

The General Anti-Avoidance Tax Law: Statutory Interpretation on the Road Less Travelled By

Professor Craig Elliffe



THE UNIVERSITY OF
AUCKLAND
Te Whare Wānanga o Tāmaki Makaurau
NEW ZEALAND

**AUCKLAND
LAW SCHOOL**

The Context for the Paper

- With the rise of the Tax State (a government dependent on and defined by its power to tax), preventing the avoidance of tax has become increasingly important
- Yet the paradox of a GAAR is that the taxpayer has complied with the substantive provisions, yet the anti-avoidance provisions negate that compliance, trading off the principles of the rule of law and its certainty with broader concepts of tax equity and fairness.
- Reconciling the peculiar interpretive demands suggests that the interpretation of every statutory provision is not necessarily the same and provides an insight into the role of lawyers (as administrators, advisers and most importantly the judiciary) in interpreting GAAR provisions

What are GAARs?

- GAARs are predominantly domestic laws which draw a line between legitimate tax planning and tax avoidance. Although usually statutory, countries also rely on judicial interpretation. Even if you have perfect tax legislation, "it is impossible to avoid rules that may create avoidance opportunities" (Zimmer).
- Countries have significantly differing approaches to avoidance. Why?
 - 1) **Judicial perspectives on taxation and other statutory interpretation**; do the courts have a history of textual, purposive, or even teleological interpretive approaches?
 - 2) **The role of legislatures and legal drafters and their confidence in the courts and administrators**. How confident is the government in delegating significant power and authority to the judiciary and a responsible revenue authority?
 - 3) **The approach of ordinary citizens to tax planning and tax payments**: what is the extent of tolerance in the society towards aggressive tax planning and attitudes towards the role of the state in social welfare and redistribution?

What are GAARs?

- Krever has categorised them into four groups:
- (1) rules that allow authorities to identify transactions that have the purpose of providing a tax benefit (the *transactional approach*). It is designed to overturn arrangements intended by the taxpayer to defeat the contemplated legislative intentions and policies of the ordinary tax legislation,
- (2) rules mandating an interpretation and application of tax law following the *economic substance* of a transaction rather than compliance with legal form,
- (3) rules based on the adoption by the courts of a broad *abuse of law* doctrine,
- (4) rules based on a *statutory abuse of law* model when a taxpayer adopts either a fictitious arrangement or one valid in law used to defeat the intention of the tax legislation

Common Features of GAARs

- Although there are many different forms of GAARs, they arguably have, in essence, two simplified tests (some countries' rules might emphasise one limb of the test more than the other, or even exclusively so that an economic substance or abuse of law test may focus on the authenticity of the transaction, primarily a factual question)

(1) a legal use or misuse of the tax legislation: This is an analysis of the use of the provision and its intended purpose. Where a mismatch occurs between the use and the intended purpose, then this will be indicative that the GAAR needs to operate so that the ordinary provisions of the Act operate as intended

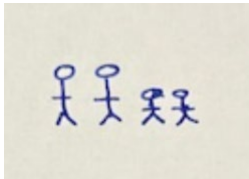
Common Features of GAARs

- (2) Considering the context for the misuse of the provision through a factual assessment: A test made up of a great many factors focusing on criteria such as artificiality, contrivance, pretence, circularity of funds, timing mismatches, unnecessary steps inserted into a transaction, a lack of business purpose, a divergence between the economic and legal effects of the transaction, dealing between associated parties, the duration of the arrangement, and many more ...
- In some jurisdictions, the statutory GAAR references specific criteria; in others, the courts are left to decide the tax avoidance features.

A simple example

Interest payments

The Smiths



A family, a couple with two kids, want to purchase an apartment to live in. The black letter rules say (1) you can claim a deduction for interest when you borrow to purchase a property and let it out, and (2) you cannot get a deduction if you purchase the apartment and live in it, as personal expenses are not deductible (and the mortgage interest would be incurred on your own apartment purchase).

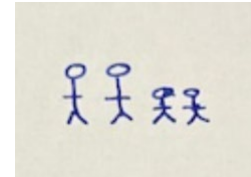
What if there were a second couple, also with two children, who wanted to live in the same apartment block and purchase the same type of apartment?



The Lees

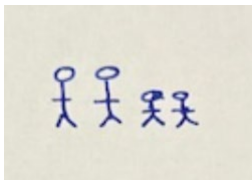
Could you see a way to allow each family to get a deduction for their interest on borrowings to buy their apartments?

After the tax advice



What if the Smiths
borrow and buy the
apartment to lease it to
the Lees?

Interest payments



The Lees

And the Lees borrow and
buy the apartment to
lease it to the Smiths??

The Interpretation needs of the GAAR

- A GAAR provision that is trying to assess the hypothetical use of a statutory provision against the actual factual use, measured using commercial and economic reality (the two tests together), is likely to use broad language:
- Partly, to ensure that all potential transactions apply, and
- Partly, to allow the interpreter the chance to properly assess the use of the substantive provision against the hypothetical conventional standard that Parliament would have contemplated.

There are some particular features where a statute requires interpretation

- (1) Where you have two contradictory or contrasting provisions in the same Act
- (2) Where you have a lack of certainty, so that Parliament may leave the general anti-avoidance provision deliberately general, and the court should not strive to create greater certainty than Parliament has chosen to provide

The Interpretation needs of the GAAR

So, *how* does the GAAR work regarding statutory interpretation?

- Given that, GAARs instruct interpreters on how to (not) apply substantive tax law provisions because of the discrepancy between the actual legal analysis and the legislature's intended use of the rule (the legal test), in the context of assessing the factual components of the test, which might involve myriad indicia of tax avoidance features and the assessment of commercial and economic reality
- Close textual interpretation led the way, then to the early adoption of purposive interpretation, but judges have questioned whether these traditional statutory interpretation principles provide the answer to what is happening

Theorising the interpretation of the GAAR

The vision of **correctness-independent** and **correctness-oriented** interpretive techniques

- ***Correctness-independent interpretation*** means the interpreter should not deviate from the decision of the legislature because it will diminish the legislature's legitimate control over the context of statutory law. This means the decision will be determined by the plain meaning of the statute text (textualism) or the identification and motivation behind the statutory text is the goal of the interpretive process (intentionalism or purposivism). Such an interpretation cannot exceed the plain meaning of the statutory text or intention

Theorising the interpretation of the GAAR

- The vision of correctness-independent and correctness-oriented interpretive techniques
- *Correctness-oriented interpretation* does not prescribe strict adherence to the text of the legislative decision or the intent behind it but focuses on maximising the correctness of the outcome in terms of the much broader and wider policy objective that the legislation articulates. Statutes that require interpreters to go beyond text and intent, perhaps to consider issues in the light of moral principles and a consideration of values, might require such an approach

Conclusions

- The GAAR reflects the communal value of, and is designed for, the prevention of aggressive taxpayer behaviour. The community does not accept such behaviour because it is not right that one person in the same or similar circumstances should avoid tax when another pays it. This causes a problem in the integrity of the tax system and the maintenance of social cohesion.
- On the other hand, another communal value facilitates genuine commercial activity and the use of appropriate business structures, which encourages legitimate tax planning behaviour. Good legal systems include certainty upheld by the rule of law.

Conclusions

- The GAAR is the type of statute which requires a high degree of interpretation because of the judgment involved in applying the legal mismatch test in the factual context. It uses breadth and generality of language to articulate the tests, but the type of interpretation required falls into the correctness-oriented category, requiring judges to reference societal and communal values to balance the undesirable aggressive tax planning with the need to encourage entrepreneurial and sound commercial structuring



THE UNIVERSITY OF
AUCKLAND
Te Whare Wānanga o Tāmaki Makaurau
NEW ZEALAND

**AUCKLAND
LAW SCHOOL**