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A critique of the GAAR Report [1]

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Introduction

For many years, the boundary between acceptable and unacceptable plans to reduce a UK tax bill has been depicted by tax ?avoidance? versus tax ?evasion?, the former being acceptable and the latter not.

The General Anti-Avoidance Rule (GAAR) report [3] (commissioned by the Government in December 2010 and published in November 2011) has chosen to up-the-ante by using *avoidance* for *unacceptability*, and combining it with ?abuse? (i.e. ?egregious? tax planning) thus dropping off ?evasion? altogether. The document refers more than 40 times to ?avoidance?, 18 times to ?abuse?, 5 times to ?egregious?, and 60 times to ?reasonable?.

Apart from some unnecessary changes to current terminology, this may not matter were it not for the clear views of the author, Graham Aaronson QC: ?My own approach ? is based on the premise that the levying of tax is the principal means by which the state pays for the services and facilities which it provides for its citizens?.

This sentence, together with a belief that tax rates should be progressive according to income or wealth, encapsulates the whole ethos of the report. There is no question or worry as to who decides on what and how large these ?services and facilities? are to be. There is no evidence that Mr. Aaronson understands that all taxes reduce aggregate living standards ? irrespective of whether or not collection costs exceed tax revenue ? as they often do in respect of higher rate taxes for the ?wealthy?.

I return later to both these points and the general dynamics of taxation. In the meantime we can reflect that whichever minister (behind the scenes) it was who asked Graham Aaronson to head up this enquiry chose very well indeed. Of course, no government is likely to commission an ?independent? report unless the author is sympathetic to government in the first place, and will select his team of advisers accordingly.

It is interesting, therefore, to first concentrate on the GAAR report?s scope and methodology. At the outset Mr. Aaronson himself selected a small Advisory Committee, consisting of four top-ranking lawyers, a Professor of Taxation Law at Oxford University (also a lawyer), and the Group Head of Tax at BP plc. The plethora of lawyers is unfathomable and surely a major concern, as is the complete absence of any kind of economist.

For the first five months attention focused on the possible need for some kind of GAAR, and included discussions with nine representative bodies (basically from Tax Committees at trade groups such as CBI, Accountants? Institutes, Institute of Directors, TUC, Law Societies, Revenue Bar Association).

Mr. Aaronson soon decided that the crucial question (for him) is whether current powers and legislation are effective enough to prevent ?the sort of tax-avoidance schemes which many citizens and taxpayers regard as intolerable?. This is populism at its worst, and for what it is worth it certainly wouldn?t satisfy two of the Ten Commandments (8 and 10). I show later that in both moral and practical terms progressive taxation according to earned income is truly egregious. In a free market, which we unfortunately no longer have, all earnings are the direct result of successfully serving others, pro-rata to the amount involved. To me, at this point the whole of the GAAR argument falls down; surely it is a dereliction of duty to allow sheer envy to hold sway, especially when, as shown later, every person in the land is poorer as a result.

Representative bodies

I now return to the representative bodies and their views, which were sought on two separate issues, firstly current tax ?avoidance? schemes and secondly (later in the proceedings) reactions to specific proposals in the early drafts of an illustrative GAAR. Specifically, their views were sought on (i) attitude to tax ?avoidance? (per se), (ii) GAARs in general, (iii) the illustrative GAAR (developed during the proceedings) and (iv) aspirations. Tax ?avoidance? was unanimously held in disapproval, but there were several concerns on the other three items, with particular regard to the discretionary powers of HMRC officials.

The report goes on to say that there was ?strong support? from these representatives for the concept of an Advisory Panel, with an independent chairman and a non-HMRC (HM Revenue & Customs) member. At this point the report appears to assert not only that the representative bodies supported such an Advisory Panel, but also that this would remove all their previously expressed worries. This may be just my cynicism but readers may wish to look at pages 23 ? 27 of the report [3] (http://www.hm-treasury.gov.uk/tax_avoidance_gaar.htm [3]) and form their own views. I would have thought that concerns about HMRC officials would hardly disappear via the creation of a 3-person advisory panel which includes an HMRC representative!

The GAAR Report's appendices

Appendix 1 provides an illustrative Draft GAAR, essentially concerned with supporting rules ? in particular a General Anti-Abuse Rule, under which ?Abuse? depends heavily on what is ?reasonable? and other such elastic words. The burden of proof would be on HMRC but any comfort from this would seem to disappear, given the ?reasonable? qualification. HMRC investigators may receive bonuses for increasing the tax take, irrespective of the costs incurred (which it appears can be unlimited). At the same time, HMRC charges interest on late submissions of tax returns yet pays nothing on late refunds! Finally senior HMRC staff and the whole of the public sector appear to be up there with the best of us in trying to minimize our tax bills as well as cosying up to business executives in return for favours such as wining and dining.

Appendix 2 provides an Illustration Draft Guidance Note, similar to Appendix 1 in that it talks of ?anti-abuse rules?, ?abnormal arrangements?, ?reasonable tax planning? and suchlike. It also confirms the proposed Advisory Panel of 3 referred to earlier.

Given my conjectures above on Appendix 1, it seems that words like abuse, abnormal, and unreasonable, fit the tax collector at least as much as the taxpayer.

The Dynamics of Taxation

I now turn to an investigation of what I call the dynamics of taxation, which can be considered in three parts namely;

(i) The shifting of the tax burden to other groups (an economic fact rather than a deliberate ploy).
(ii) taxation and economic growth.
(iii) income taxes levied as a proportion of income, with or without the proportion itself increasing with income. `

Tax-shifting

Most people do not realize that the physical payer of a tax may not be the person who actually suffers the burden. It is often said that the true burden of sales tax such as VAT or other excise duties are shifted forward to the ultimate consumer. In fact this is utterly wrong; no tax can be shifted forward in this way. The main point to note here is that most taxes are shifted backwards to income tax and cannot be shifted anywhere else. (See Man, Economy & State by Murray Rothbard, The Ludwig von Mises Institute, Chapter 12). This applies to all four of the taxes proposed for GAAR ? income tax, corporation tax, capital gains tax, and petroleum revenue tax.

Furthermore, income taxes fall more heavily on savers than consumers. This means that there is huge scope to radically reduce the number of taxes (from well over 20 at present). A simple case would be corporation tax, which is actually paid by company shareholders, to the detriment of savings, and hence of capital itself, which is the fountain of growth.

Corporation tax could be subsumed very easily into income tax, bringing far greater clarity. The same could apply to the other 2 taxes relevant here, namely capital gains tax and petroleum revenue tax. Of course, this will never happen; governments don?t do clarity. As first remarked by Jean-Baptiste Colbert in the 17th century ?the art of taxation consists in so plucking the goose as to obtain the largest number of feathers with the least possible amount of hissing?.

Taxation and economic growth.

Firstly, it is an incontrovertible truth that all taxes reduce living standards, in the aggregate. The reason is that living standards rely heavily on both the division of labour and the amount of capital stock in the country concerned. The division of labour into specialist skills means greater production via greater efficiency, as argued by Adam Smith (1776) and David Ricardo (1817). There is no tax on do-it-yourself labour (DIY); the tax comes only when labour is exchanged for money.

This means that under a total tax rate of 50% (as in the UK) inefficient DIY will be cheaper unless the division of labour amongst specialists creates at least 100% increase in output. I calculate that at the margin almost 70% of output is lost in lower productivity, ignoring any waste via bureaucrats operating the tax-and-spend system. All of this should be common knowledge, and probably it would be without the indoctrination of state ?education?.

Innumerable statistical studies back up these numbers up in showing time and time again that high economic growth is associated with low taxes. For example, Hong Kong (which actually has a GAAR, but more to the point has an overall tax rate of 17% compared with the UK?s 50%) has turned itself into one of the most free and wealthy countries in the world in the last 50 years or so.

A paper for the Adam Smith Institute [4] written a year ago by Peter Young and Miles Saltiel makes the effects of high personal tax rates abundantly clear throughout the world. For example, under the new 50% tax rate introduced by Alistair Darling, the paper shows that over a ten year period, the level of economic activity would be 20% less as a direct result of this measure. Eight reasons cited include working less or retiring early, emigrating, maximum use of (valid) tax shelters, transferring income-producing assets top lower-rate taxpayers in the family, and deferring income to later years.

Corporation tax is a double whammy, with corporation tax first taking a slice of profit and secondly on the net income paid to shareholders. This double whammy should be removed whether or not corporation tax is merged with income tax. Exactly the same could be done with Capital Gains Tax.

The taxation of savings ? from which latter all capital equipment derives, is a similar double whammy. It is a tragedy that while much bile is aimed at capitalists for ?obscenely high? earnings, sports stars and other celebrities and entertainers are considered well worth their money even though the element of capital equipment (the fountain of all growth as explained above) is largely missing.

"Proportionate" taxation

This is yet another double whammy, guaranteed to reduce the country?s capital stock and therefore its living standards, as well as being totally immoral, as per Denis Healey in his prime, ?squeezing the rich until the pips squeak?. In a free market, those with the most income have shown by definition the biggest and the best discoveries of products and prices which enable consumers to satisfy their desires in (voluntary) purchases to the highest degree possible.

Consumers alone are the great beneficiaries, multiplying many times over the take of the entrepreneurs in providing the items most desired. Yet these entrepreneurs are penalized, not rewarded, by the tax system, suffering not only in paying higher amounts at the same tax rates but also paying higher rates altogether. These conditions cost the country dearly.

I find it astonishing that consideration of a GAAR, clearly aimed at collecting more tax (and seemingly irrespective of whether the resulting increase is or is not negative after collection costs) can be attempted prior to a full investigation of a tax system which draws money from so many sources, most of which are clearly anti-growth. If this isn?t putting the cart before the horse then I don?t know what is.

The abuse of taxation power by government

The mind still rankles over Mr. Aaronson?s bare-faced and open-ended claim that ?tax is the principal means by which the state pays for the services and facilities which it provides for its citizens?. Not only does this ignore whether or not all these ?services and facilities? are desired; it also ignores the abuse of taxpayers themselves, in ways that are far more reprehensible and indeed egregious, as I shall show below.

Unfortunately the view that governments hold about themselves as highly moral guardians is very deep-seated. Thus David Cameron in a speech praising business on 23rd February said that ?business can be every bit as moral as the public sector? and refers to ?anti-business snobbery that says business has no inherent moral worth, *like the state does*? (my italics). Like the state does? Who are you kidding David? I can see precious little ?inherent moral worth? in either the state or the public sector.

As if to illustrate my point, the former Mayor of London, Ken Livingstone who according to Andrew Gilligan of The Sunday Telegraph has attacked tax avoiders as ?rich bastards? who should ?not be allowed to vote?, has avoided at least £50,000 in tax by having himself paid through a personal company.

Two examples out of many are (i) the lack of any principle of protecting retrospectively accrued rights and (ii) the vested interests of those wanting to live off others. A prime example of destroying accrued rights is Gordon Brown?s removal in 1997 of Advance Corporation Tax relief for occupational pensions schemes ?

which covered not only future contributions but also applied to assets already accrued on behalf of pension promises for past years of service, which meant an immediate loss of value at that time of £100 ? £150 billion, around 25 per cent of the assets backing pensions in payment and past service pensions, and far more for mature schemes. (An updated number is at least £300 billion.) Quite literally this retrospective tax has virtually killed off one of the world?s greatest pension scheme systems.

The second feature is the transformation over less than a century from a workable democracy into a country in which millions of people (both poor and rich) and including the politicians, see it as their right to receive special favours at the expense of others.

Bill Bonner, writing for Money Week on 17th February, is right on the button regarding the American ?Democracy?.

> *?Hillary Clinton calls up Egypt, Syria, Libya, and China to ?democratise?. But democracy, as practiced by the US and other developed countries, is a fraud. It is just a way for insiders to scam money and power from the outsiders, by pretending that the voters are in charge.*
>
> *Just ask how many taxpayers would vote to spend about $10,000 each on the war against Iraq? How many would vote to spend $1.60 cents for every dollar in tax revenue?How many would vote for the latest mortgage deal where homeowners who saved their money and paid their mortgages are forced to make up for those who bought houses recklessly? then couldn?t make their payments?How many would vote to bail out Goldman Sachs, Bank of America or Citigroup?*
>
> *But voters never get the chance to vote on the issues. They vote for candidates financed by insiders, with agendas the outsiders cannot even imagine.*
>
> *The word ?democracy? arose in small, Greek city states, where the voters actually voted on the concrete issues, not just the slippery candidates. Citizens voted to go to war knowing not only that they would have to pay for it? but that they could be killed in the battles themselves. War was a matter of life and death, not just a campaign slogan of a chubby, middle-aged draft-dodger.*
>
> *American democracy, circa 2012, has no more in common with real democracy than American capitalism has in common with real capitalism. Both are degenerate, corrupt and geriatric?*

And the same goes for the United Kingdom, where the politicians fix the agendas and the voting intervals. That the GAAR would further undermine British capitalism is clear; and that the government may press on with it nonetheless is no surprise.
