The Morality of Tax Avoidance

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I. INTRODUCTION

A. Tax Avoidance, Tax Planning, and Estate Planning

This article addresses the question of whether tax avoidance is moral. It considers tax avoidance in a number of contexts, but, in deference to the subject of this symposium issue of the Creighton University Law Review, it specially mentions tax avoidance in the context of estate planning. Estate planning ordinarily involves taking precautions to protect one’s property from taxation, from creditors, or from spouses and others with family-based claims. These precautions typically entail transactions that transfer assets from one person to other people or to other entities. With such transferred assets goes income that the assets generate. Planning to minimize, or sometimes to avoid, tax on such income is thus frequently a bedfellow of estate planning. Sometimes income tax minimization can overshadow the apparent goal of protecting assets.
For these reasons, while not all estate planning is accompanied by tax planning, the expressions "estate planning" and "tax planning" frequently find themselves together. These expressions are so often concatenated as "estate and tax planning" that it will surprise no reader of this article to hear that an electronic search for ["estate and tax planning" course] returns nearly thirty-thousand entries, with offerings from university law and business faculties, technical institutes, publishers, private training providers, and enterprising individuals all over the world. Princeton University, which, famously, does not have a law school, even posts a page of tax planning advice.1

The authors address the meaning of "tax avoidance," and attempt to describe it, in Part II of this article. For purposes of this introduction, a working definition is: "Contriving transactions and structures that reduce tax in ways that are contrary to the policy or spirit of the legislation." That is, as used in this article, "tax avoidance" involves more than simply engaging in activities that reduce one's tax. What that "more" amounts to is the subject of most judicial decisions on tax avoidance.

Tax planning does not necessarily amount to tax avoidance, but it is hard to conceive of an activity that one might describe as "tax avoidance" that is not preceded by or accompanied by at least some tax planning. Further, while, as mentioned, not all estate planning is accompanied by tax planning, some of the tax planning that accompanies estate planning crosses the line into tax avoidance. Some schemes that are driven by income tax avoidance involve templates that in basic structure vary little from estate planning patterns. For instance, a scheme to reduce tax on income by splitting the income among several people so that each can make use of personal exemptions and lower-rate tax bands may look very similar to a scheme that transfers assets to a trust or company to look after assets for the next generation and meantime to share income between a number of people. Later, when explaining examples of what amounts to tax avoidance, this article discusses two cases decided in London, England, in the Privy Council and the House of Lords, where taxpayers utilized schemes of broadly this structure.2

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B. Estate Duty and Tax

This article focuses on the morality of the avoidance of income tax. Before proceeding to a summary of the analytical framework of the article's arguments, the following sections address some of its terminology and categories.

Some jurisdictions use the term “estate duty” to refer to taxes payable at death on the property of the deceased. “Duty” can provide a useful distinction from “tax,” which may be more often thought of as referring to income tax, including tax on capital gains. Adopting this framework, for some scholars and practitioners the expression “estate and tax planning” refers to planning to minimize both estate duty and income tax. On the other hand, for those who use the term “estate taxes” for fiscal imposts that apply on death, “estate and tax planning” or “estate tax planning” may refer to planning for death imposts only. The present authors are in the first group: in this article, “tax,” “tax planning,” and “tax avoidance” generally refer to income tax, whether or not the income tax in question has some relationship to planning or to fiscal liabilities at the time of death.

C. Jurisdictions With, and Jurisdictions Without, General Anti-Avoidance Rules

Most tax legislation contains specific anti-avoidance rules that attempt to frustrate taxpayers who try to exploit tax regimes in ways that legislators did not intend. In addition, some tax statutes contain general anti-avoidance rules that stipulate that arrangements having the purpose of tax avoidance are void. These general anti-avoidance rules operate in much the same way as the judge-made substance over form rules of the United States and the fiscal nullity rules of the United Kingdom. Though there are differences between statutory and judge-made anti-avoidance rules, the broad meaning of “tax avoidance” as used in this article does not change from one jurisdiction to another. Moreover, the question that is the subject of this article, viz, whether tax avoidance is moral, is essentially the same for every jurisdiction. That question, however, is sharpened in jurisdictions with general anti-avoidance rules, since these rules attempt to draw a statutory boundary between acceptable tax planning and unac-
ceptable tax avoidance. As a result, while this article draws on examples from a number of countries, it emphasizes cases from jurisdictions that have anti-avoidance rules.

D. EXOGENOUS AND ENDOGENOUS TAX AVOIDANCE

At first sight, there is a distinction between tax avoidance in the context of estate planning and tax avoidance as a general category. Tax avoidance in the context of estate planning seems to involve only endogenous avoidance, whereas tax avoidance in general may be either endogenous or exogenous. "Exogenous tax avoidance" refers to avoidance of tax by resorting to transactions or structures for their own sake, that is, to transactions and structures that are independent of other economic activity of the taxpayer. "Endogenous tax avoidance" refers to avoidance that is effected by adjusting transactions and structures that the taxpayer was proposing to enter, or has already entered, in any event. In some circumstances, endogenous avoidance might be, or might appear to be, a by-product of ordinary transactions that are otherwise unexceptionable.

Exogenous avoidance typically involves taxpayers participating in tax shelters that generate losses to set off against ordinary income or that otherwise produce fiscal effects that reduce tax payable on such income. A notorious example is Cridland v. Federal Commissioner of Taxation,⁵ which involved a scheme designed to take advantage of a rule that allowed primary producers to average their incomes over a number of years and to pay tax on that average. The rule was intended to make the tax system fairer for farmers, whose income often varies from one year to the next. Pursuant to the scheme, Cridland, a university student, bought a share in a unit trust. The trust was a primary producer. Cridland's interest as a beneficiary of the trust amounted to only one dollar a year. The years in which he was a beneficiary straddled his time as a student and his time as a salaried graduate, when his income was much higher. He claimed to average his income as a primary producer. The High Court of Australia upheld the claim.

By way of contrast, endogenous avoidance ordinarily involves avoidance in the context of some other transaction or structure, most commonly a business or estate planning structure. An example of the latter has been mentioned: income splitting that comes about as a result of transferring income-producing assets to the ownership of others. Examples of business structures adjusted to obtain fiscal benefits abound. Treaty shopping to reduce tax on cross-border income

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⁵. (1977) 140 C.L.R. 330 (Austl.).
flows in the context of international financing is one. That is, endogenous avoidance entails transactions that endeavour to stay on the right side of tests like economic substance, business purpose, substance over form, sham, commerciality, and so on.

The distinction between exogenous and endogenous avoidance is more apparent than real. If one can argue that a tax-reducing effect is a natural incident of certain economic activity, it is less likely that the authorities will stigmatize that effect as avoidance. Even a naked tax shelter like that in the Cridland case purports to be part of the taxpayer's regular income-earning operations, not simply a tax-reducing machine disconnected from economic activity. Formally, the template of a tax avoidance scheme may be similar to the template of a regular business operation that happens to result in deductible losses.

Alternatively, an avoidance transaction may be similar to the template of an ordinary estate planning asset transfer, as was the case in Higgins v. Smith, decided by the Supreme Court of the United States in 1940. Indeed, estate planning seems to have been an original driver of the scheme in Higgins v. Smith. Smith owned corporate stock that had declined in value. Also, he was the sole owner of Innisfail, a company. In 1932, Smith sold the stock to Innisfail, realizing a book loss. There was, of course, no economic loss, since Smith and Innisfail were a single economic unit. Nevertheless, Smith claimed to deduct the loss in calculating his income tax for 1932. Judges Learned Hand, Augustus Hand, and Chase upheld Smith's claim in the United States Court of Appeals for the Second Circuit, stating that the transaction "involve[d] a real sale to an actual buyer." The Supreme Court reversed, "disregard[ing] a transfer of assets without a business purpose but solely to reduce tax liability." That is, for the Second Circuit the transaction was endogenous to a structure that was unexceptionable. The Second Circuit did not put it this way, but essentially it was saying that the Smith/Innisfail arrangement either was, or was tantamount to, a common estate planning structure. For the Supreme Court, the structure was exogenous to the substance of Smith's economic ownership of the stock that he

7. For a comprehensive survey of these concepts, see Leandra Letterman, W(h)ither Economic Substance 95 IOWA L. REV. 389 (2010).
9. Higgins v. Smith, 308 U.S. 473 (1940); see Letterman, supra note 7, at 423.
transferred to Innisfail: the legal form of the change of ownership was not a factor that was inherent in the substance of the case.

E. TAX AVOIDANCE IN THE CONTEXT OF ESTATE PLANNING NOT SPECIAL

The point to be taken is that there is no fundamental distinction between tax avoidance that is exogenous and tax avoidance that is endogenous to the taxpayer's economic activity. This conclusion holds whatever the economic activity in question: investment, business, or estate planning. It follows that when asking whether tax avoidance is moral, whether the answer is "yes" or "no," there is no logical distinction to be drawn between taxpayers who subscribe to tax shelters that have no connection with their economic activities and taxpayers engaged in estate planning who contrive, or who opportunistically seize, the chance of avoiding income tax by means of transactions that are related to that planning. For this reason, bearing in mind that in the present context "tax avoidance" means more than entering transactions that happen to reduce tax, in examining tax avoidance from a moral perspective this article does not confine its examples to cases that follow estate planning templates. Instead, it examines the morality of tax avoidance as a discrete topic, not necessarily dependent on a context of estate planning, though recognizing that tax avoidance is often related to or incidental to arrangements for estate planning.

F. FRAMEWORK OF ANALYSIS OF THE MORALITY OF AVOIDANCE

The question of the morality of tax avoidance is best illuminated by comparing tax evasion and tax avoidance. Both tax evasion and tax avoidance aim to reduce or to minimize tax liability, but avoidance is legal whereas evasion is illegal.\textsuperscript{13} This article responds to a line of judicial authority that stands for the general proposition that there is a moral entitlement to avoid taxes. The proposition has some intuitive and popular appeal but the authors argue that (a) it is not supported by sound reasoning and (b) it is predicated on flawed assumptions.

The assertion that tax avoidance is moral appears to rest on four main assumptions that this article will set out and evaluate. Section III addresses the first assumption: that taxpayers have a moral enti-
tatement to their pre-tax incomes. Section IV discusses a second assumption: that tax avoidance and evasion are not seriously harmful and therefore are not immoral. It will clarify the harms that both types of conduct cause. Section V will address a third key assumption: that tax evasion is *malum prohibitum* rather than *malum in se*. That is, the sole moral content of tax evasion is derived from its legal status. According to this assumption, since avoidance lacks illegality, the one quality that differentiates it from evasion and the one source of evasion's immorality, then avoidance must be moral. Section V will demonstrate that despite the traditional conception of *malum prohibitum* and *malum in se* as mutually exclusive and exhaustive categories, there is logical space for other hybrid types of legal wrongs to exist between the two extremes. Section VI will address the assumption that morality exists wholly independently of the law with particular reference to the writing of Professor Tony Honoré.

This article demonstrates that not only do all four assumptions fail to justify the view that tax avoidance is moral, but that the evidence and the logic of the argument support the opposite view. To test this conclusion, Section VII considers public opinion as to the morality of tax avoidance.

G. PHILOSOPHICAL STANDPOINT

This article generally speaks in terms of the "morality" of tax avoidance, but there is no intention in the present context to distinguish that usage from the "ethics" of tax avoidance. As used by the authors, the terms are synonymous.

The authors do not explore basic principles of philosophy, but to define the bounds of the article, though at some risk of over-simplification, they note two primary approaches to ethical questions: deontology and consequentialism. A third possibility is virtue ethics, though some philosophers argue that virtue ethics is not a separate category.

The article adopts a deontological approach. That is, it looks at the morality of the fact of tax avoidance. It does not try to justify avoidance by its consequences. A deontological study parallels the usual approach of courts in determining whether a transaction

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amounts to tax avoidance: an objective focus that looks at the purpose and effect of schemes or arrangements that are impugned as avoidance by fiscal authorities rather than at the subjective purpose of taxpayers. As Lord Denning explained in the context of a case from a jurisdiction with a statutory general anti-avoidance rule, "You must . . . look at the arrangement itself and see which is its effect—which it does—irrespective of the motives of the persons who made it." The Supreme Court of the United States, a jurisdiction that operates under judge-made economic substance rules, adopted the same approach in Gregory v. Helvering: "[T]he question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended." This objective approach, which regards the taxpayer’s motive as not being decisive, also rules out virtue ethics as a framework, in that the focus of virtue ethics tends to be on the virtues of the agent rather than on the quality of the act.

Except incidentally, the authors do not examine consequentialist claims that tax avoidance, as a means, may be justified by an objective, or end. Indeed, their search has unearthed only one possible consequentialist claim for the merits of tax avoidance, and that is made (if at all) only by implication.

II. TAX EVASION AND TAX AVOIDANCE

A. THE DISTINCTION

Tax evasion and tax avoidance involve similar taxpayer behaviour and are each undertaken in pursuit of the same broad aim: to minimize or to eliminate tax liability. They are factually similar, but legally distinct.

Tax evasion is illegal. It consists in the wilful violation or circumvention of applicable tax laws in order to minimize tax liability. Tax evasion generally involves either deliberate under-reporting or non-reporting of receipts, or false claims to deductions. This conduct is legally straightforward to identify; a taxpayer has committed tax evasion only if he or she has breached a relevant law. Indeed, evasion ordinarily involves criminal fraud.

Tax avoidance is not illegal. Rather, it is the act of taking advantage of legal opportunities to minimize one’s tax liability.
lan and Lord Hoffman separately captured the essence of avoidance in these passages:

The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability.\(^{25}\) 

\[
\ldots \text{Transactions which in commercial terms fall within the charge to tax but have been, intentionally or otherwise, structured in such a way that on a purely juristic analysis they do not. This is what is meant by defeating the intention and application of the statute.}^{26}\]

Since tax-avoiders engage only in legal behaviour, even when the Commissioner detects avoidance schemes, they are not ordinarily subject to criminal punishment. This is not to say that the Commissioner will allow tax avoidance schemes to stand unchallenged, and tax legislation may contain provision for penalties specific to avoidance.

**B. General Anti-Avoidance Rules**

Avoidance is never easy to define, particularly in jurisdictions like the United States that have no general statutory definition. These jurisdictions must feel their way to a concept of avoidance via a congeries of the related doctrines discussed earlier,\(^{27}\) doctrines that, broadly, look at the substance of transactions rather than at their form. Jurisdictions that have a statutory general anti-avoidance rule, known as a GAAR, are marginally better off in this respect, in that in the framework of legal argument there is a concept, “avoidance,” that has legislatively-defined consequences. GAARS also define the concept of avoidance itself, but invariably do so in such general terms as to leave a good deal to judicial reasoning. The world’s oldest GAAR is thought to be that of New Zealand, which traces its history from section 62 of the Land Tax Act 1878, and which was modified and retained as section 40 of New Zealand’s first income tax legislation, the Land and Income Assessment Act 1891. The New Zealand GAAR’s text has often been refined, but it retains its original thrust and constitutes a reasonably typical example of a GAAR, except that it is disaggregated among three sections of the Income Tax Act 2007: BG 1 (core), GB 1 (the Commissioner’s reconstruction powers), and YA 1 (definitions). Section BG 1 provides that:


\(^{27}\) See supra Part I.D.
(1) A tax avoidance arrangement is void as against the Commissioner for income tax purposes.

(2) Under Part G (Avoidance and non-market transactions), the Commissioner may counteract a tax advantage that a person has obtained from or under a tax avoidance arrangement.

Section YA 1 defines “arrangement” broadly to include “an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect.” The section defines “tax avoidance” to include “altering,” “relieving” or “avoiding, reducing or postponing” the incidence of tax.

Section GA 1 sets out the consequences that follow where an avoidance arrangement is void under section BG 1. Section GA 1(2) provides that the Commissioner may adjust the taxable income of a person affected by the arrangement “in a way the Commissioner thinks appropriate, in order to counteract a tax advantage obtained by the person from or under the arrangement.” Essentially, the Commissioner may reconstruct in order to take account of the business reality of structures or transactions that would have eventuated but for the arrangement.

Together with sections GA 1 and YA 1, section BG 1 allows the Commissioner to undo or ignore avoidance schemes that taxpayers have devised. Suppose a tax avoidance scheme has the effect of splitting income or of generating deductions. In such cases section GA 1 would operate to unwind the scheme’s surface effect by “un-splitting” the income or “un-generating” the deductions. The GAAR allows the Commissioner to look behind legal appearances of tax avoidance schemes and to give effect to their true substance.

There are so many parallels between GAARS and judge-developed doctrines of substance over form, of business purpose, of economic substance, and so on that for purposes of exposition one can usefully speak of “statutory GAARS” and of “judge-made GAARS” or “judicial GAARS.”

The United States judge-made economic substance doctrine moved from judge-made to legislative while this article was in proof. Congress codified the doctrine as section 7701(o) of the Internal Revenue Code 1986, enacted by section 1409 of the Health Care and Education Reconciliation Act 2010. President Barak Obama signed the Act into law on March 30, 2010. Section 7701(o) differs in form from...
GAARS in tax legislation of other jurisdictions. Instead of creating an autonomous rule, Congress provided that section 7701(o) generally applies to "transaction[s] to which the economic substance doctrine is relevant." One result of this drafting is that section 7701(o) does not turn on, and does not contain, a definition of "tax avoidance." Nevertheless, the new rule appears to have been drafted with a view to operating in a manner much the same as the *modus operandi* of standard GAARS.

C. CONTRASTING TAX AVOIDANCE AND TAX MITIGATION

Unlike tax evasion, avoidance is not easily defined. While general anti-avoidance rules provide definitions, these definitions are too broad to be directly helpful. Taken literally, section YA 1 of the New Zealand legislation, discussed above, defines tax avoidance in such a manner that it includes many forms of tax activity that Parliament would have intended to let stand or even to encourage. For instance, if I make a donation to charity, I will qualify for a tax rebate; if I give income-producing assets to my children, I reduce my tax and I reduce the overall tax of the family as the income enjoys the lower tax rates of the children. In the language of section YA 1, both are examples where I have "altered" or "reduced" my incidence of tax. Yet everyone accepts that section BG 1 does not affect these arrangements. According to a literal interpretation of section YA 1, these are "tax avoidance arrangements," but it is clear that Parliament did not intend that they should be void against the Commissioner of Inland Revenue. The rebate that I qualify for seems to be intended to encourage just this sort of donation, and no one would suggest that parents should not be able to make valuable gifts to their children.

The State often provides tax incentives of one kind or another. If taxpayers respond by investing in fiscally preferred industries and thereby achieve a reduction in their tax liability, then they have succeeded in "relieving," "altering" or "avoiding, reducing or postponing" their incidence of tax. Yet, this conduct is not contrary to the policy behind the tax incentives in question. Almost every case dealing with section BG 1, or an equivalent GAAR in another country, recognizes that GAARS are not intended to catch activities that Parliament seeks to encourage.31

Courts occasionally use the expression "tax mitigation" to refer to measures that reduce tax (or avoid it, if one will) but in circumstances such as those described in this and the previous paragraph: that is, in

30. *Id.* § 7701(o)(1).
cases where the reduction of tax is the result of the taxpayer adopting a course of action that is clearly (and, ordinarily, expressly) encouraged by the relevant legislation.32

"Tax mitigation" is a label for a conclusion: that a scheme under examination that reduces tax is valid under relevant legislation (including relevant specific anti-avoidance rules), and not vulnerable to a GAAR, either statutory or judge-made. That is, "mitigation" does not inform us about the rules or processes of reasoning that led us to this conclusion. Nevertheless, it is a useful term, serving as a label for a concept that must be distinguished from avoidance. It does not tell us where the line between avoidance and acceptable reduction of tax is drawn, but it gives a name to the territory on the acceptable side of that line.

D. CONFLATING AVOIDANCE AND MITIGATION

We do not need to search far to see the utility of the term "mitigation." Scholars sometimes use "avoidance" to include both acceptable and unacceptable tax minimization. For instance, Christian Traxler tackled his topic of Majority Voting and the Welfare Implications of Tax Avoidance by employing:

... a model of tax avoidance in the spirit of Slemrod. Individuals decide on legal but costly activities that minimise their tax liability. For instance, taxpayers might shift income into untaxed fringe benefits, into preferentially-taxed capital gains, or into the future (eg, via pension plans).33

One could argue, and the present authors probably would argue, that from a tax policy point of view none of these minimization schemes is a good idea, in that by providing preferences they distort taxpayer behaviour. But standard examples of each scheme are unexceptionable from a legal perspective. No one complains if citizens contribute to tax-preferred pension plans. That is the government's whole point in offering the incentive. If people buy bigger holiday houses than they need, anticipating tax at preferred capital gains rates when they sell, or if they negotiate with their employers for more fringe benefits and lower salaries, it may not be very good for the economy, but no one objects from a legal or moral perspective. Sometimes, however, taxpayers exploit preferences in ways that are contrary to the policy or spirit of the legislation. The classic case of Gregory v.

Helvering\textsuperscript{34} is an example of attempting to convert revenue gains to capital gains to benefit from a preferential tax rate. This article describes other examples of avoidance in the sections that follow.

Christian Traxler’s paper is an example of why it may matter to divide tax minimization between avoidance and what this article has called “mitigation.” Citing the “well-known benchmark in voting literature: whenever the median voter’s income is below the average taxed income, the political process will result in an inefficiently high tax rate.”\textsuperscript{35} Traxler defends the fascinating thesis that: “The political inefficiency will be the smaller, however, the higher the average level of tax avoidance is in the economy.”\textsuperscript{36} The problem, however, is that, as mentioned, Traxler uses “avoidance” in two senses. He uses the word first in the sense of “avoidance” as used in GAARS and in this article. Secondly, he uses avoidance in the sense of “mitigation,” to mean minimizing one’s tax by adopting patterns of economic behaviour that are within the spirit of applicable tax legislation and that may even be encouraged by government policy. Under this two-prog- nged definition of “avoidance” it seems that, startlingly, “tax avoidance in Germany accounts for a loss of one third of income taxes paid.”\textsuperscript{37}

In fairness to Traxler, the problem that the present authors see in conflating tax avoidance and tax mitigation is more of a problem for them than for him. The authors’ thesis to be laid out in the present article is that from a moral perspective one cannot separate evasion and avoidance; it follows that one cannot defend avoidance morally. Traxler, however, argues that with certain income and voting patterns avoidance leads to greater fiscal efficiency. If Traxler is correct, and if Traxler and the present authors are talking about the same thing, does this amount to an argument against the authors’ position?

Of course, we are not talking about the same thing; the authors’ avoidance is a subset of Traxler’s avoidance. Since Traxler’s paper does not examine this subset no one knows whether increases in avoidance by contrived transactions that are contrary to the spirit and purpose of legislation lead to improved fiscal efficiency when the income of the median voter is below the average taxed income in the electorate. But assume that this may be so. Can improvements in efficiency justify breaches of moral norms? This is simply a reformulation of the ends against means argument, which is outside the philosophical underpinning of this article. Nevertheless, the authors offer

\begin{itemize}
\item \textsuperscript{34} 293 U.S. 465 (1935).
\item \textsuperscript{35} Traxler, \textit{supra} note 31, at 1.
\item \textsuperscript{36} \textit{Id.} at 1-2.
\item \textsuperscript{37} \textit{Id.} at 1 (citing O. Lang, et al., \textit{On Income Tax Avoidance: The Case of Germany}, 66 J. PUB. ECON. 327, 327–47 (1997)).
\end{itemize}
this observation: if one assumes (a) (as the authors will argue) that
tax avoidance cannot be justified morally, but (b) (as the authors will
not argue) that ends may sometimes justify means, it does not follow
that the possibility of improved fiscal settings justifies tax avoidance.
The reason is that these benefits, improved fiscal settings, are claimed
for increased avoidance only under certain electoral conditions. Tax-
payers cannot know whether those conditions will obtain as their
avoidance plans mature. This state of ignorance is no foundation for a
decision to do an act (to engage in tax avoidance) that, on the present
hypothesis, is not moral.

E. Boundary Uncertainty

The foregoing paragraphs leave unaddressed the problem of locat-
ing the boundaries between evasion and avoidance on one hand and
avoidance and mitigation on the other. This uncertainty is a chal-
lenge in any discussion of tax avoidance, but it is far from fatal to the
prospects of meaningful argument on the morality of avoidance, for
two reasons. First, although it is impossible to draft precise rules that
define these boundaries conceptually, decisions as to whether particu-
lar schemes or arrangements amount to avoidance tend to fall into
place more easily. Secondly, uncertainty as to the status of particular
cases does not vitiate judgments about cases that are clear. For in-
stance, even if we are uncertain whether euthanasia or failure to take
an acceptable risk to save human life amount to murder, we can be
sure that some instances of killing are murder and that some are not.
Similarly, we can be sure that some instances of tax minimization
amount to avoidance as the term is used in this article.

The analogy that the previous paragraph draws between uncer-
tainty as to the boundaries of avoidance and uncertainty as to the
boundaries of moral norms is relevant to the subject of this article
from another perspective, also, namely the question of the significance
in the present context of the consideration that moral norms are by
nature imprecise. For instance, we may agree that the key concept of
theft exemplifies immorality while disagreeing whether, say, feeding
one's family renders it moral to steal food. It is no surprise that mo-
rality in respect of tax avoidance exemplifies this same kind of fuzzi-
ness at its boundaries, fuzziness that is ultimately unable to be
resolved. But just as boundary uncertainty does not mean that we
cannot logically hypothesize that core examples of theft may be im-
oral, so boundary uncertainty does not put discussion of immorality
in the context of tax avoidance out of court. We may sensibly discuss
such morality in its central meaning. The fact that we cannot, for ex-
ample, agree whether reducing tax by making charitable donations to
take the benefit not only of tax rebates but also of some collateral ad-

dvantage does not prevent sensible discussion of whether at least the
core of avoidance may be immoral. For clarity, the point made in this
paragraph is the same argument the authors make in the previous
paragraph, though from a different perspective. Here, the focus is on
the meaning of “morality,” whereas in the previous paragraph focuses
on the meaning of “avoidance”: two sides of the same coin when one is
examining the morality of tax avoidance.

Clear examples of tax avoidance are available. These examples
tend to exhibit such qualities as “artificiality,” “undue complexity and
circularity” or “lack of business reality.” And while “avoidance” de-

fies comprehensive definition, we can begin to fill in a picture of avoid-
ance through listing examples. Gaps will remain. It seems that we
know tax avoidance when we see it, but we have to see it to know it.

It is useful here to consider a few examples of tax avoidance arrange-
ments that have reasonably uncomplicated facts.

F. INCOME-SPLITTING SCHEMES: MANGIN V. COMMISSIONER OF
INLAND REVENUE

The case of Mangin v. Commissioner of Inland Revenue involved
a tax avoidance scheme of a kind known as “income splitting.” The
taxpayer owned a farm with six fields. The land was only fertile
enough to produce crops every sixth year and had to be left to pasture
for the rest of the time. The taxpayer rotated the cropping field every
year. In any one year, the cropping field was the most profitable.

The taxpayer established a trust with his wife and children as
beneficiaries. Each year he let the current cropping field to the trust
at a low rental. The trust engaged him as a contractor to sow the field
in wheat and then to harvest it. The profits went to the trust. In re-
spect of that field the taxpayer derived only rent and fees for his work.
This rotation was repeated from year to year. The taxpayer thus re-
duced his income and incidence of tax. The trust was taxed each year
for the income derived from the cropping field but at a lower tax rate
than the taxpayer would have suffered.

The Privy Council agreed with the New Zealand Court of Appeal’s
finding that the scheme fell within a general anti-avoidance provision
and that as a result the scheme should be ignored for tax purposes.

W.L.R. 1383 (H.L.) (U.K.) (citing the High Court).
39. Newton v. Comm’r, (1958) 98 C.L.R. 1, 8 (Austl.) (P.C.) (noting a disting-

uishment between the accompanying text of this note with the comment Lord Denning made on

page eight of Newton).
G. SCHEMES FOR DEDUCTING INFLATED EXPENSES: CECIL BROS. PROPRIETARY LTD. V. FEDERAL COMMISSIONER OF TAXATION

The taxpayer in *Cecil Bros. Proprietary Ltd. v. Federal Commissioner of Taxation* was a shoe retail company. Cecil Bros., the taxpayer, engaged in a tax avoidance arrangement that involved paying higher than the market prices for some of its trading stock. Instead of buying from its usual supplier, the taxpayer bought some of its stock from a third company, Breckler Proprietary Ltd. ("Breckler"). Breckler bought the stock wholesale and then sold it to the taxpayer at increased prices. The taxpayer was willing to pay higher prices for the trading stock because the owners of Breckler were related to the owners of Cecil Bros. For that reason, the owners of Cecil Bros. were pleased when Breckler profited at the expense of Cecil Bros. Indeed, the purpose of the scheme was to transfer profits from Cecil Bros. to Breckler.

The Australian High Court held that the taxpayer was entitled to deduct the extra costs that it had incurred through the scheme. It did not matter that there was an avoidance purpose; the costs related to the acquisition of trading stock and the economic benefit to Breckler was not legally relevant.

H. INCOME REDUCING SCHEMES: JONES V. GARNETT (INSPECTOR OF TAXES)

In *Jones v. Garnett (Inspector of Taxes)*, the taxpayer, a specialist in information technology, set up a business with his wife. The couple established a company with two shares. The taxpayer and his wife each bought one share for a nominal sum. The taxpayer did not have a written employment contract but worked as director and employee of the company. The taxpayer represented all the earning power of the company, which provided his services to outside users for fees. His wife performed part-time administrative duties for which she received a fair salary. The taxpayer's salary was much lower than his experience and skills could command. The scheme enabled the company to earn profits, which were then distributed as dividends to the two shareholders, each being taxed at progressive rates. This structure resulted in lower overall tax liability for the couple than if the dividends had been paid solely to the taxpayer or if he had received a realistic salary and been taxed on it.

42. (1964) 111 C.L.R. 430 (Austl).
In the English High Court, the existence of a specific anti-avoidance rule allowed the revenue to unravel the scheme and to tax the dividends paid to the wife as part of the husband's income. However, the House of Lords found that the anti-avoidance rule did not apply. Instead, the benefit to the wife of obtaining a fifty per cent shareholding in a company to which she had contributed no capital or goodwill was a gift. She now owned the donated share and should be taxed accordingly. Such disagreement illustrates the inherent difficulties courts face when identifying avoidance transactions.

I. Duke of Westminster's Case

In *Duke of Westminster v. Commissioners of Inland Revenue*, the taxpayer had a number of employees, such as servants and gardeners, who were all on fixed wages or salaries. The taxpayer covenanted to make weekly payments to them of the same amounts they would otherwise have received as salary. The deed did not prevent the employees from collecting their ordinary salaries in addition to the covenanted payments. However, the employees wrote letters to the taxpayer in which they agreed that in practice they would forego their wage rights in consideration for the payments under the deed.

This arrangement qualified the taxpayer for a surtax deduction in respect of the payments made by deed. He would not have received a deduction if he had paid the employees' salaries in the usual way because the expenditure related to his personal needs. The arrangement was within the letter of the law but clearly was outside of its spirit. The policy behind the relevant legislation was that if part of a taxpayer's income never actually belongs to him because, as an annuity, it belongs to someone else, though paid through the taxpayer, then he should not pay tax on it. However, in this case the annuities effectively functioned as salaries.

The House of Lords, however, upheld the taxpayer's scheme because there was no GAAR and because their Lordships adopted a strict approach to statutory construction, favouring the arrangement's form over its substance.

J. Secrecy and the Line Between Tax Avoidance and Tax Evasion

"The law draws a line" between tax avoidance and tax evasion. This line may be fine, but it is supposed to be crisp, such that any set

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45. [1936] A.C. 1 (H.L.) (Eng.).
of facts will fall “on one side of it or the other.” By definition, tax avoidance falls on the “safe side,” whereas tax evasion is on the “wrong side” of the line. In practice, however, the line can become blurred in a way that definition alone does not suggest.

Suppose that the facts of Mangin v. Commissioner of Inland Revenue were repeated today: a farmer establishes a trust, rents out his cropping field on a rotational basis, and sows and harvests as a contractor. In one sense, this arrangement is legal and is merely avoidance: technically, the transactions have the effect that the taxpayer claims they do and the prima facie consequence is that he is liable for less tax. But if a taxpayer were to repeat the Mangin scheme today and were challenged by the Commissioner of Inland Revenue, the courts would certainly hold the scheme to be void for tax purposes; Mangin itself is the direct authority for striking it down. The taxpayer’s only hope would be that the Commissioner would not become aware of the scheme. Secrecy would be a necessary condition for the scheme’s success.

Even some schemes not yet tested by the courts may depend on secrecy for their success. For instance, consider the case of BNZ Investments Ltd. v. Commissioner of Inland Revenue, which involved several transactions, including one that was undeniably circular. This transaction was so obviously artificial that the taxpayer did not even attempt to argue that it did not amount to avoidance for the purposes of the general anti-avoidance rule. Yet, if the Commissioner had never noticed the arrangements that were carried out, the transaction would have had the effect of reducing the taxpayer’s liability, though only as a result of secrecy. In the case, the taxpayer won for other reasons, which are not relevant to the present point.

K. Is Tax Avoidance Robustly or Only Contingently Legal?

If an avoidance scheme cannot achieve a reduction in tax liability without secrecy, it is hard to see it as legal in any robust sense. A scheme that will clearly be struck down if it should ever be challenged seems to be only weakly or contingently within the law.

Such an avoidance scheme does not seem robustly legal because usually we think of legality as involving a strong predictive aspect. When I say, “it is illegal for me to commit murder,” only part of what I

47. Bullen, 240 U.S. at 630.
48. Id.
49. [1971] A.C. 739, [1971] 2 N.Z.L.R. 591 (P.C.); see supra Part II.F.
mean is that if I kill someone with the appropriate intent, and am found guilty in court, then I have broken the law. Surely, I also mean that even if I am never found out or challenged, still I have acted illegally.

This analogy should not be stretched too far; getting away with murder is of a quite different order from getting away with tax avoidance. An undetected murder is still not even weakly legal. In order to properly reflect the predictive aspect of law, it is necessary to recognize that much of tax avoidance is only legal in a weak sense.

L. THE STRICT CONSTRUCTION OF TAX STATUTES

There is a strong tradition of construing tax statutes literally. That is, the Commissioner can levy tax only by bringing taxpayers within the letter of the law, and if he fails to do so, the taxpayer is free from tax even if his case appears to be captured by the spirit of the law. The emphasis is on the legal structure, and legal effect, of the transactions that make up a purported tax avoidance scheme.

This strict interpretation approach is important for the success of tax avoidance schemes. We have seen that tax avoidance is not just the structuring of one's affairs to receive a legal tax advantage; it is doing so in ways that are inconsistent with the underlying policy or aims of the law. A tax avoidance scheme can succeed then if the court confines itself to the literal interpretation of the formal dimensions of the tax law; a scheme is likely to fail if the court looks beyond the form of transactions to whether their underlying substance is within the law's spirit, not just its letter.

M. MOTIVE IS NOT A RELEVANT LEGAL CONSIDERATION

According to the strict approach to statutory construction, courts must analyze parties' transactions by reference to the exact words of the statute. A corollary is that taxpayer motive is irrelevant when considering whether the taxpayer has remained on the safe side of the

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The important question is whether a transaction satisfies the letter of the law; all we can learn from motive is whether a transaction coheres with the law's spirit.

N. ASSUMPTIONS ABOUT THE MORALITY OF TAX AVOIDANCE

A key assumption seems to underlie this traditionally strict approach to tax statutes. This assumption is that evasion may be immoral, and those who engage in illegal evasion may be "bad men," but tax avoidance is not a moral wrong. Taxpayers are assumed not only to have the legal ability to avoid tax liability, but also a corresponding moral entitlement to do so.

This assumption is evident in many tax avoidance decisions. Lord Tomlin famously said in *Duke of Westminster v. Commissioner of Inland Revenue* that "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." He did not expressly say whether he was referring to moral, or only to legal, entitlement, but Lord Clyde was explicit on this point in the *Ayrshire Pullman Motor Services and DM Ritchie v. Commissioner of Inland Revenue* decision. He considered that an arrangement was "neither better nor worse" for the reason that it had a tax avoidance purpose, adding that "[n]o man in this country is under the smallest obligation, moral or other, so to arrange his legal relations . . . as to enable the Inland Revenue to put the largest shovel into his stores."

Other cases have confirmed that there is "nothing illegal or immoral," and "nothing wrong" about transactions with tax avoidance purposes. Tax avoidance is not in the least "fraudulent" but a basic taxpayer entitlement; and a tax avoider "neither comes under liability nor incurs blame." In *Helvering v. Gregory*, Judge Learned Hand rejected the notion that there is "even a patriotic duty to increase one's taxes."

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56. Vestey's Ex'rs v. C.I.R., [1949] 31 T.C. 1, 81(Eng.); Craven v. White, 3 All E.R. 495, 518 (H.L.) (Eng.).
58. [1936] A.C. 1 (H.L.) (Eng.).
61. *Ayrshire*, 14 T.C. at 763-64.
66. 69 F.2d 809 (2d Cir. 1934).
There is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right; for nobody owes any public duty to pay more than the law demands. Taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.68

This line of authority has been very influential.69 Many tax lawyers suggest that the idea of ethical or moral considerations impinging on the tax-planning domain is simply absurd.70 Some in the media have promoted the view that taxpayers have “a legal and moral right to work out how to pay as little tax as possible.”71 Lawyers and taxpayers who wish to engage in tax avoidance tend wholeheartedly to agree with judges like Lords Tomlin and Clyde and Judge Learned Hand, seeing tax avoidance “as being not only legal ... which it is by definition ... but [also] thoroughly respectable.”72

O. IS THE MORAL LINE THE SAME AS THE LEGAL LINE?

There is a wide variety of possible tax minimization behaviour that taxpayers might engage in. It spans a continuum from illegal tax evasion, to tax avoidance, where taxpayers reduce or alter their tax liability in a way that is contrary to the spirit of the legislation, and then to the reduction or alteration of tax liability in a way that is in line with the intent of the legislature. It seems clear that there is a moral distinction between illegally evading tax on the one hand and making a donation to charity and receiving a deduction on the other. Few would dispute that acceptable tax mitigation like charitable giving is moral and that tax evasion is immoral. Accordingly the moral line must be somewhere between these two extremes. Avoidance sits between acceptable tax mitigation and tax evasion. This means there are several possibilities as to where the moral line lies. The moral line might fall cleanly between avoidance and evasion or it might clearly fall between the two extremes.

separate avoidance from mitigation. The remaining possibility is that the line cuts less neatly through avoidance itself, so that some avoidance is morally acceptable and some is not. The issue then is where exactly the moral line is drawn.

The prevalent view discussed above is that tax evasion is immoral while tax avoidance is moral. By definition, tax evasion is illegal and tax avoidance is legal at least in the weak sense discussed earlier. According to this view, then, the moral line between different types of tax minimization behaviour coincides with the legal line.

P. A Logical Error: The Split from Legal to Moral Language

While it is true by definition that tax avoidance is legal and evasion is illegal, it is a logical confusion to draw moral conclusions from legal facts. The question of whether particular conduct is moral is a matter of morality, not a matter of law. It is true that taxpayers are legally entitled, at least in a weak sense, to avoid tax. However, moral entitlement does not necessarily follow from legal entitlement. It is this logical error that many judges, lawyers and commentators make when they assert that there is "nothing illegal or immoral" about tax avoidance; they have good evidence for the first claim but give no persuasive justification for the second.

Q. The Alleged Morality of Tax Avoidance Requires Justification

The cases have not provided any principled reason for us to believe that taxpayers are morally entitled to avoid tax. There have been judicial pronouncements on both sides of the debate on the morality of tax avoidance. Some judges have noted that tax avoidance is legal but have not considered it to be moral. Lord Denning famously remarked that tax avoidance "may be lawful, but it is not yet a virtue." However, on the whole, arguments for the immorality of tax avoidance have not seemed to catch the imagination of commentators, lawyers, or taxpayers to the same degree as statements asserting the opposite.

73. See supra Part II.N.
74. See supra Part II.K.
78. In re Weston's Settlements, [1966] 3 W.L.R. 786 (H.L.) (Eng.).
79. Weston, 3 W.L.R. at 786.
This debate need not be "never-ending." Statements that tax avoidance is not immoral are attractive to some taxpayers and lawyers, apparently letting them off the moral hook and free to pursue their own interests without restraint. This kind of attractiveness, however, tells us nothing about the truth of these statements. The moral status of tax avoidance merits closer scrutiny.

R. THE PLACEMENT OF THE MORAL LINE: TWO ALTERNATIVES

There are two broad alternatives regarding the placement of the line that separates moral from immoral tax minimization activity. One possibility is that the authorities discussed above are correct and that the legal line between evasion and avoidance maps exactly onto, or indeed defines, the moral line. According to this view, legal tax avoidance is morally permissible and we are able to conclude that tax evasion is immoral simply because it is illegal.81

The alternative possibility is that the moral line is different from the legal line, that is, the legality of tax avoidance is a matter separate from its morality. This view allows that it may be true that many or all instances of tax evasion are immoral and that many instances of tax avoidance are morally permissible. But this view at the same time holds that the bald statement that "taxpayers are morally entitled to avoid tax because it is not illegal" is not necessarily true.

S. THE SPECTRUM OF TAX MINIMIZATION BEHAVIOUR: GAARS AND EQUIVALENT DOCTRINES

Tax avoidance and evasion occupy different places on a spectrum of possible tax minimization behaviour. At one end are transactions like gifts to charity or the disposal of income producing assets. As discussed, these are within the policy of the law and are not intended to be affected by a GAAR. The situation is similar in jurisdictions without a GAAR. There would be no question of disallowance of the above examples of tax mitigation under the economic substance rule in the United States,82 nor under the fiscal nullity rule in the United Kingdom.83

82. Helvering v. Gregory, 69 F. 2d 809, 810 (2d Cir. 1934), aff'd, Gregory v. Helvering, 293 U.S. 465, 469 (1935) (said to have legitimized the substance over form approach); see Jay A Soled, Use of Judicial Doctrines in Resolving Transfer Tax Controversies, 42 B.C. L. Rev. 587, 591 (2001) (where a number of references are collected).
More serious and thus a little further along the scale are avoidance schemes that, although artificial, happen to succeed; as illustrated in the *Cecil Bros. Proprietary Ltd. v. Federal Commissioner of Taxation*\(^8^4\) and *Peterson v. IRC*\(^8^5\) decisions. More serious again is avoidance that might succeed but in fact does not because of a GAAR or equivalent judge-made doctrine. That is, the tax-avoider does not know beforehand that the arrangement's success depends entirely upon its secrecy. Further along the seriousness scale is tax avoidance that will certainly not work if challenged. Avoidance that can only succeed if not discovered is only contingently legal and is just short of tax evasion at the most serious end of the scale.

T. THE FOUR ASSUMPTIONS BEHIND THE VIEW THAT TAX AVOIDANCE IS MORAL

As has been explained, there is a good deal of judicial authority for the proposition that the legal and moral lines between different modes of tax minimization behaviour are the same. This authority is not well reasoned; rather, it is based on unsubstantiated assumptions. The rest of this article will test these assumptions. It will demonstrate that not only do these assumptions fail to justify the view that tax avoidance is moral, but also that the contrary view is supported by both logic and evidence.

The first unsubstantiated assumption is that taxpayers are morally entitled to their pre-tax incomes and that taxation is an unjustified governmental incursion onto individuals' private property rights. A second assumption is that tax evasion and avoidance are not especially harmful and so not immoral. A third assumption is that the crime of tax evasion is *malum prohibitum* rather than *malum in se*; that is, rather than concerning conduct that on any terms is wrong, the crime derives its only moral content from its legal status. The fourth and final assumption is that morality exists wholly independently of the law. Once these assumptions are rejected, it becomes clear that *mala in se* and *mala prohibita* are not exhaustive categories and that tax evasion is not immoral simply to the degree that it represents a breach of the general duty to obey the law; it is immoral in a much a much deeper sense. Since tax avoidance is so factually similar to tax evasion, and evasion is immoral in a deep sense, then avoidance is also immoral; it is not rendered moral by a distinction from evasion that is strictly, and only, legal.

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84. (1964) 111 C.L.R. 430 (Austl.).
III. THE FIRST ASSUMPTION BEHIND THE VIEW THAT TAX AVOIDANCE IS MORAL: THAT THERE IS A MORAL ENTITLEMENT TO PRE-TAX INCOME

The traditional approach to interpretation of tax legislation is to construe it strictly and literally. Tax law is often likened to penal law in this respect; just as there cannot be punishment without law, so too there cannot be taxation unless "[the Crown . . . [can] make out its right to the [tax]." Taxpayers have the fundamental right "to arrange their affairs to minimize the taxes they must fairly pay." Implicit in this approach is the assumption that individuals have a prima facie moral and legal right to their pre-tax income; if an individual accumulates property through commercial and social transactions, the state cannot deprive that individual of it without unambiguous legal authority. Private property rights are viewed as the natural, free-market ordering of things. Taxation is thus a largely unjustified governmental interference in this natural order. Even the limited levels of taxation that are "justified" are coercive takings by the State.

A. Nagel's and Murphy's Response to the Assumption

The intuition that there might be a moral entitlement to one's pre-tax income is familiar to most taxpayers who have ever looked at their payslips and noticed the difference between the pre-tax and post-tax income figures. Liam Murphy and Thomas Nagel challenge this view. The assumption that pre-tax market allocations of resources

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91. Simister & Chan, supra note 89, at 714.


are an appropriate moral starting point from which to assess the morality of taxation systems needs to be substantiated, not just asserted. Murphy and Nagel reject the philosophical underpinnings of the assumption on the ground that it is logically incoherent.

B. THE PHILOSOPHICAL UNDERPINNINGS OF THE ASSUMPTION

The assumption that the free-market ordering of property is morally privileged draws on the Lockean concept of natural property rights. Other philosophers of the early modern period had argued that property is not a natural kind but instead something that has been created by the State or has arisen out of society-wide convention. Bentham later asserted that “property and law are born together and die together. Before the law there was no property; take away the law, all property ceases.”

John Locke had a different view; he thought that property could exist independently of particular politics or conventions. According to Locke’s account, resources from the natural world are reduced to the ownership of individuals through their labour. Government or the State are not necessary for the creation of property. Instead, Government and the State arise after property, as a necessary mechanism for protecting natural rights.

C. THE LOGICAL INCOHERENCE OF THE ASSUMPTION

Murphy and Nagel reject the Lockean-inspired view that property rights exist independently of special legal or political conventions and that we have a moral right to our pre-tax, market-derived income; they consider such a view, which they call “everyday libertarianism,” wholly incoherent.

In a pre-legal state of nature, such as envisaged by Thomas Hobbes, there would not be a “market” to yield “free-market outcomes” in anything like the sense that the everyday libertarian uses these

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Why Liberty Depends on Taxes (W.W. Norton & Co, New York, 1999); Brooks, supra note 90, at 97; at 97; Simister & Chan, supra note 89, at 714.
98. Id. Part 4.
99. MURPHY & NAGEL, supra note 93, at 74.
terms. The market depends on law. A working legal system is a necessary precondition for the existence of "money, banks, corporations, stock exchanges, patents, or a modern market economy . . . the institutions that make possible the existence of almost all contemporary forms of income and wealth." A legal system cannot exist without Government; Government depends on taxation. Thus property rights fundamentally depend on taxation. It is therefore "meaningless" to speak of a prima facie property right in one's pre-tax income. The distribution of resources via the free market thus has no position of moral privilege compared with other distribution models.

The assumption that there is a moral right to pre-tax income arises in the context of the debate between legal positivists, like Bentham, and natural law theorists like Locke, and more recently between exclusive and inclusive legal positivists, about the relation between law and morality. It is beyond the scope of this article to do more than simply draw attention to this jurisprudential context. It is worth noting however that while Murphy and Nagel's position is non-Lockean, it need not be construed as purely positivist.

D. CONSEQUENCES OF REJECTING THE ASSUMPTION

If there is not even a presumptive moral entitlement to pre-tax income, then the imposition of taxes by the Government is not interference in the natural or moral order; any particular scheme of taxation and Government spending is simply one among many possible distribution models. This alone is not to say that any particular
taxation system is moral or immoral. Murphy and Nagel argue that questions of tax policy comprise just a small part of much wider set of questions of political philosophy and conceptions of justice. We can only evaluate the justice of after-tax income by reference to the legitimacy of the wider political and social system in which it is set.\textsuperscript{107}

Rejecting the assumption that there is a moral right to pre-tax income does not by itself allow us to conclude that tax avoidance is necessarily immoral. However, rejecting this assumption removes part of the basis for the conclusion that tax avoidance is moral.

IV. THE SECOND ASSUMPTION BEHIND THE VIEW THAT TAX AVOIDANCE IS MORAL: THAT TAX AVOIDANCE AND TAX EVASION ARE NOT HARMFUL

In the context of criminal law, three key elements are often used to justify criminalizing particular conduct: culpability, social harmfulness and wrongfulness.\textsuperscript{108} These three criteria for criminalizing conduct offer ways of analyzing judges' statements that that tax avoidance, as compared with tax evasion, is morally permissible. These three criteria are not mutually exclusive; there is considerable scope for overlap between them. Nor are they exhaustive; there could be other reasons why a community might feel criminalization is justified. However, within the context of this article, these criteria will provide a sufficient overview of the elements from which tax evasion and tax avoidance might derive moral content.

A. Culpability as a Moral Justification for Criminalizing Conduct

Tax evasion and avoidance each seem to satisfy the culpability element. Both share the same sorts of causes and motivations.\textsuperscript{109} The tax avoiders and tax evaders alike seek to reduce or to avoid their tax liabilities. If anything, tax avoidance might often comprise a more involved and substantial mental element. The detailed planning of a tax avoidance scheme suggests a mind deeply engaged in the enterprise of minimizing taxes. There is some overlap here with the other two criteria for criminalizing conduct; if conduct is not harmful or

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\textsuperscript{107} Id. at 33; see also Michael Schler, Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach, 55 TAX L. REV. 325, 395 (2002).

\textsuperscript{108} See Stuart P. Green, Why It's a Crime to Tear the Tag Off a Mattress: Over-criminalization and the Moral Content of Regulatory Offenses 46 EMORY L.J. 1533, 1547 (1997).

\textsuperscript{109} Anthony Christopher, The Law is the Law is the Law... in Tax Avoidance: The Economic, Legal and Moral Inter-Relationships Between Avoidance and Evasion 75, 80 (A.R. Ilersic ed., 1979).
wrongful, then its deliberateness need not mean that it is particularly culpable. But assuming that some harmfulness and wrongfulness can be established, tax evasion and avoidance both seem to satisfy the culpability requirement.

B. Harmfulness as a Moral Justification for Criminalizing Conduct

The harmfulness criterion is concerned with the quality of the act and its effects rather than with the characteristics of a particular defendant.110 People and communities have interests, that is, things in which they have some stake. An act is harmful to the extent that it intrudes on such interests.111 Harmfulness is not a sufficient condition for criminalizing conduct; individuals’ interests will often have some negative effect on each other but not all resulting intrusions will be harmful enough to justify criminal sanctions. Some conflicts, such as the potential conflicts of interest between competitors in a competitive marketplace, are seen as acceptable. However, harmfulness seems to be a necessary, or at least a close to necessary, condition for criminalizing conduct; many commentators doubt whether conduct that is not harmful should ever be criminalized.112

The assertion that tax avoidance is not morally wrong perhaps relies to a certain extent on an assumption that it is not really very harmful conduct. The harm criterion can be difficult to assess in respect of so-called victimless crimes where it is difficult or impossible to identify a direct victim. However, tax evasion and avoidance cannot be described as of victimless crimes or victimless conduct; crimes tend to be considered victimless if only consenting adults are involved, for example, illicit drug use or consensual incest or consensual sexual deviancy.113 Attempts to claim that avoidance is harmless because it is victimless cannot succeed.

C. Diffuse Harms and Harms that are Difficult to Identify

Tax evasion is not a victimless crime in the sense described in the foregoing paragraphs but there is a superficially analogous argument that seems to be implicitly relied on to show that tax evasion is not harmful and so is morally neutral.114 This argument is not that tax

111. Id. at 1550.
113. BLACK'S LAW DICTIONARY 400 (8th ed. 2004).
evasion is victimless in the standard sense of the term. Instead, the argument begins by posing the focus question, "who are these victims and what is the exact harm?" The idea seems to be that it is very difficult to pinpoint any particular victim of tax avoidance or evasion. The argument proceeds from lack of identifiable victims to the conclusion that no harm is caused by tax avoidance and evasion.

The flaw in this argument is that it assumes that a lack of individually identifiable victims is the same thing as a lack of victims altogether and that sufficiently diffuse harm is substantially similar to a total absence of harm. It is true that if taxpayer X chooses to pay less than taxpayer X's lawfully level of tax, we cannot point to some other individual Y who is a direct victim of this conduct. But this does not mean that no one is affected by taxpayer X's tax avoidance or evasion. Taxpayer X has caused harm, and this harm affects real people, but the harm is diffuse. These diffuse harms associated with tax avoidance and evasion are more difficult to visualize than the harms that affect the very tangible victims of street crime. Nevertheless, the harm criterion is satisfied whether the harm in question is spread thinly but widely or concentrated on one identifiable victim. The harm caused by tax evasion may be significant only in the aggregate, and many of the victims of tax evasion may remain unaware of the harm that they suffer, but the harm is significant nonetheless.

The problem with suggesting that diluted harms at some point cease to be real harms can be illustrated by reference to the dilemma of large numbers, a form of the prisoners' dilemma. In a community, any individual knows that individual's decisions will affect others and that in turn their decisions may affect that individual. When individuals act within a group as large as a political community or society, the "others" become impersonalized and there is no way for any individual to control or reliably to influence the behaviour of all other people in the community. If others seem not to be complying with social duties, such as the duty not to freeload, or the duty not to harm others, then from a self-interested, game-theoretical point of view, there is little incentive for an individual to comply either. The dilemma is this: for any individual it may appear that the harm that will result from refusing to comply with a social duty is so diluted

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116. Id. at 509.
119. Id. at 12.
as to be negligible; yet, if everyone followed that line and refused to comply, the negligible harms would add up to a very great harm. Eventually the system "bursts;" this is in no one's best interest.\textsuperscript{120}

\section*{D. The Harmfulness of Tax Avoidance}

Economically speaking, there is no distinction between tax avoidance and tax evasion.\textsuperscript{121} They are motivated by the same desire to minimize tax liability and have the same economic consequences. It is very difficult to gauge the amount of revenue lost to tax avoidance schemes, but even according to conservative estimates the sum lost in the United Kingdom each year to tax avoidance runs to tens of billions of pounds every year.\textsuperscript{122} The United States tax avoidance boom of the 1990s was estimated to cost the federal government billions of dollars in lost tax revenue.\textsuperscript{123}

Tax avoidance is harmful in that it results in a misallocation of resources.\textsuperscript{124} Taxpayers spend time and money devising tax avoidance schemes. This expenditure of effort may be profitable for the taxpayer but only because that taxpayer manages to extract an unintended tax benefit.

Tax avoidance therefore represents a deadweight loss to the economy, as the taxpayer in achieving the tax benefit undertakes no actually beneficial activity.\textsuperscript{125} The activity is demonstrably non-beneficial according to the following thought experiment: imagine that everyone, rather than just a subset of taxpayers, actively and aggressively pursued tax avoidance schemes wherever there was an opportunity to do so and there was little chance of being found out. The effect would be that tax rates would have to be raised and no one would achieve any gain. In fact, everyone would be worse off because tax avoidance is itself a deadweight cost.\textsuperscript{126}

Tax avoidance also undermines governments' revenues and governments' progressivity policies.\textsuperscript{127} In practice, it has substantially

\begin{thebibliography}{99}
\bibitem{120} Id. at 14.
\bibitem{122} See Tax Justice Network figures quoted in Monbiot, supra note 71, at 21.
\bibitem{123} Rostain, supra note 55, at 77.
\bibitem{124} Brooks, supra note 90, at 96.
\bibitem{125} Id.
\bibitem{126} Michael O'Grady, Revenue Comm'r, address at KPMG Tax Conference: Acceptable Limits of Tax Planning: A Revenue Perspective (Nov. 7, 2003).
\end{thebibliography}
negative distributional consequences.\textsuperscript{128} Not all taxpayers are able or willing to devise or to take advantage of tax avoidance schemes.\textsuperscript{129} Generally it is wealthy taxpayers or those with more sophisticated knowledge of tax law who are in the position to take advantage of tax avoidance opportunities.

Both avoidance and evasion risk undermining public confidence in the tax system. This can give rise to a vicious circle: as confidence falls, members of the public become less likely voluntarily to comply with tax laws.\textsuperscript{130}

As a generalization, tax evasion is more likely to be carried out on a smaller scale than tax avoidance. For instance an individual taxpayer who engages in evasion by not declaring under the table income from that individual's second job might thereby deprive the revenue of a few hundred dollars over a year. However, a company that structures a series of artificial transactions may generate legal tax deductions worth millions of dollars.

E. KANTIAN CATEGORICAL IMPERATIVES

Tax avoidance, and tax evasion for that matter, fail to satisfy the moral theory that Immanuel Kant called the "categorical imperative." The categorical imperative is a moral requirement deduced as a rational argument. Its essential postulate is that conduct is only moral if it would be acceptable even if all adopted it.\textsuperscript{131} The argument from Kant's categorical imperative would proceed similarly to the point made above that tax avoidance is a deadweight loss to the economy and that for individual taxpayers to achieve gains through avoidance it is necessary that only a minority of taxpayers should engage in this behaviour. The categorical imperative would proceed as follows: to see whether tax avoidance is moral, one must consider whether it would be rational behaviour for everyone to engage in it. We have seen that universal tax avoidance cannot be rationally justified. Everyone would be worse off if all taxpayers avoided tax: tax rates would rise and since avoidance is a deadweight cost, all would be worse off. Tax avoidance thus fails to satisfy the categorical imperative.

\begin{thebibliography}{99}
\bibitem{128} Brooks, supra note 90, at 96.
\bibitem{129} Id.
\bibitem{130} O'Grady, supra note 126.
\end{thebibliography}
F. WRONGFULNESS AS A MORAL JUSTIFICATION FOR CRIMINALIZING CONDUCT

In order to examine tax avoidance from an ethical perspective, this article has employed an analogy with the three qualities that are ordinarily required of an action before it is criminalized, namely culpability, social harmfulness, and wrongfulness. Foregoing sections of the article have argued that tax avoidance satisfies the culpability and harmfulness requirements at least as well as does tax evasion. It follows that the only possible point of difference between the two is in terms of their respective wrongfulness. As a quality, wrongfulness focuses on the act rather than on the actor. A wrongful act is one that violates some kind of norm or moral standard. However, wrongfulness is the very question at issue here; so consideration of this criterion cannot tell us much at this stage. The article will revisit this factor in section VI.

V. THE THIRD ASSUMPTION BEHIND THE VIEW THAT TAX AVOIDANCE IS MORAL: THAT TAX EVASION IS MALUM PROHIBITUM

An analytical framework that appears to have escaped earlier commentators is that tax avoidance and evasion, while legally distinct, are factually very similar. That is, the difference between evasion and avoidance is essentially a matter of law, not of relevant fact. Legal distinctions certainly provide sound bases for legal conclusions, but they cannot similarly justify moral conclusions. This observation is similar to the Humean point that one cannot derive an “ought” from an “is.”

To defend tax avoidance as legal and thus moral is not just to say something about tax avoidance but implicitly also is to comment on evasion. People who aver that there is a moral entitlement to avoid tax often make a point of contrasting avoidance and evasion; saying that there is a moral entitlement to avoid tax but no corresponding entitlement to evade it. This argument is hard to sustain when one takes into account that, the ingredients and effect of avoidance and evasion being factually similar, they are divided from one another by a line drawn according to law, not according to the facts of the case.


In contrast, generally speaking we expect that if two actions are factually similar, then they will be morally similar as well. There must be some basis for morally distinguishing two factually similar actions. If the only difference between evasion and avoidance is one of legality, and if avoidance is wholly moral then the immorality of evasion must be entirely attributable to its illegality. Put another way, it is not the content of the conduct itself that makes judges think that tax evasion is immoral, but simply that the evader has breached an overriding moral obligation to obey society's laws. Thus, judges return to the comparison between tax avoidance and evasion. Tax avoidance lacks the one characteristic that renders evasion immoral. People conclude that since avoidance is legal it must also be moral.

A. **Mala Prohibita and Mala in Se**

There is a longstanding conceptual distinction between acts that are *mala in se* and those that are *mala prohibita*. An act that is *malum in se* is an evil in itself. For instance, murder, theft, and rape are *mala in se*; such conduct is immoral because of its inherent nature, not because of its legal status. Murder or rape would still be immoral even if not criminalized. On the other hand, a crime that is *malum prohibitum* is a prohibited evil. For instance, jaywalking or not carrying a driver's licence while driving are *mala prohibita*. Such conduct is criminal simply because it is prohibited by statute; it is not necessarily immoral in its own right. *Mala prohibita* and *mala in se* have customarily been understood as mutually exclusive terms: acts are either wrong in their own right or only wrong because they have been prohibited.

B. **Mala Prohibita and Mala in Se: Mutually Exclusive Concepts**

Although judges who identify tax avoidance as moral have not expressly used the terms *malum in se* and *malum prohibitum*, these concepts seem to underlie their views on the respective moral statuses of tax avoidance and tax evasion. Since the terms are supposed to be mutually exclusive and exhaustive, any wrong that would not be a wrong independently of its illegality is by definition not *malum in se* but is necessarily *malum prohibitum*.

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138. Id. at 979.
It is at least technically or trivially true that tax evasion is not malum in se. Tax evasion is the wilful attempt to defeat or circumvent the tax law so as to reduce one's tax liability. If there is no tax law, there is nothing wilfully to defeat; that is, no conduct that could even arguably be independently immoral. For instance, unlike many jurisdictions, New Zealand does not have a genuine capital gains tax. While there are circumstantial or policy reasons for the presence or absence of capital gains tax in any country, from the point of view of an individual taxpayer it is fairly arbitrary whether such a tax exists. Consider two identical taxpayers, each with the same business and earnings structures. One is based in the United States and the other in New Zealand. Each makes identical capital gains, but only the first taxpayer is liable to capital gains tax. We know that the New Zealand taxpayer is not legally guilty of capital gains tax evasion because of the absence of any law imposing that tax. But more than this, we are sure that the taxpayer has done nothing that is morally wrong.

The judges who assert a moral entitlement to avoid tax seem to assume that it follows from the above observations that the United States taxpayer who evades the capital gains tax is morally culpable for breaking a valid law, but would not be morally culpable had that law not existed. Accordingly, if tax evasion is not malum in se, it must be malum prohibitum. If it is malum prohibitum, it is only immoral by virtue of its illegality. Thus, tax avoidance, which is not illegal, is wholly morally permissible.

It is true that evasion involves lying when it concerns the under-declaration of income. Evasion is very often achieved through criminal fraud, such as the fabrication of false accounts. It seems quite reasonable that conduct involving lies or fraud might be malum in se. But this does not mean that tax evasion itself is malum in se. The frauds or lies perpetrated by the tax evader may be highly wrongful independently of their legal statuses. Fraud and lies may accompany the non-payment, or under-payment of tax. But it need not follow that the tax evasion itself is malum in se.

In practice tax evaders tend to embroider their transactions in order, for instance, to generate deductible losses. But tax evasion does not in theory require elaborate embellishment and often is not embellished in practice. Perhaps the simplest form of tax evasion is the failure to file a return. Assuming that one has derived some income, the complete failure to file a return is certainly evasion since it is a deliberate attempt illegally to defeat the tax law. This may be an austere kind of tax evasion, but it is evasion nonetheless. Such evasion does not involve any lying, nor does it constitute fraud, since both catego-

ries seem to require more than a deliberate omission, that is, some positive act or statement. So, this purest form of evasion is not accompanied by any actual lies or fraud. If it is morally wrong, it is not wrong in virtue of its association with other morally wrong behaviour.

C. THE "ARBITRARINESS" OF TAX LAW

Judges who say that tax avoidance is moral do not think that tax evasion is excluded from being malum in se in only a trivial or technical sense. They further suggest that even where there is a tax law relating to the conduct in question, the conduct's moral content does not extend beyond that which it derives purely from its illegality. They draw on tax law's perceived arbitrariness: tax law is arbitrary and an arbitrary law surely cannot be malum in se. Their persistent reference to line drawing in tax law seems calculated to suggest this arbitrariness. If tax is an area governed by no universal moral imperative, then a legal line, wherever it is drawn, has no necessary relation to the facts that it governs. Legal rules like the rules of taxation are not logically deduced, but posited: "the claim of our [tax] code to especial respect is simply that it exists, that it is the one to which we have become accustomed, and not that it represents an eternal principle."

D. IS IT TRUE THAT TAX EVASION IS ONLY MALUM PROHIBITUM? A THIRD CATEGORY OF WRONGFULNESS

We have seen that tax evasion logically cannot be malum in se; any talk of evasion of tax law where there is no tax law is meaningless. However, it is dangerous to proceed from that observation to the conclusion that tax evasion is necessarily malum prohibitum and that the conduct itself is therefore morally neutral.

The division of all wrongs into mala in se and mala prohibita has a long history. It is appealing because it seems to capture some observable truths: some wrongs like murder and rape do seem to be immoral independently of their legal categorization; some crimes do seem largely regulatory, such as jaywalking or failing to carry one's driver's licence when driving. However, the flaw that seems to have accompanied the terms mala prohibita and mala in se throughout

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141. Id. at 685.
143. See Lord Oliver, Judicial Approaches to Revenue Law, in Striking the Balance: Tax Administration, Enforcement and Compliance in the 1990s, 174 (Malcolm Gammie & A. Shipwrite eds.) (1996).
their history is the notion that they are mutually exclusive and exhaustive. Most particularly, it is not self-evident that the categories are exhaustive of the possible relationships between the legality and morality of various types of acts.

Tax evasion may not be *malum in se*; however, it seems a quite different type of conduct from paradigmatic *mala prohibita*. Even if tax evasion is not *malum in se*, there seems to be more wrong with it than is wrong with purely regulatory violations. Tax crimes are generally classed as "regulatory" as they are governed by statutes that are administered by an administrative agency, that is, by an official state organization charged with collecting revenue. But mere definitional sleight of hand is not enough to justify the alleged moral entitlement to avoid tax. The very questions at issue are first, whether there is a moral duty not to evade tax and secondly, whether there is a similar duty not to avoid it. Blindly assuming that *malum in se* and *mala prohibita* are exhaustive of the moral landscape does not take us far in answering these questions.

It is similarly circular to identify tax evasion as a "regulatory offense" and then to assume that all regulatory offenses are *mala prohibita* such that their content is morally neutral. Concepts like *malum prohibitum* and "regulatory offense" seem often to be called upon to do more explanatory work than they are logically capable of. The mere fact that a statute is administered by an administrative agency is no necessary indicator that the statute lacks moral content. The concepts *malum in se* and *malum prohibita* may have the weight of tradition on their side, but any proposition that they are exhaustive is based on assumption, not on reason. People who say that tax avoidance is not immoral seem to rely on a false dichotomy: it is not correct to say that unless a wrong is immoral entirely independently of all law, its content must be morally neutral and that its sole claim to moral weight must be derived from a general obligation to obey the law. There is plenty of logical space between these two paradigms for other hybrid types of moral relationship between law and moral obligation. The final part of this article discusses this logical space.

146. Devlin, supra note 136, at 16.16.
147. Green, supra note 108, at 1544.
VI. THE DEPENDENCE OF MORALITY ON LAW

Most commentators and judges who assert a legal and moral right to avoid taxes would not go so far as to say there is also no moral duty not to evade taxes. That is, they are not skeptics about the existence of at least a prima facie moral duty to obey the law. In their legal decisions, judges do not usually engage in detailed theoretical discussions of political obligation. The authors have found no tax decisions in which a judge has discussed the relative merits of social contract theories of political obligation as compared to fairness theories or any other model. It is a rare judge who would deny any prima facie obligation to obey valid law. It is beyond the scope of this article to analyze all the possible derivations of such a duty to obey the law. For the purposes of this article, it will be sufficient to proceed on the same assumption as that embraced by judges, that is, that there is a general moral obligation to obey the law.

Judges who assert a moral entitlement to avoid tax derive a specific duty to obey tax law in particular from a general obligation to obey the law. They agree that since tax evasion is illegal there is a moral duty not to engage in it.

A. THE FOURTH ASSUMPTION: THAT ALL ASPECTS OF POLITICAL MORALITY ARE DETERMINE AND INDEPENDENT OF THE LAW

The picture of tax evasion as malum prohibitum and thus morally neutral is flawed. As discussed above, mala prohibita and mala in se are not necessarily exhaustive categories. Professor Tony Honore's writing helps to explain why these categories are not exhaustive. The view that tax evasion is morally neutral, except for its illegality, seems predicated on the assumption that we can always determine the moral status of an act independently of a community's laws.


According to this assumption, we can determine whether an act is immoral through rational moral argument and need not draw any firm conclusions from what the formal legal system has to say on the matter. ¹⁵³

Like many unspoken assumptions, this one has prima facie plausibility. In a great many cases we do seem to know the moral value of an act independently of its legal status; we do not need to trawl through the statute books to know that murder, rape, or theft are wrong. It is true that some conduct, for example tax evasion and avoidance, is impossible to evaluate, or even to define, if removed from its legal context. However, it beg the question to assert that because such conduct relies on legal definition, its content is necessarily morally neutral. It beg the question to assert that this conduct's only moral component is due to its legal status. Such an argument could only be logically sound if it first established that legally independent wrongfulness, in a mala in se sense, and moral content derived only from legal status, in a *mala prohibita* sense, exhausted the moral landscape.

For Honoré, a “picture of morality as a blueprint and law as a structure put up either according to or in disregard of it is . . . misleading.”¹⁵⁴ We live in collective groups or political communities. A large part of morality relates to questions of how to co-exist and to cooperate with others: “[t]he core of morality is, in a broad sense, political.”¹⁵⁵ It follows that in a complex society, a viable morality necessarily has a legal component. That is, the morality of a complex society will be incomplete without a legal system containing certain types of laws.¹⁵⁶

Broadly speaking, when we consider moral questions, we are concerned with the ways in which our actions may significantly impact on other people, either individually or collectively. We are interested in how these impacts do, or should, limit or restrain our behaviour.¹⁵⁷ For Honoré, law relates to morality in two central ways. First, law can form a part of morality. Secondly, laws are open to moral criticism.¹⁵⁸ The second of these assumptions is fairly uncontroversial from a legal positivist standpoint; if there is no necessary connection between morality and law, then it is possible to criticize an existing law on moral grounds. However, the first assumption requires further explanation.

¹⁵³. Id.
¹⁵⁴. Id. at 3.
¹⁵⁵. Id. at 2.
¹⁵⁶. Id.
¹⁵⁷. Id.
¹⁵⁸. Id.
B. Honoré: Some Aspects of Morality Depend on External Definition

Moral principles are normative in the sense that they tell us how we should act or behave. However, such principles are not always determinatively prescriptive. Moral principles are often quite general; while they provide a guide to the sorts of ways individuals should generally act, they do not always contain enough information to allow them to tell individuals exactly what is required of them in particular situations. For instance, there may be a general principle that individuals should be "generous" or "kind" or should "not always put their own interests first" but these principles are fairly open ended and vague. These broad duties are not always sufficient to define individuals' particular duties to each other when their interests conflict. Particularly when a moral requirement is considered compulsory, it requires a measure of specificity so that individuals know just what they are morally required to do. If the core of morality is interacting with others, then our morality, as a set of general principles, is incomplete or lacks specificity. For morality to be complete and meaningful in practice it needs some additional definition from a source outside of itself.

C. Primitive and Pre-Legal Societies

By Honoré's account, a "primitive" society is one without the formal legal institutions that are present in "complex societies." In primitive, tribal, small-scale or pre-legal societies, individuals' moral duties to each other tend to be well defined. Individuals in a small-scale community tend to know each other or to be closely linked. Their social roles are defined by fairly rigid customary or conventional practices and are clearly understood. It is rare for an individual to doubt how to act in a certain situation as there will generally be clear social norms to which that individual understands he or she must adhere. Despite the indeterminacy of general moral principles, it is unusual for individuals in a primitive society to experience moral conflict.

This determinacy of the social morality in a primitive society cannot stem solely from morality itself. The outside determinant is social

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162. Id. at 172.
163. Id.
THE MORALITY OF TAX AVOIDANCE

Consider an interdependent community of one-hundred individuals that does not have a legal system. If it functions as a cooperative society, its members must all know what community duties they owe. Human collective societies by nature appear to involve more than just the bare minimum level of cooperation necessary to, for example, provide shelter, avoid starvation, and allow for reproduction. In a primitive society, each individual's moral duties towards others would be defined to a large extent by convention and enforced not necessarily through rules or laws but via some means of social pressure.

A convention that might arise in such a society could be that each household contributes one able bodied man in wartime. Such a duty gives shape to the abstract duty to contribute to the protection of the community. Conventions to take in orphaned relatives or to contribute food or shelter to sick members of the community similarly define the more nebulous duty to be generous to others.

D. Modern Legal Societies

A complex, larger, modern society involves more independence and separation of individuals. While it is still a collective, the links between the members are less direct, more abstract. The links between members of a complex society are too numerous and varied for convention to determine or settle the content of individuals' moral obligations to one another. In a complex society there are more "others" to consider and a moral code needs to become even more specific. Individuals tend not to feel that they have links to a greater number of "others." Instead, they feel as though, since there are so many seemingly faceless "others," they are not linked to any of them.

Determination of vague moral norms is just as necessary in a complex society as in a primitive one, but convention and social pressure will not be sufficient to define nor to enforce particular moral requirements. Honoré argues that law fulfills this determinative role in complex societies.

164. Honoré, supra note 152, at 2.
166. Honoré, supra note 151, at 49; Sawer, supra note 163, at 37.
167. Honoré, supra note 152, at 7.
169. Honoré, supra note 152, at 8.
170. Petersen, supra note 118, at 14.
171. Id.
172. Honoré, supra note 151, at 49.
173. Honoré, supra note 152, at 11.
E. THE COMPARISON OF PRIMITIVE TO COMPLEX SOCIETIES

Some might doubt whether the primitive pre-legal societies can be validly compared to modern legal societies and political communities;¹⁷⁴ perhaps the difference between the two social models is not only one of scale and complexity, but also of kind. However, such an objection would have to be spelt out in more specific terms to be convincing. Generally, changes of scale need not affect the principles at work. It is hard to see why an individual's duties to others in a small, close-knit group would cease merely because the group reaches such a size that an individual no longer has direct links with every member. Certainly, that individual's duties take on a more abstract nature and may be less straightforwardly conceptualized by individuals, but they remain duties. Judicial statements that have reflected a belief in the moral dubiousness of tax avoidance often invoke such notions of duties of good citizenship and duties to other taxpayers.¹⁷⁵

F. TAX EVASION AND THE MIDDLE GROUND BETWEEN MALA IN SE AND MALA PROHIBITA: A LEGALLY CONSTRUCTED MORAL WRONG?

If some moral obligations need outside determinants, then the problem with viewing mala in se and mala prohibita as exhaustive categories becomes clear. Legally defined crimes like tax evasion are not necessarily morally neutral.

In cases where either convention or law is required to give an abstract moral norm sufficient definition to be socially prescriptive, the defined moral obligation cannot be said to be universal or wholly or causally distinct from the convention of law that shapes it. Within the context of a modern, complex society such as our own, convention will be insufficient for this purpose; so we will necessarily be dealing with a moral duty defined by law. The abstract moral duty that relates to tax evasion is something like "to contribute to one's cooperative society." Taxation law gives shape to this moral duty by defining the measure of taxes on the forms of income that a taxpayer must pay.

Such a legally defined moral duty does not clearly fit within the malum in se category: tax is by definition something that is legally imposed; it is logically impossible to pay a tax if no there is no tax law to impose it; to fail to do something that is logically impossible cannot be immoral. However, while this thought experiment tells us that tax evasion is not malum in se, it does not establish that, given that we do

have tax laws, there is not something wrong with evading them beyond the general obligation to obey the law. To class tax evasion as *malum prohibitum* and therefore morally neutral seems to fail to take proper account of the fact that, although legally defined, the duty is a moral one.

When tax evasion is understood this way, we can see first that it is morally wrong not only because it is illegal but also because, within our legal and societal context, our broad moral obligation to contribute to the collective has taken the specific shape of a duty to pay our taxes. Tax evasion is thus a wrong in a deep sense. Considering that tax evasion is morally wrong in virtue of its content as well as its legal status, it is not convincing to suggest that the mere fact that tax avoidance is not illegal means that it is also not immoral. From this perspective, the factual similarity between avoidance and evasion and the fineness of the legal line between them suggest the opposite conclusion from the one drawn by judges. If tax avoidance is factually almost indistinguishable from tax evasion, and if despite being a legal construct tax evasion is in a deep sense immoral, then tax avoidance is similarly immoral.176

VII. PUBLIC PERCEPTION OF TAX AVOIDANCE

A. INTRODUCTION

This article has argued that tax avoidance cannot be justified morally. In doing so, the article has endeavoured to limit its a priori assumptions and has tried to argue on the basis of logic. Its main starting point is that tax evasion is immoral. In examining the morality of avoidance the article builds from that assumption about evasion.

Although the article sometimes incidentally mentions attitudes to tax avoidance, it has not relied on the attitudes of individuals or on public opinion as foundations for its argument, since individual attitudes and public opinion may be wrong. Nevertheless, while one cannot justify reference to individual or public opinion to discover a priori criteria, comparing the conclusions in the article with individual and public opinion may serve to test conclusions. This section of the article therefore moves to qualitative assessment. To do so, it examines attitudes to the morality of tax avoidance in four contexts: general press reports, attitudes to politicians, defamation proceedings, and tax litigation.

Like the rest of this article, this section examines tax avoidance in a general rather than confining discussion to tax avoidance in the context of estate planning. This treatment extends a major theme of this article: that from the perspective of morality there is no difference between tax avoidance in the context of estate planning on one hand and, on the other hand, tax avoidance in business, or, indeed, tax avoidance that is altogether exogenous to the taxpayer’s regular economic activities. Conclusions about these latter categories are relevant to inform arguments about the former. The authors do not hesitate, therefore, to take examples from a range of contexts.

B. PRESS REPORTS

Considering that tax avoidance and resort to tax shelters in modern capitalist societies are common, if not commonplace, it is surprising that an electronic search discovers relatively few references to these activities in the general press. Where there are such reports, one finds that journalists go to considerable lengths to avoid recording express personal judgments. Nonetheless, such reports often reflect adversely on the ethics of the people who are their subjects by way of quotations that journalists choose or by their presentation.

One example is an article in the London *Sunday Times* of April 19, 2009, on the corporate structure employed by the Internet search group Google for certain business activities outside the United States. The author, Richard Watts, reported that the Google group set up companies in Bermuda, one of which owned a company in Ireland. Google clients who wish to advertise to potential United Kingdom customers on the Google search engine contract with and pay the Irish company. The result is that “more than 90% of Google’s UK revenues are channelled through Ireland, where corporate tax is levied at 12.5%, compared with 28% in Britain.” The Sunday Times engaged Richard Murphy, an accountant, to investigate Google’s United Kingdom, Irish, and American accounts. Watts quoted Murphy as asking rhetorically, “Is it morally right that a company can hoover up £1.25 billion of revenues from the UK in a single year and pay back just £600,000 of tax?” Watts leaves little doubt about the answer. The American scholar, Professor Paul Caron, made a similar point about Google’s operations in Norway.

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178. Id.
179. Id. Watts and Murphy were referring to the 2007 tax year.
C. Politicians

There are few if any records of politicians defending tax avoidance. When they comment, politicians are generally against it. Take the Right Honourable Stephen Timms, who, as Financial Secretary to the Treasury, is the United Kingdom minister responsible for strategic oversight of taxation. Timms denounced tax avoidance as “morally wrong” on September 21, 2009. Of more interest for present purposes, however, is the impact of public suspicion that a politician may have engaged in tax avoidance. Here, the story of Lord Ashcroft, formerly Treasurer and now Deputy Chairman of the United Kingdom Conservative Party, and a major donor to party funds, is a prominent example.

Lord Ashcroft is a dual citizen of Belize and the United Kingdom. He is suspected of employing base companies in tax havens. In addition, until March 2010 he was suspected of exploiting the United Kingdom “non-dom” rule. On March 1, 2010 he admitted that these suspicions were correct, as explained two paragraphs below. Broadly speaking, the non-dom rule provides that United Kingdom residents who are not domiciled in the United Kingdom (that is, they are domiciled in other jurisdictions) only pay United Kingdom tax on United Kingdom source income. The rule makes London a Mecca and tax haven for rich people from many countries. Stories about Lord Ashcroft on non-dom and other avoidance themes have appeared regularly in the press since the late 1990s. An early example was an article by Sarah Schaefer, which mentioned both business and tax issues. Schaefer described the then Mr. Michael Ashcroft as “a tax exile who lives in Florida” who wanted to set up a bank in the Turks and Caicos Islands (a tax haven). Schaefer referred to a telegram written in 1997


All [methods of avoidance] are alike in that they are definitely contrary to the spirit of the law. All are alike in that they represent a determined effort on the part of those who use them to dodge the payment of taxes which Congress based on ability to pay. All are alike in that failure to pay results in shifting the tax load to the shoulders of those less able to pay.


by Gordon Baker, Her Majesty’s High Commissioner\textsuperscript{183} in Belize, warning that rumours about Ashcroft’s business dealings “cast a shadow over his reputation which ought not be ignored.” More recently, the London \textit{Times} wrote:

The Conservative Party has . . . taken millions of pounds from a man who refuses to say whether he is resident and pays tax in this country. . . . [T]here is a growing concern at the highest level in the Conservative Party that what Shadow Cabinet members call the “Ashcroft question” has still not been resolved.\textsuperscript{184}

The \textit{Daily Mail} put the matter more trenchantly: Lord Ashcroft was “a long running Tory embarrassment,” a “multi-millionaire [who] refuses to answer questions surrounding his tax status,” and a “running sore inside the Tory Party [that] needs to be cleaned up once and for all.” \textsuperscript{185}

Eventually, Lord Ashcroft admitted by statements reported on March 1, 2010 that he is in fact a non-dom in tax status:

My precise tax status therefore is that of a “non-dom.” Two of Labour’s biggest donors - Lord Paul (recently made a privy councillor by the Prime Minister) and Sir Ronald Cohen, both long-term residents of the UK, are also “non-doms.”

As for the future, while the non-dom status will continue for many people in business or public life, David Cameron has said that anyone sitting in the legislature - Lords or Commons - must be treated as resident and domiciled in the UK for tax purposes. I agree with this change and expect to be sitting in the House of Lords for many years to come.\textsuperscript{186}

His intention seems to have been to remove the secrecy and uncertainty that made his suspected non-dom status an issue in the first place, while at the same time pointing the finger at Labour’s own non-dom donors.

Lord Ashcroft soldiers on. These passages establish what is relevant for this article, that the press (a) regards tax avoidance as morally wrong and (b) takes for granted that the public agrees.

\textsuperscript{183} Within the Commonwealth, heads of diplomatic missions are “High Commissioners” rather than “Ambassadors”, recognising that Commonwealth countries do not consider each other to be foreign.

\textsuperscript{184} Id.

\textsuperscript{185} Id.

D. Defamation

If tax avoidance is immoral we might expect to come across reports of claims for libel where publishers have wrongly made allegations of avoidance, but such reports are rare. One reason may be that claimants do not wish to expose their affairs to public gaze even though they are confident that their tax position is unexceptionable. A notable exception is a claim by the United Kingdom-based supermarket chain, Tesco, the world’s fourth-largest retailer, against The Guardian newspaper. Tesco has suffered a number of accusations of tax avoidance, including an allegation of a scheme that was said to have involved ninety lawyers to construct. Eventually, Tesco drew the line in respect of comments about an arrangement that involved complex property dealings via Jersey and the Cayman Islands. The Guardian incorrectly wrote that Tesco was avoiding up to £1 billion in corporation tax on those transactions and Tesco launched libel and malicious falsehood actions against the newspaper and its editor on April 4, 2008. Tesco described the allegation as “a devastating attack on its integrity and ethics,” though the company added:

By structuring these transactions in this way Tesco expects to achieve savings of £23m in stamp duty-related taxes on the transactions completed to date. The maximum additional savings in stamp duty-related taxes that might be achieved from using these structures could be another £30m to £40m.

During interlocutory proceedings on July 29, 2008, while acknowledging that “massive” tax avoidance was unethical (indeed, this accusation was the reason for Tesco’s claim) Tesco appeared to adopt a consequentialist stance in respect of tax avoidance at a “low level.” Adrienne Page QC, counsel for Tesco, acknowledged that the company engaged in “low level planning, tax avoidance,” but said that Tesco

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189. Rusbridger, see supra note 187.
190. The United Kingdom term for income tax on companies.
191. On 29 July 2008 Eady J in the High Court ordered the malicious falsehood claim stayed. Leigh, supra note 188.
192. Rusbridger, supra note 187.
193. Id.
194. Id.
objected to being accused of "massive" avoidance and "plundering the Treasury." 195

Probably, not too much should be taken from a short passage in counsel's submissions in interlocutory proceedings, but as a minimum it appears that one large company is adamant that "massive" tax avoidance as immoral.

E. TAX LITIGATION

Just as Tesco believes massive avoidance to be immoral, so, it seems, does Westpac, the Australian bank that is twelfth in the world by market capitalization. 196 At least, certain Westpac staff and advisers appear to be aware that some of the public take that view. Their opinions emerged in evidence before Justice Harrison of the High Court of New Zealand in the Westpac Banking Corporation v. Commissioner of Inland Revenue 197 decision. The Westpac case was the second to go to trial, and the second win for the Commissioner of Inland Revenue, in a suite of international arbitration cases that involve approximately NZ$2.4 billion in tax and interest (approximately US$1.8 billion as at October 2009), with possible penalties in addition. 198 All cases that are still live involve Australian-owned banks that operate in New Zealand. These claims are among the largest sums of tax subject to active litigation anywhere in the world. By way of comparison, Compaq Computer Corp. v. Commissioner, 199 one of the most discussed international arbitration cases of recent times, 200 involved claims for $3.4 million in foreign tax credits and tax in respect of $1.5 million of deductions.

Bearing in mind that New Zealand has a population of only four million, the sum of US$1.8 billion at issue in one suit of cases may instructively be compared with the Internal Revenue Service estimate of an annual total of US$30 billion of avoidance by United States companies through international tax planning. 201 Several arbitration counterparties of Westpac and other banks were well known American companies, including Koch Industries, General Electric, Credit

195. Leigh, supra note 188.
198. The first was BNZ Inv., Ltd. v. C.I.R., [2008] 1 N.Z.L.R. 598 (H.C.).
199. 277 F.3d 778 (6th Cir. 2001).
Suisse First Boston, Citibank,202 and American International Group.203

The schemes were known as “repos” or “repurchase” transactions, in form mortgages by sale of securities and redemption by repurchase. The schemes relied on an arbitrage opportunity that arose from treatment of certain income flows from the United States as interest and into New Zealand as dividends. Details are not important for this article, but the opinions of those involved are instructive.

Rob Nimmo was Westpac’s chief credit officer in Sydney and a member of the bank’s Structured Finance Committee, a group responsible for approving proposals for the kinds of transaction involved. Ian Gibbs was Westpac’s principal employee responsible for the transactions. As Justice Harrison recorded his evidence, Gibbs did not mention questions beyond strict black letter law, but Nimmo took a broader view. He was concerned at the then proposed Koch transaction’s “‘flimsy’ commercial purpose;” [at] the risk that the tax issues were ‘inconsistent with Westpac’s good corporate citizenship;’” and as to “whether the transaction would be seen publicly as tax avoidance.”204

By August 2002, eighteen per cent of Westpac New Zealand’s total assets were invested in international repos.205 The effect was dramatic. New Zealand’s corporate tax rate was thirty-three per cent, but so successful were the repos that Westpac could in effect choose a tax rate as low as it liked. Richard Mataira, head of tax for Westpac’s New Zealand group,206 became concerned that people might notice. He was correct. Bank tax payments fell so low that the Reserve Bank of New Zealand in its banking supervisory role became curious and drew the position to the attention of the Commissioner of Inland Revenue.207

John Shewan, Chairman of the accounting firm, PriceWaterhouse Coopers New Zealand, and Westpac’s tax adviser, was also concerned. By 2001, when Westpac’s effective tax rate had fallen to eleven per cent, Shewan expressed discomfort,208 but eventually he recommended payment of a sum that amounted to an effective tax rate of 6.5 per cent against reported profit.209

205. Id. at [1].
206. Id. at [85].
207. Author’s knowledge. It seems likely that the Commissioner was already aware.
209. Id. at [555], [556].
It was not essential to the case, and Justice Harrison does not explain, whether bank employees and advisers took any view on the morality of tax avoidance, but his Honour's judgment shows that people were worried about public perceptions of the bank's position. To put the matter at its lowest, there appears to have been a concern that ethics were relevant to that issue, though the bank's case throughout was that its repo arbitrage was not avoidance but legitimate structuring.

In summary, from the examples from several countries chosen for study (reports in the general press, attitudes of and towards politicians, defamation cases, and tax litigation) there is evidence of public opinion as to the morality of tax avoidance that supports the argument in this article.

VIII. CONCLUSION

Judges and commentators have made much of the legal difference between evasion and avoidance. Many judges have considered that while evasion is immoral because it is in breach of the law, legal avoidance involves no such moral misstep. But to draw moral conclusions from legal observations constitutes logical confusion. The fact that conduct is not illegal does not necessarily mean that it is also moral. It is legal to sell cigarettes, but this observation does not tell us whether selling cigarettes is moral. It is true that conduct that is legal cannot be immoral in one special sense: that is, since it is not illegal, it cannot be immoral for the reason of illegality. But conduct can be immoral for many reasons other than that it breaches the law. Evasion is immoral for more than legal reasons alone.

The difference between evasion and avoidance is a matter of law, not of relevant fact. This difference cannot tell us anything about the differences or similarities between evasion and avoidance in moral terms, except for the special case that evasion is immoral anyway to the extent it is illegal. Judges overlook the considerable factual similarity between avoidance and evasion: both aim to minimize tax liability and both have similar economic effects. Judges are correct when they note that there is a legal dissimilarity between the evasion and avoidance, but the factual similarities between the two are of much greater moral significance than the legal difference; from the perspective of morality we should look at the two phenomena as being just one phenomenon. Public opinion appears to reach the same conclusion.

The same considerations apply to avoidance in the context of estate planning as to avoidance in any other context. If a transaction is contrived to defeat the object of relevant legislation, and if it amounts in consequence to avoidance that is immoral, there is no logic in an
argument to the effect that embedding the transaction in an estate planning structure can somehow cure that immorality. This is not to say that the presence together in a single transaction of a reduction of tax and an estate planning structure is enough to conclude that the transaction in question amounts to avoidance or that it offends morality. An outright transfer of income-producing property reduces the donor's income, but without more we cannot stigmatize the transfer as avoidance. If the transaction needs a label, "tax mitigation" is appropriate. It is sometimes difficult to categorize a transaction as "avoidance" or as "mitigation," perhaps particularly so where the transaction is a transfer in the context of an estate plan, but that difficulty does not invalidate the distinction.