Tax Research UK

Tax Briefing

Tax avoidance, evasion, compliance and planning

Introduction

The language of the tax gap and all issues relating to it is confusing for many lay observers of the tax world. This briefing seeks to tackle one major cause of confusion, which is the difference between tax evasion, tax avoidance, tax compliance and tax planning.

Tax evasion

Tax evasion is the illegal non payment or under-payment of taxes, usually resulting from the making of a false declaration or no declaration at all of taxes due to the relevant tax authorities, resulting in legal penalties (which may be civil or criminal) if the perpetrator of tax evasion is caught.

Tax avoidance

Tax avoidance is seeking to minimise a tax bill without deliberate deception (which would be tax evasion) but contrary to the spirit of the law. It therefore involves the exploitation of loopholes and gaps in tax and other legislation in ways not anticipated by the law. Those loopholes may be in domestic tax law alone, but they may also be between domestic tax law and company law or between domestic tax law and accounting regulations, for example. The process can also seek to exploit gaps that exist between domestic tax law and the law of other countries when undertaking international transactions.

The tax avoider faces uncertainty when pursuing their activities. That uncertainty focuses mainly on their not really knowing the true meaning of the laws they seek to exploit and taking the chance that either a) they may not be discovered to be tax avoiding or b) that if they are the interpretation placed on the law that they seek to exploit is favourable to them. Their risk of penalties arising as a result of their actions depends upon what the outcome of these risky situations might be.

Tax compliance

Tax compliance is different from tax avoidance and tax evasion because it is defined as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes. The significant difference between tax avoidance and tax

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compliance is the intent of the taxpayer. A tax avoider seeks to pay less than the tax due as required by the spirit of the law. A tax compliant tax payer seeks to pay the tax due (but no more).

Tax planning

Tax planning is a part of tax compliant behaviour. It is not a part of tax avoidance. Tax law reflects the complexity of modern life and the multitude of choices and options available to all taxpayers when legitimately seeking to structure their affairs. This necessary offer of options within tax legislation creates the opportunity for choice on the part of the tax payer and means that determining the right amount of tax (but no more) that they seek to pay does necessarily requires the exercise of judgement on occasion.

So long as the exercise of that judgement seeks to ensure that the taxpayer makes choices that exercise options clearly allowed by law and that they do not exploit unintended loopholes created between laws then that process of a taxpayer choosing how to structure their affairs is the process of tax planning, which is a legitimate, proper and socially acceptable act.

As example, a taxpayer choosing to save in an ISA (Individual Savings Account) is exercising an option made available to them in law that is entirely tax compliant so long as all the published conditions for saving in that way are met. As a consequence no one can accuse a person using an ISA of tax avoidance. Those who say they are tax avoiding can safely be said to be wrong.