were partnerships restructured and became limited liability partnerships (Slaughter and May (see footnote 243) remains a partnership at the date of this thesis (September 2012). In ceasing business as a partnership and commencing business as an LLP something of commercial

[244] The use of the word "entity" is not meant to suggest the nature of the ontology that might or not obtain in the arrangement or organisation, it is simply a short hand used instead of repeating the phrase "arrangement or organisation".

[245] Although enacted as the Limited Liability Partnership Act 2000, the act did not come into force until 6 April 2001 see http://www.legislation.gov.uk/uksi/2000/3316/introduction/made (last accessed 7 July 2011).

[246] The situation is different in Scotland. Under section 4 Partnership Act 1890, "In Scotland a firm is a legal person distinct from the partners of whom it is composed".

and legal significance had occurred which to the extent that this was understood might have been expected to be reflected in the language used to describe such entities.

Following the formation of the limited liability partnership which carried on the business of, for example, providing legal services regulated by the Law Society[247], the liability of the actual partners, the solicitors that had previously been together in practice as a partnership[248], is reduced. An LLP offered the individuals, who were now members of an LLP rather than partners in a partnership, a measure of protection against creditor and/or client claims. As members of a LLP, the personal liability of the members for claims made against the LLP was limited in a manner in which it had not been limited when the same individuals were partners in a partnership.

The sophistication of the new LLP structure[249], its legal and actual commercial consequences of the change of structure, from partnership to LLP, even though commonly understood, in terms of the language used to refer to and describe the actions of an LLP, meant very little to most clients and very little to most of the employees. The language used to identify and refer to the firm of solicitors and the language used when discussing the actions ascribed to the firm and to the behaviour of the firm considered as an actor continued to refer to the actions, intentions, desires and achievements of a LLP in the same manner that the use of language had previously referred to the actions, intentions, desires and achievements of the earlier existing partnership even though the legal form of the business had changed significantly.

This suggests that neither the pragmatic use of language as used to speak about and to refer to companies nor the actual legal status of a company are reliable means which enable the nature or ontology of a company to be identified and described.

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[247] The Law Society regulates the provision of legal services by solicitors in England and Wales.
[248] Before "converting" the legal practice into a limited liability partnership, the legal practice fell within the provisions of the Partnership Act 1890.
[249] An LLP, is a type of company under English law, as such it is an artificial person.

Even though there exists a tendency to refer to the actions, intentions, desires and achievements of a certain type of organisation as if such an organisation was an actor in a similar ontological category as a human being[250] this does not give rise to a definitive position and has been a source of discussion and debate for over one hundred years[251].

It should not be surprising therefore that such discussion and debate have led to widely divergent views on the nature of a company. These different views in turn have informed and coloured the descriptions and explanations offered when seeking to identify and describe the powers, rights, duties and responsibilities associated with or attributed to a company.

It has also been suggested (Ripken (2009), that there may be some form of reciprocal relationship between (i) the position taken as to the nature or ontology of a company and (ii) the regulatory framework (which in turn informs practice) under which a company falls and (iii) the powers, rights, duties and responsibilities of a company.

10.9: The end of history and the twenty first century company

The summary above focussed on certain aspects of the history and characteristics of UK limited companies and the UK corporate code. Other jurisdictions also introduced versions of the limited company in the late eighteenth to mid nineteenth century and just as the understanding and operation of the corporate form developed over time within the UK so it also developed in these other jurisdictions.

As business activity increased and the world economy has become larger and more complex the development of the corporate form has continued. Although a limited company is created, operates and exists in accordance with the provisions of the corporate code of a particular jurisdiction, it has been

[250] It is assumed that most sentient human beings who are no longer children would merit the description "actor".
[251] See previous extracts and references

argued by, for example, Hansmann et al. (2000) that there is a measure of convergence as between the different corporate codes.

Even though not all scholars are in agreement with Hansmann et al. (2000), (see for example Armour et al. (2009)), what the authors of Kraakman et al. (2009) argue is that it is reasonably clear that the type of organisation that is recognised as a limited company, in the main, possesses certain characteristics or qualities that are derived from the corporate code under which the limited company is created. These characteristics or qualities are described as "five core structural characteristics of the business corporation" (Kraakman et al. (2009)).

The five structural characteristics are identified as follows (Kraakman et al. (2009)):

- legal personality;
- limited liability;
- transferable shares;
- centralised management under a board structure; and,
- shared ownership by contributors of capital.

In the words of Kraakman et al. (2009),

> *"In virtually all economically important jurisdictions, there is a basic structure that provides for the formation of firms with all of these characteristics."*

In the book[252] the approach taken to the anatomy of corporate law is grounded in a primarily economic view of law. A corporate code should, in some manner, facilitate economic transactions in an efficient manner.

Given an approach which recognises the primacy of capital investment and ownership, a major concern of the book is what is termed the "agency

[252] Kraakman et al. (2009).

problem", a concern about which much has been written[253]. When a principal relies on an agent to act on his/her/its behalf, what safeguards or controls can be implemented in order to limit the extent to which the agent acts in its own self interest rather than on behalf of the principal and ensure that *"... the ongoing costs of organizing business through the corporate form."* (Kraakman et al. (2009)) are reduced[254].

10.10: Different views through history on the nature of a company

This view of the primary purpose of a corporate code is associated with a view of a limited company as being a "nexus of contracts" (Jensen et al. (1976)) or as suggested in Kraakman et al. (2009) a "nexus *for* contracts" (emphasis in original).

The understanding of the nature of a limited company as being nothing more than a nexus of contracts is only one of the many views that exist as to the nature of a company[255]. Avi Yonah (2005) contains a summary of the history of what he identifies as the three different views of the nature of a company that have existed over the last two thousand years or so[256].

The three different views are considered to be *"....legal conceptions of the corporation"* (Avi Yonah (2005)) and Avi Yonah (2005) argues that *"...throughout all these changes spanning two millennia, the same three theories of the corporation can be discerned"*.

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[253] There is considerable volume of literature within economics on the "agency problem", Kraakman (2009) in chapter 2 provides a description of the problem and in so doing refers to key articles in the literature.

[254] For an ethical approach to this view of a corporation see Heath (2012) and Ashman et al. (2007).

[255] There is a considerable body of literature which discusses the status of the corporate form, for example, Freund (1897), Machen (1911), Laski (1916), Hallis (1930), Mark (1987), Farrar (2007), Ripken (2009), Hart (1953), Iwai (1999). Further literature can be accessed from the literature cited.

[256] It is acknowledged that questions arise as to whether it is possible to compare the type of corporate form that came into existence in the late eighteenth century to mid nineteenth century with the form of corporation that originated in Roman times. The resolution of such questions is not within the remit of this thesis. Even so Avi Yonah (2005) is useful in that it identifies three different views on the nature of identifiable types of organisation used to perform certain types of activity that resonate to some extent with the activities undertaken by limited companies in the twenty first century.

The three views identified by Avi Yonah (2005) are " *the aggregate theory, which views the corporation as an aggregate of its members or shareholders*[257]*; the artificial entity theory, which views the corporation as a creature of the State; and the real entity theory, which views the corporation as neither the sum of its owners not an extension of the state, but as a separate entity controlled by its managers."*

These three different views on the nature of a company form part of a discussion as to *"[w]hether or not the corporation should be viewed as a separate person that owes and is owed certain obligations ..."* (Ripken (2009)).

Avi Yonah argues that the real entity view of a company has dominated over that past two thousand years or so. This dominance " *suggests that management usually finds a way to do as they wish, including engaging in CSR when it may not be in the long-term interest of shareholders."* Avi Yonah (2005)

The reason a real entity view of the corporation can act like this is because as *"...the corporation is regarded as a person just like individuals, it is permitted to act philanthropically just like individuals are, and should, in fact, be praised to the extent it does so."* (ibid)

When replying to possible criticisms of this view, in particular that it is inappropriate for the "managers" of a company to spend money on CSR because the money *"belongs to the shareholders"*, Avi Yonah's response is to claim that as long as there is appropriate disclosure of the actions of the "managers" the shareholders have the choice of moving their investments, that is selling their shares[258].

Avi Yonah's conclusion flow from his examination of the history of the corporate form and his argument that the real entity view is a *"...more*

[257] The aggregated view or a corporation can be considered to be the same as the nexus of (or for) contracts view of the corporation as discussed in Kraakman et al. (2009).
[258] See Baird et al (2007) who discusses the use of assets by a person that are not owned by that person.

accurate theory of reality than either the artificial entity theory or the aggregate theory..." (ibid).

His view starts from establishing the nature of a company and he then identifies rights, duties and responsibilities that flow from this view.

This position is to be contrasted with the position for example of Velasquez (2003) who argues that a company is not a person. The rights, duties and responsibilities that Velasquez links to a company will be different from those linked by Avi Yonah.

Given the different approaches that exist to identifying and describing the different rights, duties and responsibilities that are to be linked to a company it would appear to be very difficult to actually justify a set of rights, duties and responsibilities that are linked to a company and are relevant to answering the second research question.

The next chapter argues for a solution to this situation.

Chapter Eleven: A description of a company

11.1: Introduction

This chapter argues for an understanding of the nature of a company which can then be used to address the research questions.

The various approaches that can be and are taken when seeking to establish the nature of the corporate form would appear to result in a form of dichotomy.

In connection with the identification of the rights, duties and responsibilities (legal, moral and/or social), that are to be attributed to or associated with a limited company and which are relevant for the purposes of this thesis there appears to be a difference in possible approaches which can be summarised as follows:

> (i) it is necessary firstly to determine the ontology or nature of a limited company[259] before identifying the rights, duties and responsibilities that are to be or should be attributed to or associated with such a company;
>
> OR
>
> (ii) it is necessary firstly to determine the rights, duties and responsibilities that are to be or should be attributed or associated with a limited company before the ontology or nature of such a company can be determined?

The dilemma posed by the apparent dichotomy is acute because if the approach taken is that of paragraph (i) above, then the identification and

[259] In accordance with the analysis argued for by Avi Yonah (2005) and discussed by many others (see for example, Ripken (2009), Ribstein (1991), Sugin, L. (1996), Cohen, D.L. (1998), Graver, D. (1999) and Millon, D. (1990)), the nature or ontology of a limited company appears to fall into one of three categories: (i) the aggregate entity, (ii) the artificial entity and (iii) the real entity.

description of the collection of rights, duties and responsibilities that are considered to be apposite for the second research question will be in part determined by how "real" a company is taken to be[260]. Although possibly no more than a metaphorical way of speaking, the "realness" of a company can in some manner, be equated with the extent to which the existence of the company is separate and distinct from the individuals who are associated with that company (French (1979), Muthuri et al. (2010)).

Taking a view on the "realness" of the company as the starting point will have an impact on the content of the collection of powers, rights, duties and responsibilities identified and described as a more "real" company would possibly have certain powers, rights, duties and responsibilities associated with it or attributed to it that would not be associated with or attributed to a less "real" company[261].

Even if (ii) is selected, it would appear that the position reached as a conclusion concerning the nature or ontology of company can still differ. The description of a limited company as a real person, for example as a moral agent (French (1979), is very different from the description and understanding of a company as an aggregate of individuals which amounts to nothing more than being simply a nexus for contracts (Kraakman (2009)) yet both positions appear to have been arrived at by identifying a set of powers, rights, duties and responsibilities

As suggested earlier[262] there also appears to be an element of reflexivity between the identification of a set of rights, duties and responsibilities and the description given of the nature or ontology of a limited company. As a consequence, the nature or ontology of a company determines or at least

[260] On the basis of the Avi Yonah (2005) analysis, the real entity theory of the company assumes that a company is more "real" than the artificial entity theory does, and the artificial entity theory in turn assumes that a company is more real than the aggregate theory does.
[261] For example the flexibility argued for by Avi Yonah (2005) and the wide range of duties suggested by Murthuri et al. (2010).
[262] See Section 10.4 .

intimates the type of behaviour in which it is appropriate that a limited company engage (Avi Yonah (2005)).

Whether the approach favoured is that summarised in (i) or (ii) above, as indicated previously the process of discussion concerning the nature or ontology of a company has been in train for many years and would appear to be without a readily accessible solution. To borrow a sentiment which has been expressed in the context of seeking to understand the nature of "tax avoidance", the response to the apparent dichotomy appears to turn on the "philosophical starting point" (Freedman 2008) of the person seeking a solution[263]. Given what appears to be an impasse, it is suggested that rather than wholeheartedly adopt one part of the dichotomy rather than the other, an alternative approach to these issues might be available.

11.2: Alternative approach to the nature of a company

The alternative approach will identify and describe certain qualities and/or characteristics of the arrangement that is recognised as a UK limited company. The possession of the identified qualities and/or characteristics, it will be argued, is essential for any arrangement for it to be considered a UK limited company[264]. It will be further argued that it is difficult to dispute that what is identified as being essential qualities and/or characteristics are not relevant or not appropriate, whether wholly or partly, to an understanding of the nature of a UK limited company. Such a lack of acceptance of the identified essential qualities and/or characteristics has the consequence that any person failing to accept such qualities and/or characteristics has not understood the nature of a UK limited company.

The starting point for this alternative approach will be the CA 2006. Given that any arrangement which is referred to as a limited company requires a

[263] See Section 3.5.

[264] The subject matter of this discussion is a UK limited company. The discussion will be relevant when considering limited companies that exist under company codes that are not the CA 2006 but because the detail of each corporate code will be different, it is not possible to generalise the arguments or the conclusions with any authority.

corporate code[265], then as part of the process of identifying the essential characteristics and/or qualities of a UK limited company, the legal, rights, duties and responsibilities that are attributed to and/or associated with such an arrangement as a result of the operation of the CA 2006 and the system of law within which the corporate code exists, will be identified.

However, in order to ensure that all powers, rights, duties and responsibilities that are relevant to the research question have been identified it will then be necessary, as part of this alternative approach, to consider whether there are any non legal, rights, duties and responsibilities, such as moral and/or social, rights, duties and responsibilities, that should also be attributed to and/or associated with a UK limited company. It will also consider what the relationship is between the different categories or types of, rights, duties and responsibilities that might be important. That is, this approach will consider for example the relationship that does or might exist between a legal duty and a moral duty.

This suggested approach provides an opportunity to explore the range of, rights, duties and responsibilities, legal, moral and/or social that could be attributed to and/or associated with the corporate form without deciding first whether it is necessary to determine the ontology or nature of a company and if so, how is such nature to be described.

This approach also does not limit the type of, (that is legal, moral and/or social), powers, rights and duties that are to be considered. This approach has an affinity with Occam's Razor, a common formulation of which is: "entities

[265] It is accepted as a truism that the existence of a limited company requires a corporate code to provide the legal framework within which a particular limited company exists. Although it is possible (and such arrangements may even actually occur) to purport that a limited company with the name of say, Gregory 123ABC Morris Limited , exists and to seek to enter into commercial contracts with the purported Gregory 123ABC Morris Limited as a party to the contract even though Gregory 123ABC Morris Limited has never been formed and registered under any corporate code, the qualities and/or characteristics of Gregory 123ABC Morris Limited will be very different from the qualities and/or characteristics of any limited company that is formed and registered under a corporate code.

must not be multiplied beyond necessity"[266]. Applied in this context, Occam's Razor suggests that if it is possible to identify a set of, rights, duties and responsibilities attributed to or associated with a UK limited company that is sufficient[267] and relevant to the research question, then there is no requirement to consider further the ontology or nature of a limited company.

This alternative approach was prompted in part by a combination of a theme contained in the work of Nicholas Foster[268] and by an important aspect of the corporate form referred to in Kraakman et al. (2009).

Foster (2005) and Foster (2006) discuss the relationship between an organisation, the existence of which does not rely on a corporate code and a limited company the existence of which does rely on a corporate code. It considers this relationship through the language used to refer to, describe and attribute qualities etc to these two types of arrangement considered separately. It could be described as taking a "ground up" approach in that it considers the two types of arrangement and identifies the similarities and differences between them.

Foster notes that:

> *"If, however, we wish to know more about the reality described by the word "corporation", the answer, "A corporation is a nexus of contracts" does not progress our understanding very much; indeed, we find ourselves getting tied in mental knots and we produce unsatisfactory answers because we do not have a basic understanding of the word "corporation" and what it denotes.".* (Foster (2006)

[266] It is not certain whether Occam ever said or wrote his "razor" with such a formulation. He is known to have written "It is futile to do with more things that which can be done with fewer" (*Summa Totius Logicae*, i. 12, Ockham) which expresses a similar sentiment.
[267] In this context "sufficient" means that there is no need to consider any other powers, rights, duties and responsibilities.
[268] See Foster (2005) and Foster (2006).

Similarly progress in understanding does not improve very much if the answer given is either a "real entity" or an "artificial entity" (Avi Yonah (2005)). Instead ...

> " *we should ask ourselves: "Under what conditions do we use the term "legal entity"?" rather than: "What is the legal entity?""* (both Foster (2006)).

As understood in this thesis, the approach of Foster is pragmatic in that it supports the identification of those characteristics and/or qualities that are unique to the corporate form and are not possessed by organisations that are not recognised as limited companies.

If this approach to understanding the nature of a limited company is combined with a key characteristic of a corporation that is discussed in Kraakman et al. (2009) and the impact of this characteristic on the corporate form it is possible to craft a description and an understanding of the nature of a UK limited company that in turn will provide a useful framework which will help to answer the research question.

An important characteristic of a limited company which is referred to in Kraakman et al (2009) is what is termed "entity shielding". As footnote 12 (Kraakman et al. (2009)) makes clear this term is derived from an earlier term "affirmative asset partitioning" which was explored in Hansmann et al. (2000).

In the words of Kraakman et al. (2009) entity shielding involves:

".... the demarcation of a pool of assets that are distinct from other assets owned, singly or jointly, by the firm's[269] *owners (the shareholders),* (footnote excluded) *and of which the firm itself, acting through its designated managers, is viewed in law as being the owner. The firm's right of ownership over its designated assets include the rights to use the assets, to sell them .....*

[269] This reference to a "firm" is a reference to a limited company formed under a particular corporate code and is not a reference to an unincorporated organisation.

Conversely, because these assets are conceived as belonging to the firm, rather than to the firm's owners, they are ***unavailable*** (emphasis in the original) *for attachment by the personal creditors of these persons."*

Entity shielding articulates in a clear and understandable manner the implications of the judgement of Salomon v Salomon. The owners of the company (the members or shareholders) do not own the assets of the company. This has the consequence, in most situations[270], that if the members or shareholders of a limited company are sued by their creditors, the creditors have no access to the assets of the company.

In a correlative manner, the assets owned by the members or shareholders are not owned by the company. Should the company be sued by a creditor, it is only the assets of the company to which the creditor would have access.

11.3 Description of the alternative approach

Although there might be other characteristics, attributes and qualities that also have to be considered (whether legal, moral and/or social), based on the concept of entity shielding together with the insights of Foster, a limited company can be looked upon as an arrangement under which:

- a set or collection of property, assets and resources can be identified;
- the set or collection of property, assets and resources are within what can be understood as the same ownership; and,
- in respect of the identified property, assets and resources there are rules (contained in the relevant corporate code and other parts of the jurisdictions system of law) relating to:
    - who or what has the authority to deal with such property, assets and resources; and,
    - what can be done with the property, assets and resources so identified?

[270] Circumstances in which the corporate veil can be "pierced" are not considered in this thesis.

A number of comments are necessary in order to explain this understanding of the type of arrangement identified as a limited company in more detail.

11.3.1: Property

- Reference is made in the first bullet point to "property, assets and resources". This term is being used as a general term for all assets of whatever type, tokens of which are capable of being owned within the relevant jurisdiction. In England this would include real property, intangible intellectual property, choses in action and other types of property assets and resources.
- A society in which a robust system of property rights exists is a necessary condition for a limited company to be considered in the manner being proposed. Robust property rights exist when property, assets and certain other types of resource are capable of being identified, owned and exchanged.
- Closely associated with such a condition is a further condition which is that the recognition of property rights requires a society within which some form of the rule of law is acknowledged as being of value. Although what constitutes the rule of law within a particular jurisdiction and between jurisdictions is subject to discussion and debate[271] the general principles that are relevant to assessing whether a particular society can be said to act in accordance with a rule of law are generally known (see for example McCluskey).

  It is not the purpose of this thesis to explain in detail the nature of property rights[272] or what types of behaviour within a society are to be

[271] See Evans et al. (2011) which contains various papers that discus the rule of law in the context of taxation.

[272] This thesis does not offer an analysis of the different types of property rights that can exist within a particular jurisdiction. For example it does not distinguish between real property and moveable property or between tangible and intangible property. Different jurisdictions will have different types of property rights; there is for example a difference between property law in Scotland and property law in England. There are many textbooks that provide an introduction to the various types of property rights in England, one such textbook covering many different types of property (not just land) is Clarke (2005).

encouraged or discouraged if the society is to merit the appellation of a society which abides by the rule of law. It is sufficient to accept that most democratic societies have robust property laws and seek to operate in such a manner that enables the society to claim allegiance to a social and legal system that is consistent with and expresses the rule of law.

11.3.2: Authority and/or power to deal

-Having identified a bundle of property, assets and other resources, the understanding of a limited company set out above requires some form of system and/or collection of procedures which is capable of identifying those persons that within the system and/or collection of procedures have authority to deal with and/or use the set of property, assets and other resources in accordance with the relevant collection of law that applies. This understanding of a company does not allow just any person to deal lawfully with the property, assets and other resources included within the set or collection that is owned by the arrangement identified as a limited company. A specific class of persons is authorised or empowered to deal with or use such property, assets and other resources. Under the CA 2006 for a UK limited company that is not insolvent[273], it is the directors of the company that have such authorisation or power.

[273] What can be termed the "normal rules" for a UK limited company apply when the company is solvent and insolvency is not foreseen. Special rules apply if the company is insolvent or the directors form a view that the company might become insolvent. This thesis primarily addresses solvent companies. The issues surrounding the different authorities and powers that directors have when a company is solvent or insolvent are complex, see for example the provisions of section 172(3) CA 2006 under which the primary duty of a director contained in section 172(1) CA 2006 is put to one side if there is a provision that requires the director "to consider or act in the interest of creditors of the company.", a situation that would arise in the case of possible insolvency.

11.3.3: What is to be done?

- This proposed understanding of a company requires that in addition to identifying the persons with the authority and the power to deal and/or use the property, assets and other resources of the company, it is then necessary to establish what can be and should be done with the property, assets and resources.

As will be discussed in Sections 11.6, 11.7 and 11.8 and generally in Chapter 11, the CA 2006 includes provisions that make clear what type or class of actions can be undertaken by the persons with the appropriate authority and power over the bundle of property, assets and other resources recognised within the system of UK law as being within the ownership of a particular UK limited company.

As will also be discussed, it is arguable that the type or class of actions that can be undertaken by such authorised persons will differ from one jurisdiction to another with such differences being determined by a combination of the understanding of and application of the company code that has been adopted in each of the different jurisdictions and the system of law operating within that jurisdiction. If such an arrangement is tenable, then any conclusions reached in respect of the differences that exist between jurisdictions as to the type or class of actions that can be undertaken can be expected to have implications when seeking to understand the rights, duties and responsibilities that are considered to be part of and essential to an understanding of CSR within a particular jurisdiction.

It is considered that the above understanding of a company is consistent with the three main descriptions of a company that have been discussed over the last one hundred years or more (Avi Yonah (2005)).

Whether a company is considered to be a nexus of contracts (the aggregate theory) an artificial entity or a real entity, it is still necessary to ask three questions:

- what property, assets and resources "belong" to the company?
- who has authority and/or power to deal with the property, assets and resources?
- what can be and what should be done with the property, assets and resources that "belong" to the company by the persons that possess the relevant authority and/or power?

A more detailed consideration of the possible answers to these three questions for a UK limited company will provide a framework within which the powers, rights, duties and responsibilities that are relevant to the assessment of various categories or types of tax related behaviour can be identified.

This thesis does not intend to provide a textbook type analysis of the UK company code[274]. Rather it will identify matters relevant to answering the three questions set out above.

11.4: "Belonging" to a company

When a UK limited company is created[275] assets[276] are acquired by the relevant company[277]. The assets so acquired are identified as belonging to the company that has been created.

This is obviously the case if value is provided by the first members when shares are issued by the company. Value ceases to be owned by the first

[274] There are many textbooks that are able to provide a general understanding of the UK corporate code. For example see Davies (2008). For cases and materials in company law see Sealy et al. (2010), to which reference has been made in writing this chapter.
[275] CA 2006 refers to a company being "formed and registered", (section 1 CA 2006).
[276] The word "assets" will be used to refer in a general way to the property, assets and resources that are identified within the UK legal system as belonging to a company.
[277] CA 2006 makes clear that a company is formed by one or more persons subscribing their names to a memorandum of association (often referred to as a company's constitution), and complying with the registration requirements for a company (section 7 CA 2006). It is possible for there to be a single first member of a new company.

members and the value is then recognised by the legal system in the UK as being owned by the company so formed and registered. However, even if a company is formed and registered and the first members do not actually provide for the transfer of value as consideration for the shares issued at formation, the company is still in possession of an asset. The asset the company possesses is the right (often contained in the constitution of the company) to call for the unpaid amount outstanding on the shares that have been issued[278].

Further assets can be acquired by the company.

Additional assets will be acquired when further shares are issued, finance facilities drawn down (although a more or less equal liability will be initially recognised in the accounts), capital contributions are made to the company and the assets of the company are used in such a manner as to create value (most usually recognised in the form of profit in the accounts).

Not all of the assets recognised as being owned by a company will have a monetary value attached to them and/or be recognised as an asset in the financial accounts of the company. For example "goodwill"[279] generated by a company (in contrast to "goodwill" that is purchased), is unlikely to have a monetary value attached to it in the accounts of that company.

The assets of a UK limited company (that is not insolvent) can only cease to be "owned" by that company in one of a limited number of ways.

Assets can cease to be owned by the company when, for example, the assets are:

- given as consideration for the receipt of goods and/or services;

[278] In the case of the formation of certain types of UK limited companies, for example a public limited company, at least part of the consideration due on the issue of the first shares must be supplied to the company, see section 586 CA 2006.

[279] An interesting discussion as to the nature of goodwill, albeit from an Australian perspective is to be found in Walpole (2006), particularly in Chapter 4 of that thesis.

- used to satisfy an obligation imposed by law in respect of which no goods and/or services are received directly in return, such as the satisfaction of an obligation to pay tax;
- given as a gift to particular types of organisations, such as charities or political parties[280]. Although such gifts are not given as part or all of the consideration due for the receipt of goods or services, it will be argued that the donor should receive some benefit in return for the gift;
- made available to members of the company in the form of a distribution[281] or otherwise. The most common type of a return of assets to the members is by way of the payment of a dividend, but the distribution in kind of assets can also occur and shares can be purchased[282] or redeemed by the company in with the consideration received by the shareholder taking the form of assets or cash;
- a liquidator is appointed.

Disputes might arise as to whether or not a particular asset belongs to a particular company but such disputes as to ownership can occur between persons other than companies and the possibility of such disputes occurring will not be considered further in this thesis.

The UK corporate code in combination with the UK legal system provides a set of rules and procedures that identify what assets are owned by a UK limited company, what assets are acquired and what assets cease to be owned by the company.

11.5: Who has authority and/or power to deal with the property, assets and resources?

Although it is possible to identify the property, assets and resources owned by a UK limited company the second question then arises; who has the power

[280] Sections 262ff CA 2006.
[281] Sections 829ff CA 2006.
[282] Part 18, Sections 658ff CA 2006.

or authority to use or deal with those assets? In the words of Viscount Haldane in a judgement involving liability, in legal terms[283]:

> *"...a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation. ...."*[284]

When a UK limited company is formed and registered it is necessary that there be members who sign the memorandum of association of the company[285]and that the names of the proposed officers[286] of the company are supplied to the registrar of companies. The officers of a company are the directors and the company secretary.

As indicated in Viscount Haldane's words a company has no mind or body of its own. It is the members and officers of a company who between them can be the only candidates for the title of *"the directing mind and will of the corporation"*[287].

In a more recent judgement, Lord Hoffman sought to explain the manner in which actions can be ascribed to a company[288], Lord Hoffman said:

> *"Any proposition about a company necessarily involves a reference to a set of rules. A company exists because there is a rule (usually in a*

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[283] French (1979) argues that only understanding a company in "legal terms" is too simplistic. This matter will be considered further in Sections 10 and 11.
[284] Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd [1915] AC 705.
[285] Section 7 CA 2006.
[286] Section 12 CA 2006.
[287] It is possible for the members and officers of a company to be other companies. This complicates matters but eventually there will be one or more human beings who are members and officers of a company. For the purposes of this thesis these complications will not be addressed, instead it will be assumed that human being are the members and officers of any company being considered unless it is otherwise made clear.
[288] Meridian Global Funds Management Asia Ltd v Securities Commission [1995] (Privy Council).

statute) which says that a persona ficta shall be deemed to exist and to have certain of the powers, rights and duties of a natural person. But there would be little sense in deeming such a persona ficta to exist unless there were also rules to tell one what acts were to count as acts of the company. .... The company's primary rules of attribution will generally be found in its constitution, typically the articles of association, and will say things such as "for the purpose of appointing members of the board, a majority vote of the shareholders shall be a decision of the company" or "the decisions of the board in managing the company's business shall be the decision of the company"."

In a very summary form, Lord Hoffman highlights that in practice the authority to make certain decisions that are associated with a company resides with the members. In practice the authority to make other decisions resides with the board of directors[289] of the company. The split of authority between the members and the directors depends upon a combination of the UK corporate code, the UK system of law, together with the constitution of the relevant company.

In general, members of a company continue to have the authority to remove directors[290], change the constitution of the company[291] including the rights associated with shares[292] and in certain circumstances to bring an action on behalf of the company[293]. *"Some of these statutory rules are mandatory; others can be strengthened or relaxed by the company's own articles."* (Sealy et al. (2010).

[289] This thesis does not propose to consider in detail such matters as the appointment, disqualification and remuneration of directors, or of the manner in which the individual directors constitute a board of directors or the provisions of good governance that are applicable to a director and to a board. Further information on these matters is to be found in company law textbooks such as Davies (2008) and Sealy et al. (2010).
[290] Section 168 CA 2006.
[291] Section 21 CA 2006.
[292] Sections 636ff CA 2006.
[293] Sections 260ff CA 2006

Beyond the provisions in the UK company code, *"powers, rights and duties"*[294] relating to how the property, assets and resources of the company are to be dealt with, are split between the members and the directors in the company's constitutional document[295]. In respect of the Model Articles[296] provided in the regulations[297], *"[t]he overriding assumption in these Model Articles is that the directors, not the members, will manage the business of the company ...."* (Sealy et al. (2010)). Given that the members and the members alone, have the power to change the constitution of the company, it is not unreasonable to see all power and/or authority primarily residing with the members who for practical reasons allocate most of the power and/or authority to deal with the assets of the company to the directors.

Subject to certain provisions of the UK corporate code, the general law of the UK and any specific provisions of the constitution of the company, it is the board of directors who, in the main, have the authority to exercise the *"powers, rights and duties"* that are capable of being exercised in respect of the property, assets and resources of the company.

Attributing the *"powers, rights and duties"* of a company to the board of directors is however *".... obviously not enough to enable a company to go out into the world and do business. Not every act on behalf of the company could be expected to be the subject of a resolution of the board ....."* [298]. In order to facilitate the operation of the company, the normal rules of agency will be applied and the board of directors will authorise others, employees, *"servants and agents whose acts ... count as the acts of the company"*[299].

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[294] Meridian Global Funds Management Asia Ltd v Securities Commission [1995] (Privy Council).
[295] In the UK this is referred to as the Articles of Association of the company
[296] The "Model Articles" are a collection of standard form company constitutions that can be adopted on the formation of a company or amended before or after the formation of a company.
[297] Companies (Model Articles) Regulations 2008.
[298] Lord Hoffman in Meridian Global Funds Management Asia Ltd v Securities Commission [1995] (Privy Council).
[299] Ibid.

The need to delegate authority is clear, *"[s]ubject to the articles of association of the company, a board of directors may delegate specific tasks and functions. Indeed, some degree of delegation is almost always essential if the company's business is to be carried on efficiently: ...."*[300]. However as the Barings[301] case demonstrated, although power and rights may have been delegated by the directors to employees, servants or agents, the directors who did the delegating continue to owe a duty of care to the company. In other words, the directors continue to have a duty of care to the collection of property, assets and resources that are identified as belonging to the arrangement which is the limited company under the relevant corporate code. Barings illustrates that the rules that apply to the directors will include rules that form part of the wider UK law[302].

This part of the thesis answers the question; "Who has authority and/or power to deal with the property, assets and resources of a company?"

The answer is that subject to specific provisions of statute law and the constitution of the company, it is the directors that have such authority and/or power. In exercising that authority and/or power, the directors can delegate such authority and/or power as is considered necessary so that others can deal with certain aspects of the property, assets and resources of the company. Indeed, in practice it is almost certain that directors have to authorise non directors to act. However, having delegated authority and/or power to another, this does not mean that *"... he is no longer under any duty in relation to the discharge of that function, notwithstanding that the person to whom the function has been delegated may appear both trustworthy and capable of discharging the function ...."*[303]

[300] Re Barings plc (No 5) [1999] 1 BCLC 433 (Chancery Division and Court of Appeal).
[301] Ibid.
[302] In a similar manner the law of agency is part of the wider UK law and is not to be found within CA 2006.
[303] Ibid.

In conclusion, it is the directors that primarily have the power and/or authority to deal with the property, assets and resources of a company. This power may be delegated to others but ultimately it belongs with the directors, it is the directors that are primarily responsible for its exercise[304] and the directors have a duty of care to ensure that such delegated power and/or authority is exercised appropriately.

11.6: What can be and what should be done with the property, assets and resources that "belong" to the company by the persons that possess the relevant authority and/or power?

The previous section establishes what persons have the power and/or authority to deal with the assets of the *"persona ficta"* which is a UK limited company.

> *"Directors normally have exclusive power to manage the business of the company. The advantage .... is both concentrated expertise, relative independence from the company's various stakeholders (such as members .... and executive management), and the efficiency of centralised decision-making. The disadvantage, however, is that the directors may manage the company in their own interests rather than in the interests of those they are supposed to serve."* (Sealy et al. (2010)).

The disadvantage noted above is part of the "agency problem" discussed in Kraakman et al. (2009).

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[304] This not meant to suggest that a director is responsible for all of the actions of all the employees who work for the company. The extent of the director's duty of care depends upon many factors *"Whilst directors are entitled .....to delegate particular functions ....in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions. (iii) No rule of universal application can be formulated as to the duty referred to in [ ] above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company."* Ibid.

Under the UK corporate code, what are the restrictions that apply to such power and/or authority that apply to the directors of a company? What are the duties that are imposed on directors in exercising such power and/or authority? To what or whom do the directors owe the duties so imposed?

There is a relationship between duties and restrictions in this context. If person A has a duty to (i) act in a certain manner and a duty (ii) not act in another manner, then the duty contained in (ii) is a restriction[305]. CA 2006 contains provisions that address the duties of directors. In addition to duties that are termed "general duties"[306] contained in CA 2006 there are other duties with which directors must comply, for example in The Insolvency Act 1986. This thesis does not consider any of these other duties in any detail.

An initial issue to address is to identify the beneficiary or beneficiaries of the duties. To whom the directors owe their duties? Is it the company or is it the members of the company.

CA 2006 is very clear on this point and follows UK common law. Directors owe their duties to the company[307][308]. In certain circumstances, as a result of specific conditions obtaining, shareholders might be the beneficiaries of duties owed to them by directors but such duties do not arise from the provisions of the UK corporate code[309].

This thesis will not consider the relationship between the general duties as set out in CA 2006 and the common law rules and equitable principles on which

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[305] The distinction between a duty and a restriction might be similar to the distinction suggested by Vinelott J., that of a distinction between a duty and a disability Movitex v Bulfield [1988] BCLC 104.

[306] Sections 170 to 181 CA 2006.

[307] Section 170 CA 2006.

[308] It is not entirely clear what constitutes the company in this context although it is usual to assume that it is the *persona ficta*. A company has been held to be the company's shareholders (Brady v Brady [1987] 3 BCC 535), the "entity" (Lonrho Ltd v Shell Petroleum Co Ltd [1980] 1 WLR 627) and even both in an Australian case, both (Darwell v North Sydney Brick and Tile Co Ltd [1987] 12 ACLR 537), see Keay (1011b) page 224.

[309] Peskin v Anderson [2001] 1 B.C.L.C. 372.

such duties are based[310]. In addition this thesis will not consider in detail the following general duties:

- Duty to exercise independent judgement[311];
- Duty to exercise reasonable care, skill and diligence[312];
- Duty to avoid conflicts of interest[313];
- Duty not to accept benefits from third parties[314]; and,
- Duty to declare interest in proposed transaction or arrangement[315].

Although in answering the research question this thesis will identify the powers, rights, duties and responsibilities that are relevant to the question, this subject matter of this thesis is not primarily an examination of director's duties within the CA 2006. The duties identified above provide a framework within which the selected actions of directors are to occur. For the purposes of this thesis it is assumed, unless stated otherwise, that any action of a director or the directors collectively will not breach any of the duties identified above. Further information in respect of these other general duties is to be found in Davies (2008), Sealyet al. (2010) and similar text books.

In addition to the above general duties there are two other general duties in CA 2006 which are to be found in section 171 and section 172 CA 2006.

11.7: Section 171 CA 2006

The provisions of section 171 CA 2006 are as follows:

> ***"Section 171 Duty to act within powers***
>
> *A director of a company must –*
>
> *(a) act in accordance with the company's constitution, and*

[310] Section 170(3),(4) CA 2006
[311] Section 173 CA 2006.
[312] Section 174 CA 2006.
[313] Section 175 CA 2006.
[314] Section 176 CA 2006.
[315] Section 177 CA 2006.

(b) only exercise powers for the purposes for which they are conferred."

This section, in subsection (a) makes clear the importance of the company's constitution[316]. Referring back to Section 5.2.5 which discussed the application base for a sub category of the UK tax code, the device was used of a class of arrangements and resulting states of affairs. It is possible to consider the constitution of a company as similar in certain respects to a sub category of the UK tax code.

The similarity is that there exists a collection or set of possible arrangements and resulting state of affairs. Every act within this set is in accordance with the company's constitution. In complying with the provisions of section 171(a) any act of a director must be one of the possible arrangements within that collection or set. A director might undertake an act on behalf of a company which is not within the set of arrangements and resulting states of affairs that are in accordance with the company's constitution. In such circumstances although third parties acting in good faith are protected under CA 2006[317] the director concerned, who has not acted in accordance with the company's constitution, will not be protected[318].

Section 171(b) also places restrictions on what acts a director can undertake. When a director exercises the power and/or authority conferred upon him, it must not be exercised for an improper purpose. The director(s) can act honestly and there may be very good reasons for acting in a certain way, but whether section 171(b) is breached depends upon all of the facts surrounding the event in question. For example in Howard Smith Ltd v Ampol Petroleum Ltd[319] shares were issued to raise money. The money received was used to finance the building of two ships. However the shares issued thwarted a

[316] The constitution of a UK limited company is more than just the articles of association of that company, sections 17, and 29-30 and 257 CA 2006.
[317] Section 40 CA 2006.
[318] Section 40(5) CA 2006.
[319] Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821 (Privy Council).

takeover bid of the company. The directors were not motivated by self interest but the action was considered to be an exercise of power that went beyond the reasons for which that power had been conferred. *"The ... test, like the requirement to act in accordance with the company's constitution, is an objective test."* (Davies (2008)).

When seeking to establish what directors can do and what directors should do when exercising their power and/or authority over the assets of the company, section 171 indicates constraints on the actions that can be performed. This does not mean that actions that are outside the class of actions authorised by section 171 will not occur, rather it means that if any such actions do occur there exist sanctions which might fall upon the relevant directors.

The duties that are imposed by section 171 CA 2006 may be considered to be similar to "fencing duties" which have been discussed In Section 9.3. The fencing duties present limits to the domain rights (see Section 9.2) that the directors possess.

11.8: Section 172 CA 2006[320]

The provisions of section 172 CA 2006 *"... are one of the more important and controversial provisions in the Act ... "* (Sealy et al. (2010). Section 172 is considered to be of particular importance when answering the research question.

The provisions of section 171 CA 2006 are as follows:

> ***"172 Duty to promote the success of the company***

[320] Andrew Keay in Keay (2011b) has very robustly argued that there is a link between the success of the company and the maximisation and sustainability of a company. Keay's argument is a general one in that it is intended to apply to the corporate form in general and not to a company formed under the CA 2006 in particular but is it worthy of consideration when seeking to understand success.

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."

Section 172 identifies and states the duty of a director in terms of the actions he or she should undertake. The section is based upon the principle of enlightened shareholder value, a principle that was discussed at length in the

company law review that was conducted in the years leading up to the enactment of CA 2006[321].

There is already a considerable body of literature on the meaning and application of section 172[322]. The discussions within the literature have centred on such matters as (i) the meaning of "success", (ii) the relationship between the success of the company and the benefit of the members, (iii) the extent to which the matters referred to in section 172 (1) (a) to (f) have to be taken into account and what happens if they are not taken into account, (iv) to what extent anything has changed from the pre CA 2006 position and (v) the relationship between the types of behaviour and actions that are consistent with section 172 and the type of behaviour and actions that are encouraged by certain of the principles of behaviour associated with aspects of CSR[323].

The purpose of this thesis is not to contribute directly to these discussions. Rather this thesis seeks to identify the rights, duties and responsibilities that are relevant when considering the type or category of tax related behaviour that can or should be undertaken by a company. To that end, recognising that there are very few cases have yet been decided address the application of section 172 CA 2006[324] the purpose of this section is to develop an understanding of how section 172 CA 2006 is relevant when answering the research question of this thesis.

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[321] The documents that provide the background to the CA 2006, including all of the consultation documents prepared by the Company Law Review Steering Group together with the March 2005 White Paper and the August 2005 responses to the White Paper are to be found at http://webarchive.nationalarchives.gov.uk/+/http://www.berr.gov.uk/bbf/co-act-2006/clr-review/page22794.html (last accessed 13 September 2012).

[322] See for example Alcock (2009), Arsalidou (2007), Copp (2010), Graham (2009), Keay (2007), Keay (2010), Keay (2011a), Keay (2011b), Kong Shan Ho (2010), Linklater (2007) and Nakajima (2007). A legal practitioners view is to be found in CMS (2007).

[323] For example see Villiers (2010) which discusses section 172 and the environment.

[324] Among the few decided cases that even mention section 172 are (a) R (on the Application of People and Planet) v HM Treasury [2009] EWHC 3020, (b) Re West Coast Capital (LIOS) Ltd [2008] CSOH 72, and (c) Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm) [2009] UKHL 39. Little guidance on the meaning and application of section 172 is provided by these judgements.

For a solvent UK limited company the following analysis of section 172 CA 2006 will be used as a starting point for ascertaining the relevance the section for this thesis.

- Any act of a director should comply with the provisions of section 172 CA 2006;
- in order to be compliant any act must be undertaken:
    - in good faith;
    - with the belief that the act promotes the success of the company;
    - with the belief that the success of the company is identified with benefit of the members as a whole;
    - after taking into account the matters (and other matters if considered relevant) referred to in section 172 (1) (a) to (f).

In respect of the bullet points identified above, the following comments are relevant.

When complying with the provisions of section 172 CA 2006, each director and the directors as a board of directors, have to identify what "success" means and have to decide whether a contemplated act is likely to promote such success. Promote in this context will mean something along the lines of "likely to bring about" what is considered by the director to constitute success.

It can be argued that the acts to which section 172 applies are all of the acts of a person acting in his or her capacity as a director (or executive employee of the company if he or she occupies such a position) of a company. The acts are not just those acts relating to dealing with the tangible property, assets and resources that belong to that company. The class of acts will also include acts that deal with the intangible assets of a company such as goodwill and the reputation of the company.

This is because the relationship between a company and a director will include such matters as what the directors say about the company to others. On the face of it, talking about a company appears to have little to do with exercising authority and/or power over the assets of the company yet it can have a significant and dramatic effect on the future success of the company[325].

It is generally accepted that identifying what "success" of the company means is to be decided by the director(s) acting in good faith and using experience and judgement. The meaning of "success" will almost certainly be different from one company to another[326]. The meaning of success may also in part be framed by the members themselves, possibly through the constitution of the company.

In accordance with the provisions of section 172 CA 2006 the success of the company should be identified in such a manner that is directed to the benefit of the members as a whole. This makes clear the point that if there is more than one member of company, then as the interests of a particular member might be different from the interests of each of the other members it is the, in some manner, abstracted interests of the members as a whole that is relevant. For example, one member might be interested in and benefit from the payment of dividends, another member might prefer no dividend payments, instead would prefer profit to be retained and reinvested with a view to additional capital growth.

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[325] An example of such behaviour is to be found in the case of Gerald Ratner who was chief executive of a chain of retail jewellery shops. In 1991 during a speech made to the Institute of Directors in the UK he said that one of his firm's products was "total crap". His comments wiped approximately £500 million off the company's value. See http://news.bbc.co.uk/1/hi/business/2010949.stm.

[326] Some companies formed under the CA 2006 will be formed for charitable purposes rather than commercial purposes. The meaning of success for a company established for charitable purposes will be different from the meaning of success for a commercial company. In a similar manner, what constitutes success for a software development company might be different from that which constitutes success for a company providing holidays in the South American rain forest.

If the particular interests of each member is not to be considered a significant constituent part of the meaning of success but instead it is the "members as a whole" for whom success is to be achieved, it may be of significance to consider whether in practice, for companies formed under CA 2006, there is a difference between:

> (i) acting in the way that the directors consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole; and,
>
> (ii) acting in the way that the directors consider, in good faith, would be most likely to promote the success of the company.

In the principle of action expressed in (ii) there is no need to have regard to the actions that are for the benefit of the members as a whole. Rather the actions of the directors are focussed on the success of the bundle of property, assets and other resources identified as being owned by the arrangement which is identified as a particular limited company.

On the assumption that the directors are complying with all of the general duties and other duties that apply, if the members have to be considered as a whole, what type of act would comply with the provisions of (i) above but not (ii) above or vice versa?

This question is of significance given that it is assumed that a member of a company continues to be a member of a company in the expectation that or at a minimum in the hope that, the company of which he is a member will be a success (however success is to be identified).

A possible situation that can be considered in which a difference between these two principles of action could arise is a case that involves the potential takeover of a company. The directors might consider that the success of the company would be more likely if the company was not taken over by the potential acquirer. Indeed the directors might be of the view, based on their

experience and judgement, that the company not being taken over will not only promote the success of the company (relevant for (ii) above) but will also be for the benefit of the members as a whole (relevant for (i) above). The members might disagree and believe that a takeover is in their interests. However what is peculiar about such a situation is that if the takeover goes ahead the members are almost certainly ceasing to have a direct interest in the company and are thereby severing any link that did hold between the members and the success of the company. The continued success of the company is no longer relevant to that set of members considers as members of that company.

Is it possible for the directors to form the view that not being taken over would promote the success of the company but not being taken over would not promote the success of the benefit of the members considered as a whole? It is not clear that in the day to day operation of a company such a distinction makes sense.

A similar question is relevant when tax related behaviour is considered. Could a contemplated action of the directors which would be classified as tax related behaviour if undertaken[327] promote the success of the company but not be for the benefit of the members as a whole?

Is it possible to envisage a set of circumstances in which a distinction could possibly exist between the success of the company and the benefit of the members considered as a whole?

For example it might be argued that if all of the members were elderly and in receipt of state funded care then the members would prefer the state to receive more tax revenue than less. The members might prefer that the company did not engage in tax reduction behaviour. A different set of

[327] The assumption is that the tax related behaviour will be fully disclosed, the tax position obtain at the critical tax point will be complied with and the company will retain value as a consequence of a reduction in a liability to taxation.

members might not have the same interest in the state receiving more tax revenue.

To adapt a distinction that is used elsewhere in law, is the duty of the directors to take account of the in rem rights of members or their in personam rights? Is "for the benefit of the members as a whole" only to consider an anonymised collection of members?

When seeking to act in accordance with their duties in the context of tax related behaviour, such a question has a bearing on how the directors are to act so as to promote the success of the company, however other than noting its existence pursuing an answer to the question is beyond the scope of this thesis and possibly even not capable of being answered given the lack of court judgements on the application of section 172 CA 2006.

11.9: Section 172, sub-sections (a) to (f)

In satisfying the duty set out in section 172 CA 2006, the director(s) must take into account other matters including those that are set out in sub sections (a) to (f).

It is generally accepted by commentators that satisfying this requirement of sub-sections (a) to (f) will not require the directors to *"consider each factor one by one."* (Sealy (2010)). Rather:

"The list of factors is non-exclusive and in intended to illustrate elements of the wider principle that directors are required to make good faith business judgements to promote the success of the company for the long term benefit of its members as a whole." (ibid)

The consideration of the matters in sub-sections (a) to (f) raises a number of interesting questions that are beyond the scope of this thesis however the some of the questions do have a bearing on the relationship between the nature of a company and CSR.

Sub-section (b) requires that the interests of the company's employees be considered when the directors are acting in accordance with their duty under section 172. This is a legal obligation and it makes sense to look after employees when seeking the success of the company. But what interests are to be considered?

The definition in Muthuri et al. (2010) of CSR would suggest a very wide understanding of "interest".

> *"We define CSR as the **duty** of the companies (sic) to the development of its stakeholders, and to the avoidance and correction of any negative consequences caused by business activities."*

An employee is a stakeholder. Under this definition of CSR, what actions must the company take[328] to satisfy its duty to the development of the employees?

The training and well being of employees is important. Well trained employees would be expected to help to participate in the promotion of the success of the company. The well being of employee is important, as a happy employee is probably an effective employee and also because the duty of care owed to employees can be very wide.

However concern about the development in these areas is primarily directed in an instrumental manner to the success of the company. It is not clear from Muthuri's definition of CSR whether there are other areas of development in respect of which the company has a duty which is not a legal duty.

In addition, if the company has a duty to avoid negative consequences, what does it do about the employee who craves for a Porsche car but as a result of the business activities of the company the company does not pay the employee enough to buy one.

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[328] It has been argued that only the directors have the legal authority and/or power to take actions. It is accepted that reference to the "companies" could be a shorthand reference to the directors.

The apparent failings of this definition help to demonstrate the importance of:

- seeking an understanding of the nature of a company and the rights, duties and responsibilities that are linked to a company; and,
- distinguishing between legal, moral and social rights, duties and responsibilities that might be linked to a company.

11.10: The rights and duties "linked" with this view of the company

It has been argued in this chapter that a significant part of the authority that is required in order to deal with the assets etc of a UK limited company are possessed by the directors, who, in turn can attribute power and/or authority to others. Reference has also been made to the duties that direct how this power and/or authority are to be used and the restrictions on the use of such power and/or authority.

It is possible to use the analysis and discussion set out in Chapter 9 to provide a framework of the rights, duties and responsibilities that directors granted the authority and/or power to deal with the assets etc identified as within the ownership of a UK limited company possess.

This framework will identify the rights and duties that are at issue.

11.10.1: Strictly-correlative rights[329]

The company has a number of strictly-correlative legal rights the corresponding duties of which are owed by the directors. These will include the right that the directors comply with the duties set out in sections 171 and 172 CA 2006[330].

[329] Although the company will have rights which correlate to the duties of directors there are difficulties associated with a company enforcing those rights Almadam (2009) and Gibbs (2011).

[330] There will be other strictly-correlative legal rights possessed by the company with the corresponding duties being owed by the directors. These will include the remaining general duties referred to in Section 11.6.

The duty of the directors that is to be found in section 172 CA 2006 can be considered to be the major cause of action for the directors. The directors are obliged to fulfil this duty whenever they act as directors.

11.10.2: Domain Rights and fencing duties

The directors in dealing with the assets etc of the company have legal domain rights which enable the directors to act or not act with a view to fulfilling the duty that arises under section 172 CA 2006 that has been described under section 11.10.1 above.

In exercising the domain rights within the "protected sphere of action" others have a duty not to interfere with the exercise of the domain rights.

The directors will also be able to exercise domain rights that result in the control or non control of the acts of others within certain particular spheres. For example, the directors have power and/or authority over employees[331].

The domain rights exercisable by the directors will be subject to fencing duties.

Fencing duties will include the general laws of the UK[332] relating to bodily harm and property rights. The fencing duties will also include limits to the use of any authority and/or power that has been made available to the directors.

For example, an act might promote the success of the company but might not be *"in accordance with the company's constitution"*[333], although such an act ***could*** be undertaken such an act ***should not***[334] be undertaken because, on the analysis provided, there is no legal power and/or authority available to the

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[331] Such power or authority can be delegated to some degree to others.

[332] Reference is made to the law of the UK. It is acknowledged that within the UK there are three jurisdictions, England and Wales, Scotland and Northern Ireland. It is suggested that by referring to the law of the UK in the context of company law, tax law and certain other areas of law such as insolvency law little of significance is overlooked.

[333] Section 171 (a) CA 2006.

[334] The normative "should not" would provide an answer which refers to a legal provision if the question identified in section 9.5 above was asked.

director to undertake that act. In a similar manner, the remaining general duties and certain provisions in other parts of UK law will also constrain the types of actions that satisfy section 172 CA 2006 and fall under the heading of fencing duties.

11.10.3: Background rights

The directors will have legal background rights which related to particular interests of the company. These interests will include such matters as the right to retain and use its property without interference from others (see section 11.11 below)

11.11: Human rights and companies[335]

In Hasseldine et al. (2013), reference was made to the UK Human Rights Act 1998 ("HRA 1998") and the rights that companies possessed under that Act.

This section explores the relationship between legally protected human rights under the HRA 1998 and UK incorporated companies in more detail.

11.11.1: Company protection under HRA 1998

Companies benefit from the operation of the HRA 1998. Before the HRA 1998 was enacted companies also benefited from the provisions of the European Convention on Human Rights[336] (Emberland (2006).

Companies benefit from the protection of the HRA 1998 in many ways. Some of the protections are not relevant to companies. Article 12[337], the right to marry is of no relevance to a company.

Other rights are more relevant.

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[335] Clayton et al (2009) is a well known text on legal human rights.

[336] The full name is: Convention for the Protection of Human Rights and Fundamental Freedoms but it is commonly known as the European Convention on Human Rights.

[337] Reference to an Article is a reference to an Article in Schedule 1 HRA 1998.

Article 6, a right to a fair trial and Article 7, no punishment without law are clearly relevant to a company.

Article 1 of the First Protocol is also of importance to a company.

> *"THE FIRST PROTOCOL*
>
> ***ARTICLE 1***
>
> *PROTECTION OF PROPERTY*
>
> *Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.*
>
> *The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties"*

A company has a right to the "peaceful enjoyment" of its possessions. A company shall not be deprived of its possessions except pursuant to a law which is in the public interest. A "State" can also interfere with the "peaceful enjoyment" of property through the imposition of taxes.

The jurisprudence of the European Court of Human Rights ("ECHR") allows States to impose taxes even if a tax payer would consider the tax to be unfair[338] although there is also a suggestion from the ECHR that the rule of law requires a measure of certainty in tax matters[339].

This right, this protection provided to companies under HRA 1998 is in the nature of a strictly-correlative right where the State is the duty bearer. The State can impose a charge to tax but unless provision for such a charge has

[338] R (on the application of Professional Contractors Group Limited & Others) v. Inland Revenue Commissioners. [2001] EWHC Admin 236; [2001] STC 629.
[339] Sunday Times v. United Kingdom (1979 – 1980) 2 EHRR 245.

been enacted the company has a right not to have its "peaceful enjoyment" of its property interfered with through any form of demand for taxation.

11.11.2: Company obligations under HRA 1998?

A company is a "non State actor" and there is considerable volume of academic writing and other commentaries[340] on whether human rights legislation[341] imposes any form of obligation on companies.

In addition John Ruggie, the UN Secretary General's Special Representative on business and Human Rights has researched, consulted and written extensively on the relationship between business, companies and human rights[342].

In the main the conclusion has been that as a company is a non State actor no duties under human rights legislation attach to companies. Companies particularly multinational companies are encouraged to voluntary adopt behaviour which is consistent with human rights legislation. An argument for such an adoption being that is makes good business sense to be seen to be complying with such standards[343].

Although not subject to duties under human rights legislation, it is suggested in this thesis that the HRA 1998 does impose fencing duties on UK incorporated companies.

Section 3 of HRA 1998 sets out the consequences for UK legislation of the HRA 1998. Section 3 HRA 1998 is as follows:

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[340] See for example Dine (2005), Alston (2005), Kinley (2009), Friedmann et al. (2002) and Ziegler (2007) for an introduction to the literature on this topic.

[341] Legislation is used in a loose sense and will include not only HRA 1998 and the European Convention on Human Rights but also the various United Nation declarations and other publications relating to human rights (see the United Nations website at http://www.un.org/en/rights/ (last accessed 31 May 2013).

[342] The portal of writings by Ruggie and his team is accessed at http://www.business-humanrights.org/SpecialRepPortal/Home.

[343] See the Ruggie portal, footnote above.

"3. Interpretation of legislation.

(1) So far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with the Convention rights.

(2) This section—

(a) applies to primary legislation and subordinate legislation whenever enacted;

(b) does not affect the validity, continuing operation or enforcement of any incompatible primary legislation; and

(c) does not affect the validity, continuing operation or enforcement of any incompatible subordinate legislation if (disregarding any possibility of revocation) primary legislation prevents removal of the incompatibility."

The relevant part of section 3 HRA 1998 is that all legislation, in so far as it is possible, must be read in a way which is compatible with the Convention rights.

It is suggested that this means that the CA 2006 has to be read in a way which is compatible with Convention rights[344]. In particular that in respect of the duty of the directors contained in section 172 CA 2006 any actions undertaken have to be compatible with convention rights.

The reason for such a view is that the word "success" has to be read (and given effect) in a way which is compatible with convention rights.

It is suggested that section 3 HRA 1998 is in effect imposing additional fencing duties on the domain rights that can be exercised by directors. These fencing duties are legal duties that arise under the HRA 1998.

[344] Landlord and tenant legislation in the UK has been read in a way which is compatible with the Convention rights. A man who deceased partner was also a man was given a right to remain in the home the couple had shared even though the legislation referred to a surviving spouse (Ghaidan v. Godin-Mendoza [2004] UKHL 300).

11.12: legal and non legal obligations and duties

What has been identified and discussed in this Chapter 11 are a number of the legal rights and duties that are associated with a company and its directors. The legal rights and duties that exist enable the property, assets and other resources of a UK limited company to be dealt with by the directors.

Using the framework provided in Part C, the legal rights and duties were identified as being either strictly-correlative rights, or domain rights or background rights.

Various legal fencing duties were also identified including fencing rights that it is argued exist because of HRA 1998.

This chapter has identified and described a set of legal rights and duties. As part of the discussion in this Chapter it was also indicated that in addition to legal rights and duties any non legal rights and duties that are relevant to the second research question should also be identified and described.

11.12.1: The extent of the section 172 CA 2006 duty

It has been argued that the authority and/or power that enables the property, assets and other resources of a viable company[345] to be dealt in, is primarily derived from the nature of the corporate code.

Section 172 CA 2006 imposes a duty on directors and informs them how they are to satisfy that duty. This in turn enables the directors to decide what is to be done with the property, assets and other resources.

A company exists within such a legal framework and the legal framework provides the direction for the use of the property, assets and other resources of the company.

[345] In this context, a viable company means a company in respect of which there is no suggestion of the company being considered for liquidation.

The purpose of the actions of the directors is to promote the success of the company etc. In promoting the success of the company, the class of actions that can be undertaken by the directors is restricted by fencing duties and possibly by background rights in respect of which the directors/companies have duties.

11.12.2: Fencing duties

Fencing duties can be found within the corporate code itself[346] and are also found in the general law, including, it has been argued (see section 11.11.2) under the Human Rights Act.

To use a frivolous illustration, imagine two rival music stars each of whom operates through a personal service company[347] for tax purposes.

Music star A and music star B are rivals and the market is fiercely competitive, if music star A sells a CD then music star B loses out on a sale and vice versa.

Section172 is explained to music star A. He concludes, correctly, that the success of his personal service company would be promoted if music star B did not exist. Music star A takes out a contract on the life of music star B with a view to the death of music star B. The death of music star B is expected to promote the success of music star A's personal service company.

Such an action is of course restricted by the fencing duties that exist in the UK criminal law.

Many such fencing duties are part of the legal system of the UK. However it is possible to extend the idea of fencing duties into the moral domain and the

[346] For example the duties that are contained in section 171 CA 2006.
[347] A personal service company is understood to be a company the shares of which are owned by a person and that person is also the employee and director of that company.

social domain. It could be argued that Friedman accepted such non legal fencing duties even when stating the one and only duty of the directors[348]

> *"... there is one and only one social responsibility of business–to use it[s] resources and engage in activities designed to increase its profits so long as it stays within the* ***rules of the game*** *...."* (Friedman 1970) (emphasis added)

However care has to be taken in connection with how such non legal fencing duties are understood.

In this context it is helpful to consider the description of a tax base offered in Chapter 7. A tax base consists of a class of persons together with a class of arrangements. There are limits to a tax base because not all persons will possess the class defining characteristics, qualities or attributes required for class membership. Similarly not all arrangements will possess the class defining characteristics, qualities or attributes that are required.

The limitations that are associated with a tax base may be considered by analogy to be similar to the limitations on action that are provided by the fencing duties that limit domain rights.

The directors have liberty (domain rights) to pursue the success of the company subject to legal fencing duties. The acts that the directors believe would have promoted the success of the company but are not available (such as music star A arranging for the death of music star B) because of fencing duties are not within the domain rights that the directors can exercise (Keay (2008).

The legal fencing duties set limits to the domain rights. Within the limits set by the fencing duties all actions undertaken by the directors that fall within

[348] Friedman refers to "business" but for the reasons given in Chapter 11 this is assumed to be a reference to directors.

the class of remaining domain right must satisfy the requirements of section 172 CA 2006.

Domain rights are the:

- freedom to act or not act;
- the power to control or not control;

and are to be directed at actions that promote the success of the company.

Any non legal fencing duties if accepted will result in the non exercise of a domain right, the directors will refrain from an action or refrain from exercising control. Given that domain rights are always to be exercised subject to the duty of section 172 CA 2006, it suggested that non legal fencing duties that restrict domain rights can only be accepted if such acceptance promotes the success of the company.

For example, if it is claimed by a NGO that there are moral reasons why a company should not act in a certain manner. The directors can only accept a non legal fencing duty in that area of possible action if acceptance of such a fencing duty would in the view of the directors promote the success of the company.

If the directors did not accept the non legal fencing duty, on the assumption that the directors are acting in good faith it is not because the directors are immoral that they did not accept. Rather their moral duty is to satisfy the legal duty imposed by section 172 CA 2006. There cannot be a moral override to the section 172 CA 2006 duty.

If the directors did accept the non legal fencing duty then morality has not overridden a legal duty (the 172 duty) rather the directors have decided that their section 172 CA 2006 duty can be satisfied within the confines imposed by the non legal fencing duty.

There is a view of CSR that CSR actions go "beyond the law" (McBarnet (2003), McBarnet (2009), Carroll (1991). This view however misunderstands the overriding nature of the section 172 CA 2006 duty imposed on directors of a UK limited company[349].

Any non legal fencing duties that are accepted by the directors must be because such fencing duties either facilitate the promotion of the success of the company or do not hinder such promotion.

[349] Not all corporate codes has a such a duty set out in the legislation. Many other corporate codes are similar to the code that operated in the UK before CA 2006. The duties of directors are to be found in the common law not in statute.

Part E

Chapter Twelve: Discussion and conclusion

12.1: Introduction

Following the Introduction contained in Part A, the matters discussed in this thesis are as follows:

- Part B discussed tax related behaviour with the aim of identifying the qualities, characteristics and attributes of such behaviour;
- Part C provided a framework for understanding rights, duties and responsibilities and a workable mechanism for distinguishing between legal, ethical and social rights duties and responsibilities;
- Part D having discussed various characteristics and qualities of a company provided an explanation and description of a company. In so doing Part D identified a number of the important rights and obligations that exist in the context of the relationship between a company and its directors.

The research questions asked in Chapter 1 are as follows:

First research question:

> **"What are the different qualities, characteristics and/or attributes of tax related behaviour that can be identified and described and used to create a taxonomy of the different types or categories of tax related behaviour?"**

Second research question:

> **"When a UK incorporated company is provided with an opportunity to engage in tax related behaviour which is expected to result in a tax reduction and thereby contribute to the retention of value by that company, what rights, duties and/or responsibilities are to be or**

should be considered when deciding whether to refrain from or engage in such tax related behaviour?"

The research questions are closely linked. It is not possible to answer the second question without having provided an answer to the first question.

Although the subject matter of this thesis has been limited (in the main) to a discussion concerning UK limited companies the principles that have been identified should be relevant to non UK companies and also to groups of companies, some of the companies of which are outside the UK.

Each research question will be discussed in turn.

12.2: First research question

It has been argued in this thesis that it was necessary to craft a framework for understanding tax related behaviour because the ways of discussing such behaviour were not clear. There is no consistency across the various definitions being used to identify different types of tax related behaviour.

In addition there exists a tendency to identify behaviour that is clearly not appropriate relying as it does on fraud, deceit and cheating. This type of behaviour is often referred to as tax evasion even though a person engaging in such behaviour might never be charged with a criminal offence.

In addition to what is referred to as tax evasion there is also a tendency to identify a type of behaviour that is a clearly acceptable form of tax related behaviour. Such behaviour can have many names, "tax planning", tax mitigation" or even "tax avoidance" although "tax avoidance" is now a term that many are more reluctant to use on a regular basis.

Having identified two easy categories of tax related behaviour there remains a considerable number of possible arrangements that do not fall into one or other of the identified categories of tax related behaviour.

This catch all category of behaviour is referred to in many different ways.

If tax planning/mitigation/avoidance is legal and tax evasion is illegal then this third category is said by some to be in a "grey" area. It is said to be "aggressive", "immoral", or to "sail close to the wind". Many different descriptions are attached to it.

What Part B of this thesis does is provide an analytic and conceptual framework which can be used to explain all tax related behaviour, not just explain the "easy" types of tax related behaviour.

The framework recognises that the legal or illegal dichotomy is inadequate for classifying tax related behaviour. This is because many types of tax related behaviour, by the very nature of the behaviour that it is, originate ex ante. The legal or illegal classification can only be applied ex post once compliance has been satisfied.

This is even the case when an entitlement to a tax relief is sought through tax related behaviour. The benefit of a tax relief is receivable when a liability to taxation is mitigated. In claiming the benefit of a tax relief a position is being taken in respect of a liability to taxation.

The satisfaction of any liability to taxation, by whatever means is a compliance matter and therefore tax related behaviour that seeks the benefit of a tax relief is still necessarily linked to tax compliance.

The framework of tax related behaviour developed in this thesis has identified:

- the reasons why opportunities for tax reductions arise;
- how any such opportunities are to be assessed and in what manner;
- the possible tax consequences of seeking any one such opportunity; and,

- the nature of the behaviour that should be undertaken ex post in order to ensure compliance.

Using the difference between tax liabilities and tax reliefs and recognising the limits that are inherent with any tax base together with the uncertainty that can exist in respect of the application of a sub category of the UK tax code has provided a very useful framework for analysis.

Using this analysis together with the compliance diamond and the flowchart the "qualities, characteristics and/or attributes" of tax related behaviour have been identified and described and a taxonomy of tax related behaviour has been created.

12.3: Second research question

Before answering the second research question it was necessary to consider in some detail the nature of a UK limited company. This was necessary as the different views taken as to the "rights, duties and/or responsibilities" which are possessed by a company or to which the company is subject are in many instances coloured by the view taken of the nature of a company.

The approach taken in this thesis was to minimise the assumptions made about the nature of a company and instead to consider what is required in order to make that "thing" which is referred to as a company "act" in the world.

By approaching a company as a "ring fenced" bundle of property and then asking what is needed for the "thing" to "act" it was possible to build up a collection of rights and duties that can be described and explained.

The clarity of this approach was greatly assisted by the adoption of the framework of rights and duties devised by Harris.

What is of significance when considering the "rights, duties and/or responsibilities" that are to be identified when answering the second research question is that any answer provided by a director when asked the question:

"What reason do you have for .....?"

must refer to his or her duty to promote the success of the company for the benefit of the members as a whole.

There can of course be other reasons given also.

For example: What reason do you have for *spending lots of the company's money on a sports centre for the company's staff and local community?*

The question can be answered by admitting that such a sport centre benefits the community and the staff. But underlying that answer there must be another answer: "In benefitting the community and staff, the success of the company is being promoted".

The underlying answer must be true. The director has to act in good faith when promoting the success of the company and would be in breach of his duty simply to repeat a form of words if he did not believe them to be true.[350]

Turning to tax related behaviour, the principle summarised above remains relevant. If the company engages in tax related behaviour it has to be because it promotes the success of the company.

On the grounds that value retention, other matters being equal, probably promotes the success of a company then, on the basis of the framework of tax related behaviour, the default position for a company would be to engage in tax related behaviour with a view to benefiting from a tax deduction and thereby retaining value.

There will be many reasons why the default position will not be followed.

[350] See Elhauge (2005) for an interesting discussion of this subject.

The level of uncertainty that exists ex ante might be too great. The tax reduction benefits that are possibly available are not sufficient given the complexity and the compliance burden that will exist ex post.

The reputational damage to the company would be unacceptable.

Each of these reasons and the many other reasons that could be listed are all underpinned by a section 172 CA 2006 duty.

As was argued in Section11.12.11 a constraint on domain rights can only be accepted if such acceptance does not interfere with the section 172 obligation or it facilitates such obligation.

This means that, if asked there must be a reason or reasons for not engaging in possible tax related behaviour. The reason given for such non engagement must be linked to the promotion of the success of the company.

Based on:

i. the analytic and conceptual framework of tax related behaviour;
ii. the framework analysis of right, duties and responsibilities;
iii. an understanding of the rights, duties and responsibilities associated with a company;

the second research question has also been answered.

Abbreviations

CA 1985	The Companies Act 1985
CA 2006	The Companies Act 2006
CSR	corporate social responsibility
FB 2003	Finance Bill 2003
HMRC	Her Majesty's Revenue and Customs
HRA 1998	The Human Rights Act 1998
IA 1978	Interpretation Act 1978
ITEPA 2003	Income Tax (Earnings and Pensions) Act 2003
OECD	Organisation for Economic Co-operation and Development
TGCA 1992	Taxation of Chargeable Gains Act 1992
UK	United Kingdom
1844 Act	Join Stock Companies Act 1844
1855 Act	Limited Liability Act of 1855

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Limited Liability Partnership Act 2000

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