

RISK-MINING THE PUBLIC EXCHEQUER

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Abstract

Tax avoidance is commonly theorised on the hypothesis that, in any specific instance of it, its effectiveness or ineffectiveness is determinate, whereas in the vast majority of instances it succeeds by default without being subject to forensic scrutiny. This article offers a new theory of tax avoidance which treats indeterminacy of outcome, as at implementation, as being of its essence. It proceeds from existing tax industry discourse regarding tax risk management, and shows (using the case study of Amazon's former UK/Luxembourg tax structuring) how tax avoidance is a discrete category of tax risk management with a determinate institutional genealogy. It proceeds to consider how (on a systemic level) such behaviour yields unwarranted financial transfers out of the public exchequer, and does so notwithstanding the adequacy of tax risk mitigation in any given instance. It concludes with comments on the utility of the theory.

INTRODUCTION

There is little controversy regarding the existence of a determinate category of human behaviour known as (in the broadest sense of the expression, so as to include tax avoidance at all levels of aggression) 'tax planning'. It is a category of behaviour which is defined at one boundary by legality, insofar as it does not extend to tax behaviours which are in some way fraudulent, and, at another boundary, by its *deliberate* tax content, insofar as it does not include tax savings that arise by accident. It is, in the immortal words of Lord Tomlin in the *Duke of Westminster's Case*, where the taxpayer 'arrange[s] his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.'²

As most readers of this article will know, Lord Tomlin goes on to say that if the taxpayer 'succeeds in ordering [his affairs] so as to secure this result, then however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.' This legendary dictum is still regularly advanced in support of the proposition that there is nothing abusive about tax planning, however aggressive (McTernan, 2016).

Less often, is it noted that the dictum assumes success on the part of the taxpayer, referring to tax planning that 'secures' the intended tax saving as a matter of law. But the question of whether tax planning succeeds or fails is one to which 'only the highest court can give a definitive answer' (Devereaux, Freedman, & Vella, 2012). The starting point in order to deploy Lord Tomlin's dictum as dismissive of any suggestion that tax planning may be abusive is therefore to view tax planning as having been already considered by a court of the highest authority. That viewpoint is, of course, very far from being a starting point, chronologically. On the contrary, it takes place towards the end of the process, and (crucially) only in a vanishingly small number of cases. The vast majority of tax planning is never even considered by a tax authority, let alone forensically tested, and still less forensically tested in a court of supreme authority.

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² *Duke of Westminster v Commissioners of Inland Revenue* 19 TC 490 at 520.

The dangers of viewing the process of tax planning backwards chronologically from the perspective of a hypothetical authoritative determination as to its legal effectiveness, in as bold an act of defiance towards the second law of thermodynamics as any performed by Dr Who, are evident in a paper prepared by the Oxford University Centre for Business Taxation ('OUCBT') and published under the title 'Tax Avoidance' on 3 December 2012 (Devereaux et al., 2012). The paper presents a taxonomy of tax avoidance, the first category of which ('category A') is 'ineffective avoidance'. In other words, the paper's *starting point* for defining tax avoidance is the category of tax planning which has gone all the way through the process of being devised, implemented, attacked by HM Revenue and Customs, and found to fail. The paper's next category, 'effective avoidance' (or 'category B'), is likewise defined by reference to a determinate forensic outcome, insofar as an explanation is given as to why tax planning might constitute avoidance by some putative wider definition but still be found to succeed by the courts.

As a behaviour, however, and prior to any hypothesised definite determination of success or failure by a court of supreme authority, it is not possible to distinguish between behaviour in category A and behaviour in category B, and the authors effectively acknowledge this when they talk about a taxpayer 'deciding whether to enter into a transaction that falls within category A or B' or refer to 'types of activity which fall under categories A and B'. However, they do not offer a theory of what such behaviour, undistinguished by outcome as between categories A and B, actually is. This is a grave omission since, as already noted, most 'types of activity which fall under categories A and B' stay that way, never being resolved into one category or the other. Reversing the chronology of the OUCBT taxonomy so that it accords with the familiar one whereby time moves forwards, we can only infer that 'tax avoidance' is a category of tax planning (i.e. their categories A and B) which is defined by the fact that it may or may not turn out upon a putative authoritative forensic analysis to fall within an ineffective subcategory of itself.

The purpose of this article is to confront the possibility that the OUCBT authors, in encouraging this inference, have (perhaps in spite of themselves³) alighted on that holy grail of tax theory: the objective definition of tax avoidance. The article's approach is to foreground the category of tax planning which is potentially ineffective (i.e. it might fall into the OUCBT authors' category A), but which is never subject to a determination as to its effectiveness, and so succeeds by default. In so doing, it develops a theory of tax avoidance, or abusive tax behaviour, as an objectively determinate category of tax behaviour which may be characterised as 'risk-mining' the public exchequer.⁴

It is worth emphasising again that the vast majority of tax planning, whether or not it merits the label 'tax avoidance' or the opprobrium associated with that label, and whether it would succeed or fail upon challenge, succeeds by default rather than being forensically tested. This category cannot be dismissed as a mere wrinkle in a theory which treats all tax avoidance as subject to forensic determination as to its effectiveness, or simply swept under the carpet of the 'effective' category of tax avoidance on the basis that it succeeds by default. This category of tax avoidance, which is ignored by those who theorise about the subject, is the reality of tax avoidance in practice.

³The OUCBT authors take care to distance themselves from any such inference, warning that category B is not clearly distinguishable from their 'category C' – behaviour which is tax planning but to which the label 'tax avoidance' is not seemingly applicable at all.

⁴The theory discussed in this article has previously been presented in Quentin (2014).

CASE STUDY: AMAZON.CO.UK

As a case study for the purposes of exploring this category of behaviour, Amazon's former UK/Luxembourg tax structuring shall be considered. This planning was investigated by the UK Parliamentary Accounts Committee in 2012⁵ and widely publicised, in particular by investigative journalist Tom Bergin of Reuters.⁶ It was also considered in the UK High Court in a case only tangentially related to tax, *Cosmetic Warriors Ltd & Anor v amazon.co.uk Ltd & Anor* [2014] EWHC 181 (Ch). As the judge in that case explained:

The facts here are that the second Defendant, a Luxembourg company, operates the website at amazon.co.uk whereas the first Defendant, a UK company, operates fulfilment centres in various parts of the UK, through which goods sold by the website are dispatched to customers, and provides logistic services to the second Defendant. The first Defendant also leases offices in Berkshire and provides marketing, legal, accounting and other services which support the operation of the second Defendant's web business.

In other words, the Luxembourg entity ('LuxCo') conducted the business of selling goods to UK customers, and the UK entity ('UKCo') was a service provider to the Luxembourg entity. It may confidently be inferred⁷ that this arrangement was in the nature of deliberate tax planning. Its purpose was to (a) have the profits of the UK business arise in LuxCo rather than UKCo by virtue of the LuxCo's role in concluding contracts with customers, and (b) bring the operations performed by UKCo within paragraph 3 of Article V of the UK-Luxembourg double tax treaty.

Where a UK operation of a Luxembourg company only conducts activities within certain exemptions in that paragraph for preparatory or auxiliary activities, the UK operation will not constitute a 'permanent establishment' of the Luxembourg company, and by reference to the treaty (as implemented for the purposes of UK domestic law), the UK abjures taxing rights over the profits of that operation. Meanwhile, Luxembourg has been in the habit of granting to Luxembourg resident members of transnational corporate groups favourable rulings to assist their group tax structuring.⁸ In Amazon's case, a favourable ruling was obtained in relation to the pricing of a deductible royalty payable by LuxCo to a Luxembourg limited liability partnership also within the Amazon group structure ('LuxLLP'). Since LuxLLP is 'transparent' for Luxembourg tax purposes (meaning that the royalty is treated as arising to its members, which are resident outside the jurisdiction and are therefore not taxable in Luxembourg in respect of that income), the overall effect of the ruling was that only a small residual profit after deduction of the royalty was taxable in Luxembourg (European Commission, 2014).

Some might assert that this planning falls squarely within the OUCBT authors' category B, on the basis that if it had been challenged by HM Revenue and Customs it would have been found by the courts to have been effective. However, this analysis would overlook the need for the facts on the ground to reflect the formalities of the tax planning, and it is quite clear from the *Cosmetic Warriors* case that they did not. The claimants in the *Cosmetic Warriors* case pleaded that Amazon's UK operations, which included the tortious acts in question in the case, were

⁵UK Parliament Public Accounts Committee (2012).

⁶See, for example, Bergin (2013).

⁷As to which, see further discussion below.

⁸Marian (2017).

jointly entered into by UKCo and LuxCo. Amazon vigorously asserted the separation of the two entities' functions, but the High Court was far from persuaded:

Having heard the evidence I have no doubt that the first and second Defendants have joined together and agreed to work together in the furtherance of a common plan which includes doing the acts which are complained of by the Claimants in these proceedings. I regard the protestations that the first Defendant is not involved at all or is merely facilitating the doing of the infringing acts as distinct from sufficiently participating in them as being wholly unreal and divorced from the commercial reality of the situation. In my judgment the allegation of joint tortfeasance succeeds.

In other words, the two purportedly discrete operations were in practice indistinguishable, such that the two entities have been found to have been conducting them jointly, and therefore as agents for each other.⁹ This is an extremely unusual finding in relation to corporate group affiliates. For one member of a corporate group to be held liable for a tort nominally committed by another is to run directly counter to the general resolve of the UK courts to respect the separate legal personality of companies. As Langley J said in *Peterson Farms Inc v C&M Farming Ltd* [2004] 1 Lloyd's rep 603 at 62:

In commercial terms the creation of a corporate structure is by definition designed to create separate legal entities for entirely legitimate purposes which would often if not usually be defeated by any general agency relationship between them.

By their conduct as found to have been carried on in *Cosmetic Warriors*, Amazon's UK and Luxembourg entities created such a relationship.

It is worth noting that this finding was prompted by the mere pleaded case that the two defendants were joint tortfeasors, and (extraordinarily, given how high the legal hurdle is in the context of affiliated companies) was solely made out by Amazon's own evidence seeking to argue to the contrary. The claimants whose case it was do not appear to have had to do any work to secure this finding, notwithstanding that the legal hurdle is so high in the context of affiliated companies. Amazon appear therefore to have positively thrown themselves over that hurdle on the facts: the structural relationship on which it relied in seeking to negative joint tortfeasance was not merely divergent from the commercial reality in the way that contractual form can sometimes be divergent from commercial reality in an ordinary business context but was, to repeat the salient words of the judgment, 'wholly unreal and divorced from the commercial reality of the situation'.

This finding, if it had been made in relation to a tax appeal, would have opened up a number of specific lines of attack for HM Revenue & Customs that would not otherwise be available. There would be lines of attack referable to the disconnect between the formalities intended to give rise to the tax advantage and the actual conduct of the parties, which is a risky place for tax planning to find itself in both as a general rule¹⁰ and specifically in the context of reliance upon a tax treaty.¹¹ There would also be lines of attack referable to the specific relation of mutual agency between the parties which they clearly did not intend and which significantly weakens Amazon's treaty position. Their treaty position clearly assumed that that the activities

⁹*Brooke v Bool* [1928] 2 KB 578.

¹⁰See *WT Ramsay Ltd v IRC* [1979] STC 582 and related cases.

¹¹See paragraph 9 of the OECD commentary on the OECD model double tax treaty.

nominally carried out by UKCo are the only activities relevant to the question of whether UKCo constitutes a permanent establishment of LuxCo for treaty purposes, and that each party contracts solely on its own behalf, whereas, in fact, the entire operation was being jointly carried out by both entities, each as agent for the other.

It is not the purpose of this article to evaluate the strength of those lines of attack. All that is required for our purposes is recognition that, in the light of the finding in *Cosmetic Warriors*, Amazon's UK/Luxembourg tax planning cannot confidently be placed in the OUCBT authors' category B. It might have been ineffective; we don't know. All we can say for sure is that it was one of the 'types of activity which fall under categories A and B'.

GENEALOGIES OF TAX RISK

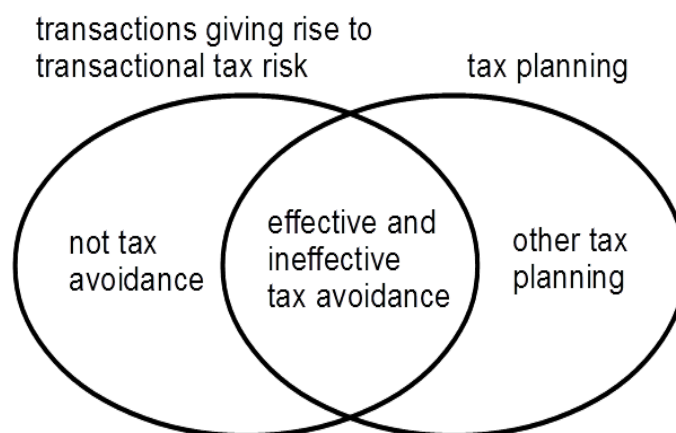
A circumstance where tax planning may or may not be effective is one where there exists what is known as 'tax risk'. Specifically, there exists the risk that the taxpayer's filing position (adopted in consequence of the tax planning) may fail upon tax authority challenge with the consequence that additional tax in excess of the amount self-assessed by the taxpayer is payable. This category of tax risk is recognised as the subject of a number of management techniques; for example, it is treated as capable of being valued. 'When looking at a tax position, there will normally be uncertainty in the possible outcome of such a position' it is explained, for example, in Bas de Mik's 'Introduction to tax risk management', forming Chapter 1 of *Tax Risk Management: from Risk to Opportunity* (de Mik, 2010). 'In order to value the position, each of the possible scenarios needs to be taken into account and an assessment should be made on the chance that each scenario would materialize. The cash flow for each of the scenarios should then be weighted to come to a valuation of a position.'

Confusingly, however, technical discussion of tax risk as managed by an organisation's tax function elides this kind of risk into a broader, composite conception of tax risk which includes, for example, the risk of paying additional tax by omitting to implement tax planning. In discussion of the 'tax control framework' advocated by Hoyng, Kloosterhof and Macpherson in the next chapter of *Tax Risk Management: from Risk to Opportunity*, 'where we refer to risks, a missed opportunity is also seen as a risk' (Hoyng, Kloosterhof, & Macpherson, 2010). These opportunities, it is later explained, include 'the ability of the organization and the tax function to create value from [...] future tax planning proposals' (Hoyng et al., 2010).

It is worth teasing these categories apart so that we can be clearer about precisely what kind of tax risk is being discussed in a particular context. First, let us consider the circumstance where a tax position is taken and there is uncertainty as to the outcome in the event of a tax authority challenge. For clarity, in order to distinguish this circumstance from other forms of tax risk, let us label it 'transactional tax risk'. It must be emphasised that the existence of transactional tax risk, albeit that it arises from transactions deliberately entered into by the company or group, does not necessarily indicate that we are in the OUCBT authors' A & B category. The transactions in question may not fall within the meaning of 'tax planning'; they may be deliberate behaviours but they are not necessarily deliberate *tax* behaviours. This would be the case where the features of the transaction are entirely driven by non-tax-related considerations, and the transactional tax risk is simply an unfortunate side-effect of pursuing the transaction in question.

Second, let us consider the risk of missing a tax planning opportunity. This risk is mitigated by looking for tax planning opportunities and implementing them. This is a category of tax risk management which is therefore essentially synonymous with 'tax planning'. All three of the

OUCBT authors' categories, i.e. the composite category of A & B which contains tax planning that may be ineffective, and category C which contains tax planning which may be expected to succeed, constitute this form of tax risk management. What distinguishes categories A & B from category C is the way in which this category of tax risk management intersects with transactional tax risk. Categories A & B (i.e. ineffective and effective tax avoidance) are where the tax planning gives rise to transactional tax risk, in contrast to category C, where it does not. The following diagram sets out this relationship (with the caveat that the complexities of the relationship are further developed as this article proceeds).



We can now proceed to examine this relationship by means of our case study. Had Amazon simply operated its UK business through a UK branch or subsidiary in the ordinary way, it would have had to pay UK corporation tax on the profits of its UK business. Its tax function appears to have identified this course of action as a missed tax opportunity, and recommended the tax planning strategy of bifurcating the functions of the UK business into the execution of contracts and certain other functions to be performed by a Luxembourg entity coupled with the performance of merely preparatory or auxiliary functions by a UK entity.¹² Managing this 'missed opportunity' tax risk by implementing the proposed planning, however, introduced the transactional tax risk of UKCo being treated as a permanent establishment in respect of LuxCo's UK profits. The formal disaggregation of functions between the two entities introduced a tax risk factor (i.e. permanent establishment risk) that would not have arisen had all of the functions of the UK business been performed by a UK-resident company.

It seems, therefore, that any elision between different forms of tax risk management obscures the possibility of transactional tax risk factors having a determinate genealogy, either arising (a) from the mitigation of 'missed opportunity' tax risk (i.e. from tax planning), or (b) otherwise. Further, given that in the former case the feature of the transaction to which the transactional tax risk is referable will have been introduced by the company or group's tax function or external tax advisers, whereas in the latter case it will not, that genealogy is *institutionally* determinate.

The possibility that transactional tax risk factors can have a determinate institutional genealogy is something that tax industry discourse is extremely coy about. As a quick bit of Googling

¹²We cannot say for sure that this is what happened because we do not have the relevant internal communications, but it is a very safe inference given that the structuring was highly advantageous from a tax perspective and, as already discussed, found to be 'wholly unreal and divorced from the commercial reality of the situation'.

will illustrate, the internet is awash with puff from professional services firms promoting their tax risk management expertise; it is rarely acknowledged, however, that part of that expertise involves deliberately creating tax risk. An exception may be found in a blog post on the PwC website, which asks:

So where does tax risk originate? Tax risk isn't typically created within the tax function; it happens earlier in the value chain, with data, and with people making decisions at the front end of the organisation without sufficient understanding of the tax consequences. (Bracco & Gooding, 2016).

This at least constitutes an acknowledgement that tax risk *might* originate within the tax function. Hoyng, Kloosterhof and Macpherson go further, identifying two types of tax risk:

First, there is the risk without any upside, e.g. failure to comply with administrative requirements. Generally, an organization should try to mitigate these kinds of risks to an efficient extent. The second risk is the risk that comes with pursuing an opportunity, there is always a risk that the opportunity will not be achieved, or that additional costs are incurred to achieve that opportunity. An organization should not try to avoid these kinds of risks but make sure that when an opportunity is pursued, the opportunity (measured against the strategic objectives) outweighs the risk. In addition, appropriate measures should be taken to mitigate the negative impact of this risk. The same applies to tax risks. When it comes to the first category of risks, the organization should mitigate these risks to the extent that it is efficient. A well designed and functioning [tax control framework] will have this effect. However, a more important role for a [tax control framework] is in relation to the combination of opportunity/risk. (Hoyng et al., 2010, p.23).

The first of these two generalised categories of risk as applied to tax appears to include the risk of a taxpayer understating its tax liability in its self-assessment (i.e. what we have labelled transactional tax risk), and the second appears to include 'missed opportunity' tax risk (i.e. tax planning), and it is clearly acknowledged that the latter category of risk can lead to the former category of risk, insofar as 'there is always a risk that the opportunity will not be achieved'.

What this means is that, for our purposes, there are indeed two distinct categories of tax risk as at self-assessment with (in a business organisation, at least) distinct genealogies. A tax risk factor can arise independently of tax planning or as a result of it. This distinction is important, because it enables transactional tax risk which has been deliberately put in place by the taxpayer to be distinguished from tax risk which arises, say, by reference to an error, or by simple dint of the uncertain application of tax law to the things which the taxpayer is doing commercially.

Given the institutional discreteness of an organisation's tax function, this is a distinction which can be drawn with something approaching objectivity, in contrast to notoriously awkward questions of whether a feature of a transaction has a tax 'motive' or 'purpose'. The objective question is whether the feature of the taxpayer's circumstances which gives rise to (or increases the level of) tax risk as at the self-assessment stage was a feature which the taxpayer itself introduced upon the prior recommendation of its own tax function or of external tax advisers.

If so, then deciding whether to implement that recommendation was the OUCBT authors' 'deciding whether to enter into a transaction that falls within category A or B' and entering into it was engaging in their 'types of activity which fall under categories A and B'. This is because, if the planning introduces a tax risk factor, then as at implementation it could either be effective

or ineffective. The transactional tax risk created or increased by this behaviour is described hereafter as ‘deliberately created tax risk’.

It should be emphasised that this does not include transactional tax risk which arises otherwise than from tax planning. We are, as already explained, at the *intersection* of transactional tax risk and tax planning: transactional tax risk arising otherwise than by reference to tax planning is outside the intersection, as is tax planning that does not introduce risk factors or otherwise increase transactional tax risk. The reason this requires emphasising is that, on former occasions when the arguments in this article have been presented, those arguments have been misunderstood as claiming that *any* transactional tax risk or uncertain filing position constitutes deliberately created tax risk. It is only ‘deliberately created’ tax risk if it derives from tax planning.

The core argument of this article is that deliberately created tax risk is abusive tax behaviour, rightly attracting the opprobrium that attaches to the term ‘tax avoidance’.

It is conventional to distinguish unexceptionable tax planning, often characterised as tax planning in pursuit of tax reliefs intentionally made available in legislation, from other forms of tax avoidance which may or may not be abusive (this unexceptionable tax planning is sometimes, as we shall see, referred to as ‘pro-purposive’ tax planning). It is also conventional to distinguish ‘aggressive’ tax avoidance from other forms of tax avoidance, and to allow that the aggressive kind (however it is defined) is abusive notwithstanding that it is not fraudulent. It is conventional also to leave a gap between the unexceptionable tax planning and the aggressive tax avoidance, and that gap is generally characterised as a ‘grey area’. The argument here is that (a) there is a sharp distinction between the unexceptionable tax planning and deliberately created tax risk, and (b) deliberately created tax risk is always abusive, even in circumstances where the risk is small.

That argument is developed below by reference to (a) the aggregate financial effect on the public exchequer of deliberate tax risk creation, and (b) the relation between the mitigation of deliberately created tax risk and legislative purpose.

TAX RISK CREATION AS A FINANCIAL TRANSFER OUT OF THE EXCHEQUER

Why, then, do taxpayers deliberately create tax risk? Clearly, it is to create the possibility of not paying tax which would otherwise be payable. However, there is a subtlety to this dynamic which needs to be expressly brought out into the open. When valuing a tax position, the amount of the tax saving which may or may not be available is no doubt to be discounted by reference to the chances of that tax position failing upon tax authority challenge. However, in circumstances where not all tax positions are challenged (and, in practice, only a tiny proportion of them are) there is a substantial additional upside for the taxpayer, to be added back in after the saving has been discounted by reference to the strength or weakness of the filing position, in the form of the tax saving which accrues in the event that no such challenge takes place. This saving accrues, it hardly need be added, whether or not the tax planning is effective.

This second tranche of upside is present in all cases of tax planning which introduces a tax risk factor, irrespective of the strength of the filing position. In a case where the filing position is weak, the possibility of not facing tax authority challenge at all forms the more substantial tranche of the upside for the taxpayer, but that tranche is nonetheless present in other cases. Indeed, such upside as is referable to the possibility of the filing position going unchallenged is not merely present, but is almost guaranteed to be realised in contrasting cases where the filing

position is likely to be upheld in any event, since tax authorities will (perfectly sensibly) positively avoid litigating in those circumstances. In the UK, for example, HMRC stated policy provides that ‘Where HMRC believes that it is unlikely to succeed in litigation it will, in the majority of cases, concede the issue.’¹³ Indeed, ‘in general, HMRC will not take up a tax dispute unless the overall revenue flows potentially involved justify doing so’¹⁴ and a dispute which it is likely to lose does not promise much by way of revenue flows.

That additional tranche of upside corresponds, of course, to an additional tranche of downside to the public exchequer. It is for this reason that the deliberate creation of transactional tax risk by means of tax planning *always* constitutes a financial transfer out of the public exchequer, irrespective of how likely the planning is to succeed or fail upon challenge. The additional taxpayer upside risk and exchequer downside risk attaching to the taxpayer’s filing position succeeding in default of a challenge creates a risk asymmetry as between taxpayer and public exchequer at all points along the spectrum, from highly aggressive tax avoidance almost doomed to fall foul of anti-avoidance law to relatively vanilla planning introducing easily managed risk factors, and, by definition, that risk asymmetry constitutes a financial transfer.

Perhaps the most useful approach to understanding the effect of this risk asymmetry in the context of filing positions which are more likely than not to succeed is a statistical one. Suppose ten taxpayers each implement tax planning which introduces a mild risk factor such that each position bears a 20% likelihood of failure upon challenge. This should be understood to be different tax planning in each case, such that each case bears that 20% likelihood of failure independently of the others. Suppose further that in each case £1000 of additional tax will be payable if that 20% likelihood eventuates. In a world where all uncertain tax positions are litigated, the probabilities are that eight of the taxpayers will succeed and two will fail, such that £2000 of additional tax is collected out of the £10,000 total at stake. In the event, however, no additional tax will be collected because in no particular case will it be worthwhile for the tax authority to challenge the filing position. A tax position with an 80% chance of success is therefore effectively worth something approaching 100% of its nominal value. Thus it is that even low levels of deliberately created risk to the exchequer, in circumstances of full disclosure to the tax authority, create actual losses of tax.

Of course, in no individual such case is the money legally payable in tax; still less can it be said that the money is legally the property of the Crown. In each individual case, however, the upside for the taxpayer in creating the risk has been augmented by the non-negligible possibility of the filing position being wrong but going unchallenged, and that is the mechanism by means of which (in our example above) £2000 is effectively lost to the public exchequer. It is by reference to this dynamic that I have elsewhere described the deliberate creation of tax risk as ‘risk-mining’ the public exchequer.¹⁵

MITIGATION OF DELIBERATELY INTRODUCED TAX RISK FACTORS

As the example of Amazon illustrated, the distinction between tax avoidance which is likely to succeed and tax avoidance which is likely to fail is, in any event, a false one, since that distinction relies on taking at face value structural claims inherent in the tax planning which may not be borne out on the facts. This failure on the part of the taxpayer’s arrangements in reality to live up to the intentions of the tax planning it has adopted (a failure on the part of

¹³HM Revenue & Customs, *Litigation and Settlement Strategy*, p.5.

¹⁴ibid p 2.

¹⁵See footnote 4.

clients familiar to many tax practitioners and tax tribunals¹⁶) gives rise to a further question, fundamental to the ‘risk-mining’ analysis of tax avoidance. What is the significance, in the risk-mining analysis of tax avoidance, of the mitigation of deliberately created tax risk?

We have seen that mitigating the risk of missing tax opportunities (otherwise known as tax planning) can introduce tax risk insofar as it can give rise to features of a taxpayer’s circumstances which potentially result in its self-assessed tax liability being less than its actual liability. We also saw Hoyng, Kloosterhof and Macpherson mention that tax risk in this latter category, irrespective of its institutional genealogy (i.e. whether or not it derives from tax planning), should, in turn, be mitigated.

This imperative to mitigate transactional tax risk, in the specific context of transactional tax risk which traces its origins back to tax planning, is illustrated in the case of Amazon by their need to keep the functions of UKCo and LuxCo distinct, and it has important implications.

Let us suppose, for the sake of argument, that had Amazon been challenged on their tax planning by HM Revenue & Customs, any appeal by Amazon would have failed on the basis of findings such as those in *Cosmetic Warriors*. This is, as discussed above, by no means an implausible hypothesis given how strongly adverse those findings were from the perspective of Amazon’s tax structuring. Under this hypothesis, a substantial additional tax liability would no doubt have arisen. If they had mitigated their transactional tax risk, however, by substantively (rather than merely formally) disaggregating their functions between UKCo and LuxCo, then HM Revenue & Customs’ challenge would be unlikely to have led to additional tax being payable. That being the case, on the hypothesis of the tax planning being challenged, a subsidy would have been available to Amazon out of the public exchequer for disaggregating its functions.

Crucially, however, it is no part of the purpose of the UK domestic and international tax law regarding permanent establishment to positively encourage companies to disaggregate their otherwise commercially integrated business functions into two separate corporate entities, one inside and one outside the jurisdiction. The relevant legislation exists to give effect to an international consensus about how the corporate tax base should be shared between jurisdictions in circumstances of cross-border business activity, rather than to positively encourage the disaggregation of otherwise commercially integrated functions. The subsidy that Amazon was in a position to have extracted from the public exchequer (on the hypothesis of an HM Revenue & Customs challenge, that is) for substantively as well as formally disaggregating its functions as between UKCo and LuxCo does not therefore exist, as such. Amazon conjured it into existence by means of their tax structuring.

It is at this point in the ‘risk-mining’ analysis where we learn how it intersects with a more common framing of theoretical discussions of tax avoidance, which is by reference to the legislative purpose behind the relevant legislation. To take a widely-disseminated illustration, tax specialist, blogger and political activist Jolyon Maugham QC contrasts ‘anti-purposive’ with ‘pro-purposive’ avoidance, the former alone being the abusive kind. This framing is by no means unhelpful but it works best in the context of a relief or exemption from a tax charge, where there is often a clear policy purpose to do with courses of action which the taxpayer may or may not adopt. In circumstances where the relevant legislation exists simply to give effect

¹⁶See, for example, *Flanagan and others v Revenue and Customs Commissioners* [2014] SFTD 881; [2014] UKFTT 175 (TC) in which tax avoidance implemented by the famous DJ Chris Moyles failed on the basis that, in reality, he was not the used car dealer that his tax planning relied upon him being.

to the conceptual structure of the tax and is not trying to encourage or discourage any particular behaviour it is, however, harder to apply.

This difficulty of applying a definition of abusive tax behaviour such as Maugham's (which area of difficulty corresponds, more or less, to the 'grey area' noted above as conventionally being located between unexceptionable tax planning and aggressive tax avoidance) is well illustrated by the Amazon case. The legislation exists neither to encourage nor discourage the disaggregation of business functions, so it is hard to say whether the disaggregation of business functions in order to obtain a more favourable position under the legislation is actually 'anti-purposive' or merely purpose-neutral.

What we can say, however, is that the legislation does not exist to positively encourage the disaggregation of business activities. To generalise from this illustration, whereas the question 'is the tax planning anti-purposive or pro-purposive?' may not have a clear answer, a clear answer can be obtained from the following two questions:

- (1) Does the tax planning introduce a tax risk factor?
- (2) If so, is the action which might be taken to mitigate that tax risk factor something which it is within the purposes of the legislation to positively encourage?

If the answer to the second question is 'no', then the taxpayer is, by implementing the tax planning, seeking to extract a subsidy from the public exchequer which the legislation does not intend. This is abusive.

SUMMARY OF THE 'RISK-MINING' THEORY OF TAX AVOIDANCE AND CERTAIN CAVEATS

The foregoing arguments may be summarised as follows. Where a tax risk factor is introduced by tax planning then, (1) to the extent that the filing position might *fail* upon challenge, it effects a financial transfer out of the public exchequer and into the hands of the taxpayer by virtue of the taxpayer's augmented upside referable to the possibility of the planning going unchallenged, and (2) to the extent the filing position might *succeed* upon challenge, where such possibility is referable to tax risk mitigation, the taxpayer is extracting a subsidy which, by definition (since it rewards compliance with the requirements of the tax planning rather than statutory conditions for a tax advantage), is outwith the purpose of the legislation to grant. In any case of a deliberately introduced tax risk factor, however weak or strong the resulting filing position, at least one of these analyses must be in play (and in most cases it will be a combination of the two). Tax avoidance, *qua* abusive tax behaviour on the part of taxpayers, may therefore be defined as the introduction of tax risk factors insofar as they originate in tax planning, and the degree to which mitigation of such risk factors is successful is irrelevant to the status of the originating tax planning as tax avoidance.

This is offered as a general theory of tax avoidance although, as such, it is subject to a number of caveats. First, it is inapt to catch circumstances where taxpayers are exploiting a loophole in a way which would fail upon challenge, but where exploitation of the loophole is known to be tolerated by the tax authority. This, however, is effectively tax legislation by executive inaction and is therefore better characterised as a constitutional abuse by the state rather than tax abuse by the taxpayer. Second, the theory is inapt to catch pure exploitation of a cross-border mismatch, where tax arises in neither jurisdiction because each jurisdiction's tax regime regards the transaction as placing the taxable receipt or event in the other jurisdiction.

The third, and perhaps most significant, caveat is to do with the application of the theory to a situation where the risk factor in question increases existing transactional tax risk rather than creates it. In these circumstances, the theory relies on the assumption that any tax advantage which a taxpayer has structured for will be exploited as at filing. Take, for example, a simple cross-border intra-group transaction, entered into without any tax planning. This transaction introduces a risk factor in the form of transfer pricing risk, but the risk factor is not traceable back to tax planning and so there is no abuse of the kind identified by the risk-mining theory of tax avoidance. Now suppose that a tax haven hub entity is inserted between the buyer and the seller, in circumstances where there is no applicable anti-haven legislation. This is nonetheless abuse of the kind identified by the risk-mining theory of tax avoidance. The reason for this is as follows.

Transfer pricing is not an exact science and it generally yields a range of viable prices which means it can be manipulated to achieve a tax advantage. Absent the tax haven entity, however, a high deduction in the buying entity, while yielding a tax advantage in that entity's jurisdiction, would give rise to a cost in the form of the increased taxable receipt in the other jurisdiction. By the same token, a low taxable receipt in the selling entity would yield a tax advantage in that entity's jurisdiction but there would be a cost in the form of the decreased deduction in the other jurisdiction. The insertion of the haven entity eliminates these costs, and so (on the basis of the assumption regarding claiming the benefits of tax planning) it may be supposed that a greater deduction will be claimed in the buying entity jurisdiction, and a lower taxable receipt will be reported in the selling jurisdiction, than would otherwise be claimed or reported. These filing positions would give rise to an increased transfer pricing risk, and the insertion of the haven entity therefore constitutes the deliberate creation of tax risk as defined above.

There may be further areas where the theory is more awkward to apply than others; the purpose here is really to do with the fundamentals of how we look at tax avoidance - treating it as a process where multiple possible outcomes are engaged and then resolved into one as time progresses onwards, rather than something which can be treated as having a determinate outcome *ab initio*.

CONCLUSION: WHAT IS THE RISK-MINING THEORY FOR?

What, then, is the practical relevance of the theory? First, it is a theoretical basis for a number of existing policies. In the UK, for example, one might point to policies such as DOTAS,¹⁷ APNs,¹⁸ and GAAR penalties,¹⁹ which, one way or another, seek to neutralise the taxpayer-favouring informational and cash-flow asymmetries of deliberate tax risk creation. These policies are all consistent with a 'risk-mining' theory of tax avoidance. To expressly ground them in a coherent shared theory of tax avoidance would facilitate the development of further such policies, adding to tax authorities' armouries when it comes to dealing with tax abuse.

Secondly, the risk-mining theory of tax avoidance could increase the prevailing levels of sophistication in the public debate about tax avoidance generally. As things stand, tax avoidance is broadly described as 'legal' and, while it is true that tax avoidance is not fraudulent, the fact is that (as may well have happened in Amazon's case) it can lead to tax going unpaid that is legally payable. As a category of behaviour it is not, therefore, 'legal' in

¹⁷Part 7 Finance Act 2004

¹⁸Part 4 Finance Act 2014

¹⁹Schedule 43C Finance Act 2013

the sense that tax avoidance which has been challenged by HM Revenue & Customs and forensically determined to be effective is ‘legal’. It is a process of ‘legally’ pocketing what could ‘legally’ be public money and hoping, one way or another (i.e. either because the avoidance turns out upon challenge to be effective, or because it is ineffective and never challenged) to get away with it.

Thirdly, and perhaps most importantly, an area where the risk-mining theory of tax avoidance has a tremendous amount to offer is in improving discourse around tax as an area of corporate responsibility. Tax is an area where companies are being exhorted to behave better by civil society, consumers, investors, governments and international organisations, and companies are responding with increasingly detailed statements about their responsible tax behaviour. Currently, however, tax risk management is generally presented as an unalloyed all-round good, both in the exhortations to better behaviour²⁰ and in the claims made in response,²¹ whereas (as we have seen) tax risk management includes tax avoidance, and in those circumstances, better tax risk management means better and more effective extraction of unintended tax expenditures out of the public exchequer.

This discourse needs to improve: corporate tax discourse needs to start acknowledging that ‘tax risk management’ encompasses within it tax avoidance at any level of aggression, and better and more responsible corporate tax behaviour involves not simply managing tax risk better, but eschewing tax planning that introduces tax risk factors or otherwise increases tax risk. It is not even enough to promise that tax positions are only taken if they reflect a filing position strength above a given threshold. If that filing position strength is obtained by competent mitigation of deliberately created tax risk, then the claim merely constitutes a claim that the taxpayer has done its best to ensure that the proceeds of its abusive tax behaviour will be realised.

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²¹See, for example, BP (2016).

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