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Striking the Balance: Tax Administration, Enforcement and Compliance in the 1990s

The Institute for Fiscal Studies
Sixth Residential Conference
16–17 April 1993

CONFERENCE REPORT

Edited by
Malcolm Gammie

with a
Conference Introductory Note
by
Adrian Shipwright

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INTRODUCTION

Malcolm Gammie*

1. The IFS Sixth Residential Conference

Every other year, in Oxford, the Institute for Fiscal Studies holds its Residential Conference. Since the first Conference in 1983, our aim has been to bring together individuals from a variety of backgrounds – commerce and industry, the professions, government, academia – to discuss tax issues drawing on their different perspectives, experiences and expertise. In doing so, we have regularly called upon distinguished individuals from other jurisdictions to provide a comparative aspect to the debate. At the Sixth Residential Conference, we benefited greatly from the contributions of Professor John Prebble from New Zealand, Professor Brian Arnold from Canada and Donal de Buitleir from Ireland.

In the best traditions of the IFS, our intention is that the Residential Conference should not examine merely the topic of the moment. We ask delegates to focus their attention not on the problems of the day but on the issues of the coming years, to look forward and debate the direction of tax policy, reform and administration. The 1993 Conference was no exception. Indeed, it is not every conference the papers of which you could publish three years after the event and which would still demand attention through their continuing relevance to the issues of the day, three years later.

The fact that the papers do demand that attention is testimony to the efforts of the Conference organising

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* Malcolm Gammie is Chairman of the IFS Executive Committee and chaired the IFS Sixth Residential Conference. He is a tax partner with Linklaters & Paines in London.

committee, to the standing of the speakers who contributed to the Conference and to the time the speakers willingly gave to the preparation of their materials for this Report. The active and enthusiastic participation of delegates in the debate is also an essential part of any Residential Conference. In 1993 we were particularly grateful to Professor Cedric Sandford who, with his unrivalled knowledge of compliance issues, led the discussion in Sue Green's session on compliance costs.

2. The Balance Between State and Taxpayer

Responsibility for the delay in publication of the conference proceedings rests entirely with the Editor, due in part to his supervening term of office as President of the Chartered Institute of Taxation. The Editor's delay, however, has its compensations. We can look at matters in 1996 and see how progress has measured up to what was said in 1993.

The 1993 proceedings have a continuing relevance because change in taxation – especially large-scale administrative change – while constant and ongoing, takes time. And we will never resolve once and for all the fundamental issues embodied in the Conference title, "Striking the Balance". The search for the right balance in taxation between the interests of the state and those of taxpayers is constant and ongoing and reflects the continuing evolution of the tax system and methods of taxation.

I do not propose in these opening remarks to comment on every issue raised in the Conference papers. I will concentrate on three particular topics:

the relationship between taxpayer and Fisc,
rulings,
and tax avoidance.

In doing so, I have chosen a domestic focus to my remarks. Domestic tax issues these days, however, must be seen in their international, and especially their European context. In this, Donal de Buitleir's and Leonard Harris' papers remain relevant and valuable commentaries on the international issues that the UK faces in both the direct and indirect tax fields. It is relevant at the outset, therefore, to see whether the international rather than the domestic context may drive developments.

3. The International Context

Three years have seen little agreement on European tax issues. For its part, the OECD has taken several strides forwards in seeking some international consensus on transfer pricing issues.[1] However, as Donal de Buitleir notes,[2] with characteristic understatement, the arm's length principle "is not always easy to implement in practice" and no amount of OECD work can resolve significantly the practical difficulties of the subject. Within Europe at least, the central longer-term issue remains whether an arm's length basis is viable at all when business no longer organises itself on a state-by-state basis and the volume of related party traffic for which there are no real comparable arm's length prices continues to expand.

In the United States, the pressures of business integration, a single currency and common accounting led the National Tax Association in 1939 to comment in relation to the state allocation of profit that " ... it is impossible to determine, in most cases, the profit at various stages of production or distribution".[3] In Europe, a single currency

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[1] OECD (1995), *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, Paris.

[2] See p. 146.

[3] See Weiner, J.E. (1992), *Tax Co-ordination and Competition in the United States of America*, Annex 9C in Report of the Committee of Independent Experts on Company Taxation, Brussels, Commission of the European Communities.

and common accounting may still be some way off. Nevertheless, the pressures that led some 46 states of the Union to adopt formula apportionment, are already detectable within Europe and some of the arm's length methods that the OECD now recognises have distinct formulary overtones.

Donal de Buitleir draws attention to the rejection of formulary apportionment by the Ruding Committee, but notes that this was arrived at "under the guidance of the Chairman who was particularly concerned about the possible abuse by certain elements of the US Congress of a more measured conclusion".[4] Business necessity may ultimately prevail over political discretion. As de Buitleir notes, transfer pricing disputes are, to business, the classic zero-sum game, involving as they do how states allocate a given tax base between themselves. However, you cannot present formula apportionment as a complete solution to this problem. It is a practical response to the difficulty of calculating on any other basis the profit of an integrated enterprise that takes in several taxing jurisdictions. Formula apportionment presents its own challenges in arriving at an allocation of profit in those circumstances.[5]

It is tempting to look beyond formula apportionment to the United States to see what other tax lessons it may offer an integrated European Community. However, with no dominant tax policy-maker in Europe corresponding to the US Federal Government, the analogy is imperfect. A European corporation tax, imposed and administered at a Community level, could offer the best prospect for a more neutral treatment of business investment and for a reduction in the administrative and compliance burdens produced by 15 different state corporation taxes. However,

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[4] See p. 147.

[5] The 1989 IFS Residential Conference debated some of the issues in this area. See McLure, C.E. Jr. (1989), "European integration and taxation of corporate income tax at source: lessons from the US". In Robinson and Gammie (eds), *Beyond 1992: A European Tax System*, London, IFS.

the prospects for this are remote without substantial changes to Community institutions, and a significantly different approach by Community governments.

Without agreement on tax systems or changes in European institutions, the European Court has become the principal focus for progress towards the greater integration of European tax systems. In a series of decisions, it has brought home the limitations that the non-discrimination principle and the basic freedoms of the EC Treaty place upon the tax systems of Member States.[6]

Market forces, aided by the European Court, seem bound to lead to further convergence in European tax systems. At the same time, co-operation between the different Fiscs will of necessity increase in response to market integration and the opportunities that this may offer taxpayers for avoidance and evasion. As markets integrate, policy converges and administrations work more closely together, the scope for independent action in the tax field is severely restricted.

As Leonard Harris reflects in relation to VAT policy,[7] the UK does not have the luxury of sorting out VAT issues divorced from the way those issues are resolved elsewhere in the Community. British business and the Revenue Departments must work more closely to avoid adopting interpretation of the Community VAT law that disadvantages UK businesses as compared with their counterparts in Europe. In similar vein in the direct tax field, the ability in certain jurisdictions to secure certainty through rulings is seen as conferring a competitive advantage as compared with other jurisdictions.

Whatever the degree of convergence and co-operation, however, no taxing authority is likely to go so far as to

[6] See, e.g., *R* v *Inland Revenue Commissioners* ex parte *Commerzbank AG* (Case C330/91) [1993] ECR I4017; *Halliburton Services BV* v *Staatssecretaris van Financian* (Case 1/93) [1994] STC 655; *Finanzamt Köln-Alstadt* v *Roland Schumaker* (Case C279/93) [1995] STC 306; *Wielockx* v *Inspecteur der Directe Belastingen* (Case C80/94) [1995] STC 876.

[7] See p. 168.

enforce the administrative and compliance requirements of 14 other tax administrations. The scope for reducing compliance burdens in Europe and the significant simplification of European tax administration must accordingly await other basic policy and institutional developments.

However, there lies between Continental Europe and the United Kingdom a significant divide in basic constitutional approach to tax legislation and administration. David Goldberg QC has put the point in this way:[8]

> There is what I might call the common law tradition ... which requires certain laws and, in classical form, gives its administrators little discretion, and there is the French model, widely adopted throughout the western part of Continental Europe, in which very broad discretions are given to administrators, both expressly and in the way in which legislation is drafted, but administrators are then controlled by a special species of administrative law.

These differences are directly relevant to how the relationship between the taxpayer and the Revenue Departments develops and to the ways in which the balance is struck between the two. As the European influence on our law increases, it forces us to consider whether a different approach is required to tax legislation and to the way we balance the interests of taxpayer and state in the administration of the tax system, as compared to those that we have traditionally adopted in the UK.

4. The Relationship between Taxpayers and the Fisc

In the United Kingdom, the move to self-assessment has been the administrative preoccupation since 1993 as the legislative framework outlined in Leonard Beighton's paper has been put in place. Over that period, deregulation

[8] Goldberg, D. (1996), "Between the taxpayer and the executive: law's inadequacy; democracy's failure?". Third Philip Hardman Memorial Lecture [1996] *British Tax Review*, Vol. 9, No. 12.

has also been a continuing concern of government. The Deregulation and Contracting Out Act 1994 evidences its desire to lift the regulatory burdens from business and the Deregulation Task Force under the Chairmanship of the former Treasury Minister, the Rt Hon. Francis Maude, is a constant reminder to the government of its need to achieve more. The deregulation initiative has used compliance cost assessments as a way of measuring the impact of proposals on business. Compliance costs is the subject of Sue Green's paper at the Conference and the final results of her work in this area were published in 1994.[9]

There is, however, an apparent contradiction in deregulation and a change in tax administration designed to move a burden from government to taxpayers. John Prebble, in his first paper (in Ch. 4), deals with the rationale for a move to self-assessment and outlines the immediate impact that self-assessment is likely to have on the Revenue Departments. Their emphasis switches from routine examination of returns to focused auditing of returns, selected according to a variety of criteria and methods. From the taxpayer's perspective, the move to self-assessment is potentially less dramatic as the obligation to file tax returns – equally important with an assessed system of taxation – is unaffected.

To draw attention to the impact of self-assessment on the Inland Revenue is not to underplay the changes that it involves for taxpayers. In the United Kingdom in particular, there are dramatic changes required in taxpayer compliance culture. The majority of taxpayers still do not submit annual tax returns, being covered instead by the Pay As You Earn system, aimed at deducting the right tax for the year from wages. Nothing will change for many but for those that do submit returns, the age-old notion that time limits for tax returns are not taken seriously must

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[9] Green, S. (1994), *Compliance Costs and Direct Taxation*, The Research Board, The Institute of Chartered Accountants in England and Wales.

disappear, overnight. Can the "gentlemanly" relationship between Revenue and taxpayers and their advisers survive – as Roger White hopes – in the face of more efficient tax administration and collection?

At the same time as the government is pursuing more efficient methods of raising its revenue, the Revenue Departments are encouraged to greater friendliness and courtesy with the emphasis on seeing taxpayers as customers. In his paper, Brian Arnold notes that:[10]

> The idea has developed of the Revenue Department as a "customer-led" service department. This approach envisions tax collection as a service and the development of a "take a taxpayer to lunch" philosophy. In this Alice in Wonderland world taxpayers become clients or customers rather than payers. This is a misuse of language. The Revenue's main job is to collect taxes fairly and efficiently. Tax authorities and their officials will never be loved; it is not and should not be their function to be loved; attempts by the Fisc to become loved by the public are misplaced and misconceived.

More recently, David Goldberg QC expressed similar views:[11]

> ... the Inland Revenue is not a business and taxpayers are not its customers, and to think of it as a business and of taxpayers as customers does not accurately represent the rights and obligations of the parties to the relationship: if we do not think of the nature of the organisation correctly, we will not be able to state what the rights and obligations of the parties should be, and, if we do not know what the rights and obligations should be, we cannot measure properly how well or badly the parties are doing.

In theory, there is no reason why the Revenue should not collect tax with courtesy and a smile. The taxpayer is under

[10] See p. 201.
[11] *Op. cit.* at p. 22.

no obligation to return the gesture as he writes his cheque. Courtesy does not detract from efficiency or from the use, in the final resort, of methods designed to compel payment of the right amount of tax due.

In his paper, John Prebble examines the various enforcement methods under self-assessment. The efficiency of the audit process and the fear of selection are integral to those methods and, as such, run counter to a customer service approach. At the same time, however, the obligations that the state places on individuals must be comprehensible. Without that, people will lose respect for the system and it will cease to command their consent. Complexity and the need to tackle complexity are themes that come up throughout the Conference papers.

I have considered elsewhere the issues of complexity.[12] Fundamentally, complexity involves what the government is trying to tax. Taxes based on current cash flows – earnings and consumption – are conceptually simple, robust and raise a lot of revenue. Advances in computer technology facilitate the processing of such transactions without the significant compliance associated with other more complex taxes. Those more complex taxes are principally those based on net receipts or valuation, such as the taxes on business profits and savings.

Self-assessment increases the pressure to simplify taxation, but it is not enough that a tax be simple and efficiently audited. No amount of courtesy or efficiency could have sustained the poll tax in the face of its other difficulties. It failed because it was a straight levy on individuals, unrelated to any recognisably well-defined economic measure of people's ability to pay, such as earnings or consumption. Without such a base, the consent required to tax will disappear.

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[12] Gammie, M. (1995), "Why is tax law complex?", *Taxation,* Vol. 136, No. 3529, pp. 133–7, 9 November; Gammie, M. (forthcoming), "Tax simplification – right path or dead end?, *1995 Conference Report,* Canadian Tax Foundation.

5. Rulings

John Prebble, in his second paper (Ch. 5) and the Appendix, sets out admirably the issues of a formal rulings procedure. In May 1995, the New Zealand Revenue formally launched a new statutory rulings procedure. In the UK the debate on the topic continues. The Inland Revenue initially published a consultative document on post-transaction rulings[13] and announced a trial of the system in a number of Tax Districts. They have followed this up with a consultative document on pre-transaction rulings.[14] In the intervening period, the Chartered Institute of Taxation in collaboration with the IFS, published a study of rulings systems.[15]

Stephen Dorrell, during his period as Financial Secretary to the Treasury, lent support to the adoption of a formal rulings system in the UK.[16] Andrew Smith, the Labour Party's shadow Chief Secretary to the Treasury, has also spoken in its favour.[17] Yet despite a wealth of comparative material and broad political support, the pace of movement towards a formal rulings procedure in the UK has been measured but scarcely brisk. It contrasts with the almost indecent haste to implement major reform of the treatment of corporate securities, at virtually no notice.[18]

It would be wrong to suggest that the UK has no rulings system. There are a number of statutory clearance procedures, but the Courts have also actively applied administrative remedies to prevent the Inland Revenue from resiling from assurances they have given in relation to particu-

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[13] Inland Revenue (1994), *Post Transaction Rulings: A Consultative Document*, May.
[14] Inland Revenue (1995), *Pre Transaction Rulings: A Consultative Document*, November.
[15] Sandler, D. (1994), *A Request for Rulings*, London: The Institute of Taxation and the IFS.
[16] Speaking at the annual dinner of the Association of Her Majesty's Inspectors of Taxes in May 1994.
[17] Speaking at an IFS conference on the future of Corporation Tax in May 1995.
[18] Announced at the end of May 1995, originally for implementation in July 1995, but in the event applicable from 1 April 1996.

lar transactions.[19] It is true that taxpayers are usually unsuccessful against the Inland Revenue in such cases.[20] Their importance, however, lies in the Revenue's acceptance that they can be bound by their response if the taxpayer "puts all his cards face up on the table". In effect, the importance lies in the cases that never come to court because of that acceptance. If anything, the unsatisfactory aspect of all this is that appeals in such cases lie in a different direction through the High Court rather than through the normal tax appeals process. Stephen Oliver addresses this aspect of the matter in his paper.

In broad conception, rulings should present no difficulty. The taxpayer tells the Revenue Department what he plans to do and the Revenue Department tells the taxpayer what it considers to be the tax outcome. The taxpayer can enter into the transaction with a welcome degree of certainty as to the consequences of that. The rulings procedure merely identifies in advance an outcome that will have to be identified at some stage if the transaction proceeds.

The difficulty arises, however, when you consider the subtly different uses to which a rulings procedure can be put. Rulings may be sought in a variety of situations:

(1) The words used in the legislation may be capable of bearing more than one meaning. In that case a ruling may be sought to establish the Revenue Department's view of what they mean.
(2) The taxpayer may have a set of facts and he is unclear how tax legislation applies to that set of facts.
(3) The legislation may be cast in general terms because it is impossible to cover every eventuality in legislation. The Revenue's ruling may be sought as to whether the

[19] See *R* v *Inland Revenue Commissioners* ex parte *MFK Underwriting Agencies Ltd* [1989] STC 873; *R* v *Inland Revenue Commissioners* ex parte *Matrix-Securities Ltd* [1994] STC 272.

[20] An exception being *R* v *Inland Revenue Commissioners* ex parte *Unilever plc* [1996] STI 320.

circumstances in question fall within the general principle established by the legislation.

(4) The legislation may produce a particular result provided the taxpayer's motive for the transaction is a satisfactory one – usually a bona fide commercial reason rather than the desire to avoid taxation.

It is easy to conclude that a ruling should be available in the case of (4). The taxpayer alone may know the true reason why he is entering into the transaction. But he may want to be sure that the Revenue authority will accept that he has the right motive for the transaction. Without that confirmation he may feel that the transaction – which is bound to contain some avoidance ambiguity if it takes advantage of some tax relief – involves too great a tax risk. In such cases, the arguments against paying for the ruling are stronger because the measure is as much to protect the Revenue as it is to benefit the taxpayer. Similarly, there are good arguments for being able to appeal to an independent adjudicator against the Revenue's refusal of clearance in such cases.

In contrast, why should the Revenue have to express a view on the interpretation of particular provisions just because the taxpayer asks? Their interpretation should be no better than any other professional advisers. While they can see the implications of their view in the case being put to them they may be unable to see all its implications, and fairness between taxpayers may require them to extend a similar interpretation to other cases. And if they do provide this professional service to the taxpayer, he should pay for it. At the same time, the case for an appeal procedure is weak. The final view of the meaning of statutory provisions is, after all, a matter for the courts on appeal after full argument by the parties.

This reflects that the English legal tradition is for legislation to be prescriptive: the administrator should be left with little discretion, save to apply the law as stated.

Even where the legislative words appear to run counter to what you would think was the Parliamentary intention, the administrator is bound by those words and must give the taxpayer the confirmation he requires, even if this leaves a loophole a mile wide through the taxing provisions. If the administrator does not like the answer he must give, he can always solicit ministers to change the law.

And then there are those cases in which a ruling is in effect the exercise of a quasi- legislative function: filling in the detail that is missing from the legislation, or an application of general principles. It is perhaps this fear, that a rulings procedure would encourage Parliament to confer greater discretion for the Revenue to decide matters, that lies behind the ambivalence of some taxpayers to the adoption of a formal rulings procedure.

6. Tax Avoidance

As John Prebble notes, Revenue authorities may refuse to rule in cases where tax avoidance is suspected. The Inland Revenue's concern at the use of rulings for tax avoidance purposes emerges from their consultative document on pre transaction rulings.[21] The reasons for this are not wholly understandable. Failure to disclose the true reason for the transaction may obviously invalidate a clearance for lack of full disclosure. At the same time, advance clearance of a tax avoidance transaction may give the Revenue advance notice of the misuse of the legislation. While there are good reasons for coupling a clearance procedure with wide anti-avoidance provisions, the argument does not go the other way: rulings do not require additional tax avoidance measures to counter some abusive use of the rulings procedures. The right to refuse to rule on the interpretation of statutory provisions provides the Revenue with all the protection it needs.

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[21] Inland Revenue (1995), *op. cit.*, Annex 3, paragraphs 1520.

In his paper, Lord Oliver revisits the development of the new approach adopted by the Courts to tax avoidance. On balance, he prefers statutory anti-avoidance rules to a judicially developed approach, which provides few clear criteria for their application. But what is the correct statutory approach? UK legislation at present adopts a range of different methods to deal with avoidance, from highly targeted measures to broad anti-avoidance provisions such as those introduced in 1996 in relation to VAT grouping. More insidiously, however, incomprehensible legislation tempered by Inland Revenue "explanation"[22] may counter avoidance but confers considerable discretion on the Revenue. And relief from provisions by concession, with its tax avoidance rubric, is no more than a general anti-avoidance provision in a specific context.[23]

The failure of the Canadian courts to develop a judicial rule directed against avoidance led ultimately to the adoption of a statutory general anti-avoidance rule as the only adequate solution. Brian Arnold in his paper describes the path to this outcome and the response to the proposal:

> Not surprisingly, there was enormous opposition among tax practitioners to the proposal to have a statutory general anti-avoidance provision. The quality of the arguments against the rule was pathetic. It was suggested that, if the rule were enacted, commercial life as we knew it would come to an end, it would be impossible to give a legal opinion on a proposed transaction, and that the provision was a violation of the rule of law. Controlling tax avoidance is extremely difficult but it should be possible to discuss the different methods of possible control and how to distinguish acceptable from

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[22] The equity note legislation of 1992, the thin capitalisation legislation of 1995 and the anti-avoidance provisions of the 1996 Finance Bill on gilts and bonds are all examples of this approach.

[23] The 1992 changes in the group relief rules to counter *J Sainsbury plc* v *O' Connor* [1991] STC 318, coupled with extra-statutory concession C10, are an illustration of this approach.

> unacceptable avoidance in rational tones without an emotional or knee-jerk reaction to the subject.

The concern of many practitioners with proposals for a general anti-avoidance rule is that it will amount to the realisation of the Inland Revenue's dream, a one clause Act to provide that "the taxpayer shall, after due enquiry and report by the Commissioners of the Inland Revenue, be entitled to retain such proportion of his income and assets as the Commissioners shall think fit".[24] It is not clear, however, that the evidence of other jurisdictions bears this out or that Parliaments are prepared to grant unfettered discretion to the Revenue authorities in these matters. The current haphazard UK approach to avoidance at least merits further research.

7. Conclusion

At the heart of the debate on the complexity and comprehensibility of legislation, on rulings and on tax avoidance, lies a concern that we should achieve the correct balance of interest between the state as tax collector and the individual as taxpayer. That was the central purpose of the debate in 1993 and it remains the issue in 1996. I commend these papers to all those with an interest in taking the debate forward in a constructive and reasoned manner.

[24] See Walton, J. (1982) in *Innocent* v *Whaddon Estates Ltd* [1982] STC 115, 121.

CHAPTER 1
A Conference Introductory Note

Adrian Shipwright*

1.1 Introduction

General

Major changes are taking place in the UK tax system. These (particularly corporation tax "Pay and File"[1] and the proposals for "A Simpler System of Personal Tax"[2]) will have a dramatic impact on all involved. They raise difficult issues for the taxpayer, the Revenue Departments and others as to, *inter alia:*

- the administration of the system;
- the requirements for the system to function properly, for example, as to what certainty is needed and how much administrative discretion would or should be tolerated?
- cost and cost effectiveness: who is to bear the costs? Are they to be tax deductible?
- competing claims of simplicity and certainty and flexibility to deal with unusual and unforeseen circumstances;[3]

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[1] See *inter alia* ss 82–95 F(No 2)A 1987, ss 91–106 FA 1990, Corporation Tax Acts (Provisions for Payments of Tax and Returns) (Appointed Days) Order 1992 SI 1992/3066, Press Release 28 February 1991 and ICAEW TR 812 and Press Release 16 March 1993 [1993] STI 464.

[2] See Budget Speech and Press Release 16 March 1993 [1993] STI 427. For trenchant criticism, see *Reforming the Personal Tax System*, Report of a Working Party set up by the Institute for Fiscal Studies, IFS Commentary No. 35, February 1993.

[3] The more rigid the rules the easier the administration should be as a matter of theory. However, general acceptance of a system is normally needed if it is to work satisfactorily.

- the supply and verification of relevant information, particularly as to foreign income and gains: what enforcement is needed? What information is to be exchanged with other countries? What are the gains and losses of this? Are countries competing with each other for tax revenues? What impact does this have?
- do any other issues arise? If so, what?

Rigid rules perceived as imposed unsympathetically and bureaucratically can lead to difficulties even if they have the advantage of certainty. Automatic penalties, for example, with no ability to mitigate their harshness in what are generally considered appropriate cases may affect the acceptability of the system or part of it may be called into question.[4]

Disputes need to be resolved by an independent third party if the affected parties cannot do so, so that certainty and finality can be achieved.

- How should this be done?

Conference concerns

The IFS Sixth Residential Conference was particularly concerned with:

- administrative issues for the UK tax system in the 1990s;
- international issues for tax administration and enforcement;
- the role and attitude of the courts to tax law and practice against a changing administrative background.

The following introductory note was circulated to delegates to raise some issues and provoke some thought in advance of the conference discussion.

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[4] Cf. some of the difficulties with the VAT penalty regime.

1.2 Part I: Administrative Issues for the UK Tax System in the 1990s

Interests to balance

At least three (and probably more) interests need to be balanced[5] – those of:

- the individual taxpayer;
- the administration; and
- taxpayers as a body (including beneficiaries of the tax system).

A fourth concern may be the interests of any adjudicator:

- what other interests (if any) need to be included in the balance?

Individual taxpayer

The individual taxpayer, it is suggested, will want to know what has to be paid when, and to feel fairly treated. This seems to involve understanding, *inter alia:*

- when and from whom to obtain forms for completion;
- the form to be completed so that the taxpayer can (if he or she chooses) fill it up correctly or at least know what information a professional adviser will need;
- the date by which the form needs to be returned and where to return it;
- the date(s) on which payment(s) of tax is (are) to be made and to whom;
- that a usable system for resolving disputes is available; and
- confidentiality and disclosure – what has to be disclosed and how secure is the information?[6]

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[5] Cf. Rawls, J. *A Theory of Justice,* especially para. 43," Institutions for distributive justice".

[6] Some clients, in my experience, can be paranoid about this not just for fraud reasons but because they are afraid of "Big Brother". There are civil liberties' and human

The tax system requires a means of achieving certainty and finality for each period. Tax periods cannot remain open indefinitely or be capable of being reopened even if less than perfect justice is done as a result.

- Does this matter?

Tax administration

Most taxpayers "are law abiding citizens ... who can be trusted"[7] and wish to meet their obligations. These obligations need to be clear and assistance[8] should be available to encourage compliance. However, there are some people who will want to buck any system. How they should be dealt with is a potentially complicating matter.

> If ... some people are perceived to be escaping their obligations, great dissatisfaction is likely to be aroused among the majority of conscientious taxpayers. Further, more and more of them will be inclined to become less conscientious, and to join the ranks of the evaders. Thus the tax yield will become progressively eroded. Enforcement powers are therefore necessary not only to coerce the dishonest and the neglectful, but to encourage the honest and conscientious.[9]

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rights' issues that arise here, particularly if computer systems are involved. To whom is the information available? Is it commercially sensitive? Will it be given to a foreign country who will use it for a different purpose? What safeguards are to be built in for the taxpayer? Are they unreasonable? Do they prevent the system functioning? If so, should it be changed?

[7] Inland Revenue (1992), *A Simpler System for Assessing Personal Tax*, November, para. 4.1.

[8] The source(s) and cost of this are matters of detail for discussion (see Sandford, Godwin and Hardwick, 1989, *Administrative and Compliance Costs of Taxation*, Fiscal Publications).

[9] Report of the Committee on Enforcement Powers of the Revenue Departments, (hereafter the Keith Committee Report) (1983), Vols 1 and 2, Cmnd 8822, March, para. 1.1.1 .

Any tax administration is dependent on information[10] and its processing. The administration also needs to be able to obtain payment in a timely and cost-effective way which interferes as little as possible with business and other activities. Taxpayers as a body have an interest in this being done as cheaply and expeditiously as possible, but must still find the system acceptable if it is to work (cf. the Community Charge).

- How is the recalcitrant taxpayer to be dealt with so that complying taxpayers do not bear the burden of others' failings?
- How is the perception of the "intolerable inquisition"[11] and the all-powerful administrator to be dealt with?[12] Is judicial review and/or appeal the right answer?
- Payment of tax needs to be ensured. How is this to be done? Deduction at source has attractions to the Revenue because it has a low collection cost by using independent third party tax collectors. This places the burden on third parties rather than the Revenue. What is the right balance between assessment, self-assessment and deduction at source?
- What principles should be observed in establishing compliance powers?

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[10] This is particularly true with traders as "... it is only the taxpayer who has complete knowledge of his own affairs and who, however much he may rely on the advice of others, can bring together the information required to render a full and complete return". Keith Committee Report, Volume 1, para 3.1.2 .

[11] Smith, A. *Inquiry into the Nature and Causes of the Wealth of Nations* (1776), Bk 5, Ch. 2, Pt 2 "Of Taxes".

[12] The system also needs to deal with Adam Smith's concern that in some circumstances a taxpayer may be "put more or less into the power of the tax gatherer, who can aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation some present or perquisite to himself". He considered that certainty was the key to this as "the uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular even when they are neither insolent nor corrupt". He considered that a great deal of inequality could be acceptable provided there was certainty. Whether or not this is true, there seems to be a concern that it may be, so that an independent adjudicator is needed to bring about certainty.

The Keith Committee set out some principles for themselves in this connection. They are:[13]

> (a) Enforcement powers should be precise, and logically formulated, and should so far as practicable be harmonised over the whole direct and indirect tax field.
>
> (b) The scope for administrative discretion should be reduced to a minimum, so that it is available only when required for strictly practical reasons. As a general rule, particular consequences should follow particular acts or omissions in every case. In this way, everyone knows where they stand, and compliance is likely to be improved. If everyone is treated alike, grounds for complaint are minimised, provided always the sanction is regarded as broadly fair.
>
> (c) Routine regulatory mechanisms should not, in the tax field, be fenced with criminal sanctions. Automatic civil surcharges and penalties are more appropriate, and more reliable in application. Criminal prosecution, which turns on administrative discretion and is necessarily selective, is unsuited to the situation.
>
> (d) All enforcement procedures should be subject to ultimate judicial control both broadly and in matters of detail, and such control should be capable of being applied in a summary and expeditious way. This is the only reliable and satisfactory means of securing that the taxpayer is adequately safeguarded.
>
> (e) Opportunities for successful concealment of facts relevant to tax liability should be reduced.
>
> (f) Effective criminal sanctions should be available to check the incidence of deliberate and serious frauds."

- Are these the right criteria? If not, what are?

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[13] Keith Committee Report, para. 1.5.1.

- Should tax administration be privatised? Should it be subject to competitive tendering or out-sourcing?

The interests of taxpayers as a body

The individual taxpayer's interests may differ from those of taxpayers and "citizens" as a body. The individual is concerned with what he or she has to pay, whereas the interests of taxpayers as a body are more concerned with fairness, cost and the economic and social effects of taxation.

- Are taxpayers as a whole concerned that each taxpayer pays a "fair share" of the tax burden? What does this mean?
- Should tax avoidance, mitigation and evasion be treated in the same way on the basis that they all involve someone escaping their "fair share", and so are equally reprehensible? Is there a distinction that the politicians and the administrators should recognise between "acceptable" and "unacceptable" tax avoidance?
- Finality and certainty. Does this require a utilitarian approach of the greatest good for the greatest number even if this leads to "micro injustices", provided the degree of "macro justice" is sufficient for general acceptability and workability?

The development of direct tax administration

The mechanics and administration of much of the UK direct tax system are somewhat outdated, dating mainly from the nineteenth century[14] and reflect the needs and views of that time. "The tax machinery of today is founded fundamentally on that provided in the Income Tax Act

[14] If not earlier: "The administrative machinery was lifted directly from the land tax and so displayed that peculiarly English combination of central control and local executive power which still characterises it." Sabine, B.E.V. (1980), *A Short History of Taxation*, Butterworths. Addington introduced the schedular system and deduction at source which are still at the heart of the UK tax system.

1842."[15] It has formed the basis till the present with some adjustment of the administrative machinery through various statutory consolidations and tinkerings.

- Is now the time for a radical overhaul of the Taxes Management Act? Can we afford merely to amend a legislative code designed for a different era and a different system of administration?
- Does the VAT system, with its more recent introduction and different administration, provide a better role model for the administration and enforcement of direct taxes? What elements of the VAT system might be adopted for direct taxes and what would be inappropriate? Should the right of appeal be dependent upon tax being paid?

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[15] See Simon's *Taxes,* Revised Third Edition, Butterworths Vol A at A2.102. Much of this in turn was based on the 1806 Acts procedures. Some of it will change with the introduction of corporation tax pay and file. Income tax for which a company is liable (e.g. withholding from annual payments, etc. under s 350 TA 1988) is normally due without an assessment at the time when the three-monthly return required by the schedule is to be made, para. 4 Schedule 16 TA 1988. The 1842 Act reintroduced income tax as a temporary measure. Technically it still is, see s 1 TA 1988 and the Provisional Collection of Taxes Act 1968 and *Bowles* v *Bank of England* [1913] 1 Ch 57. The legislation has been consolidated (but not codified) since and piecemeal changes made by annual Finance Acts. Some of the sections show their age, eg the deduction for keeping a horse for an employee in s 198 TA 1988 which first appeared in 1853. The 1842 Act was virtually a reprint of the 1806 Act. This was the Act that incorporated all the changes made by Addington and was reapplied until the tax was repealed in 1816 after the end of the Napoleonic Wars, which were the original cause of its introduction. Peel in the 1842 Budget speech reintroduced it so as to be able to reduce the tariffs. He said, "I propose that, for a time to be limited, the income of this Country should be called upon to contribute a certain sum ... not exceeding 7d in the pound [approx 2.917 per cent] ... for the purpose of not only supplying the deficiency in the Revenue, but of enabling me with confidence and satisfaction to propose great commercial reforms, which will afford a hope of reviving commerce and such an improvement in the manufacturing interest as will react on every other interest in the country: and, by diminishing the prices of articles of consumption and the cost of living will, in a pecuniary point of view compensate you for your present sacrifices" [*plus ça change?*]. Queen Victoria expressed "her determination that her own income should be subjected to a similar charge" to her subjects. Lord Melbourne advised her "she was throwing away her money and her prerogative" (see Sabine, *op. cit.*, p. 122). Gladstone proposed in 1853 that income tax should expire on 5 April 1860 but the needs of the Crimean War prevented this. The rate was reduced to 2d in the pound [about 0.833 per cent] in the 1870s but abolition seemed almost too much trouble.

The move to self-assessment of direct taxes

The current system is laborious and not cost-effective. The taxpayer has the best knowledge of the relevant information concerning his or her affairs. Cashflow can be improved and costs saved for the Revenue if what the taxpayer has said is treated as true and tax has to be paid on that basis.[16]

The move to self-assessment must change the division of functions between the taxpayer and the Revenue. The taxpayer must be more proactive in the future. The focus of the Revenue's attention moves away from issuing tax bills to the collection of tax on the basis of the information supplied and auditing the information submitted.

- Is this just passing costs onto the taxpayer? Will this lead to more adversarial relationships between Revenue and taxpayer? Self-assessment will require a greater degree of certainty for taxpayers if the tax bill is not fixed by the Revenue.
- Does this give rise to a need for binding rulings? Is there a problem with rulings at the margin which may make them unworkable as the Revenue will say, no? Should reliance on Revenue Statements of Practice and Extra-Statutory Concessions be placed on a proper footing?
- Should the doctrine of legitimate expectation (broadly that if a government department has said that it will act in a certain way or raised a strong understanding that it will act in that way, then it should be bound by it) be expanded to deal with this or should it be put on a statutory footing?

The Revenue is undertaking a considerable internal restructuring. Reference should be made to the Revenue's, *An Outline of the Change Programme. The New Inland Revenue.*

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[16] See fn 1 above.

- Can the Revenue cope with this and with the proposed changes to the administrative system?
- How will the changes affect the traditional relationship between the Revenue, taxpayer and tax adviser?

1.3 Part II: International Issues for Tax Administration and Enforcement

International law lays down that the tax laws of one state will not be enforced by the courts of another state. This makes possible the use of foreign jurisdictions in avoidance and evasion of tax. This can only be countered by co-operation and exchange of information between different fiscal authorities:

- What rights should a taxpayer have to protect confidential information from being divulged to another Fisc?
- Should the taxpayer's home Fisc protect the taxpayer's interests or its own as against the foreign Fisc?
- How does competition between countries for tax revenues affect co-operation and information exchange? Should the provisions for co-operation and exchange of information only operate if it is to the Fisc's advantage?
- What are the administrative and enforcement issues for VAT and the Single Market? Is greater co-operation needed to prevent, for example, cross-border fraud? Is a Community Revenue Authority the ultimate solution?

> As economic integration in the OECD area proceeds, the economic, technological and institutional barriers to cross-border investment continue to wane. The pattern of international investment in corporate assets is therefore likely to become increasingly sensitive to cross-country differences in corporate tax rules. ...The increasing international mobility of capital therefore may increase

the need for international co-ordination of taxes on corporate source income.[17]

The globalisation of business also presents difficulties in allocating profits (and therefore taxes) between different taxing jurisdictions. The arm's length principle as the basis of international tax relations is under threat for a variety of reasons: the need for governments to raise further revenues; the easy option of doing so from taxpayers who do not have a vote; the perception that global business does not pay its fair share of taxation anyway; the difficulty of applying "arm's length" principles in an increasingly complicated world in which comparables may not be immediately available.

- Can the arm's length principle survive in a global environment? Are unitary methods the only long-term viable option?
- Can advance pricing methods solve the problems or do they merely amount to a unitary basis by another name? Are advance pricing agreements fair? Do they merely enable taxpayers to negotiate special deals behind closed doors?
- Can bilateral treaty or arbitration networks ensure that the arm's length standard remains the international approach? Can they operate within a single market such as the EC?

[17] *Taxing Profits in a Global Economy, Domestic and International Issues* (1993), OECD, Paris, p. 21.

1.4 Part III: The Role and Attitude of the Courts to Tax Law and Practice Against a Changing Administrative Background

Appeals and the interests of the tax tribunals

- Does any system need a means of resolving disputes? Does this require an independent adjudicator? What can just be left to the taxpayer and tax administration?
- If so what should the functions, powers and duties of the adjudicator be?
- Should the adjudicators decide their own rules of procedure to be subject to the Council on Tribunals, or should they be produced and determined by some other body? What are the powers of the adjudicator as far as evidence is concerned? Are the strict rules of evidence of the higher courts to be applied?
- Should there be a review whether the decision was *intra vires* or a complete rehearing with power to substitute a different decision? On whom should the onus of proof be?[18] Alternatively is the adjudicator to act as a conciliator or arbitrator with a view to dispute resolution by consensus?
- Hearings in public or in secret? Should the decisions be reported? In what form? Why not in full? The authority of a decision also needs to be established clearly. Strictly one tribunal is not bound by a decision of an earlier tribunal, but is it desirable that decisions should be followed in the normal case.[19]
- The differences between hearings at the Commissioners for direct tax purposes and the tribunals for VAT in this regard seem hard to justify on rational grounds.[20] Should

[18] Does good administration require that the administrator should be assumed to have acted properly unless shown not to? If not, why the exception to the maxim "*Omnia praesumuntur rite et solemniter esse acta* "?

[19] See *Pendred Hairdressing Ltd* v *C & E Commrs* (1973) 1 VATTR 81, adopting *Chapman* v *Goonevan* [1973] 1 All ER 218 and *AA* v *C & E Commrs* [1973] VATTR 116.

[20] They are doubtless explicable on historical grounds.

they be different? Should they be merged as a tax tribunal or court dealing with all direct and indirect taxes (including customs duties) with their own procedure and staff? Should there be a presumption that they will sit in public but with discretion to sit in camera where the tribunal considers it appropriate? Is public access a necessary requirement of acceptability and trust of the system?

- Does the basis on which an adjudicator can hear an appeal and who can appeal need to be made clear?[21] Is the VAT approach preferable?[22]
- Does the relationship between the initial adjudicator and the higher courts need to be clear? Should judicial review lie against the initial adjudicator? Judicial review seems to have become fashionable in direct taxes, but seems less so for indirect taxes.[23] Why?

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[21] The operation of s 40 VATA 1983 seems on the whole to be more satisfactory than the TMA. This is partly because it is more recent and partly because the "self-assessment" system for VAT means that more important matters than delay defaults appear to be dealt with by the VAT tribunals and because an appeal lies against a "decision" or the written "expression of a concluded view"; see *Effective Education* v *C & E Commrs* LON 76/95 and cf Simon's *Taxes* A 3.502.

[22] The wider rules of "sufficient interest" for VAT appeals, allowing in some circumstances someone with an economic interest (e.g. as a recipient of a taxable supply for a VAT exclusive consideration) to appeal, also seem to meet the general expectation that the person who actually has to bear the tax (or bear its economic effect) should be the person entitled to appeal; see *Processed Vegetable Growers Association Ltd* v *C & E Commrs* [1973] 1 VATTR 87 and *Williams & Glyn's Bank Ltd* v *C & E Commrs* [1974] VATTR 262. It may be that the current VAT rules should be widened to allow appeals where they are not possible at present, e.g. as to the length of prescribed accounting periods fixed by the Commissioners, see *Punchwell Ltd* v *C & E Commrs* [1981] VATTR 93. The administration may not find the widening of appeal attractive but its existence may be an important matter in acceptability. The ability of the tax tribunal to award costs might ameliorate this. The Commissioners have no power to award costs, see Simon's *Taxes* A 3.1202, whereas the VAT tribunal rules, especially rule 29, do give power to award costs, see de Voil 17.81.

[*Editor*: The Special Commissioners are now able to award costs if a party has acted wholly unreasonably in connection with an appeal hearing, Special Commissioners (Jurisdiction and Procedure) Regulations 1994/1811, Reg. 21)]

[23] For a case concerning judicial review and VAT, see *R* v *C & E Commrs and London VAT Tribunal* ex parte *Menzies* [1990] STC 263.

- Should appeals from the adjudicator also need consideration? Should they solely concern matters of law or a rehearing? Should the Case Stated procedure be retained? If so, why? Is it more advantageous than the VAT procedure?[24]

The approach to tax avoidance

It has been said that:

> Whilst the UK has a number of specific statutory anti-avoidance provisions, it has as yet no general statutory anti-avoidance provision. Further, until comparatively recently, taxation being purely the creature of statute, the general view was that a taxing statute should be strictly interpreted or construed. However, more recently the courts have been moving away from strict interpretation and the maxim that "there is no equity in a taxing statute". Instead, a purposive or teleological approach has to some extent been introduced into the interpretation of taxing statutes. This new principle is of uncertain ambit. Thus the present position with regard to the legitimacy of the avoidance of taxation is far from clear. The "new approach" to tax avoidance has been developed gradually by the House of Lords by means of four major cases: *Ramsay (WT) Ltd* v *IRC* [1981] STC 174, *IRC* v *Burmah Oil* [1982] STC 30, *Furniss* v *Dawson* [1984] STC 153 and *Craven* v *White* [1988] STC 476." In *Furniss* v *Dawson* it was said that the new approach to tax avoidance is an emerging principle, the scope of which would have to be determined by subsequent cases. There have been as yet few subsequent cases and the principle remains one of uncertain ambit and extent. Some may even doubt it is yet a principle. The ... pronouncement in *Craven* v *White* shows the House of Lords at present following a restrictive approach to *Furniss* v *Dawson*. Future cases

[24] Under s 13 Tribunals and Inquiries Act 1971 as modified by Tribunals and Inquiries (VAT Tribunals) Order 1972 SI 1972/1210 and RSC O. 91.

will have to be decided therefore before its ambit can be more clearly ascertained.[25]

What is the law ?

It is for consideration whether all or any of the following represents the present position in UK Tax law:[26]

a. The charge to tax is to be by reference to the legal nature of the real transaction rather than its economic effect, i.e. the real legal transaction is to be charged. This does not seem to require recharacterization but analysis to find what the real deal was rather than recharacterizing it as something different from what the parties intended.
b. The tax law is to be applied by reference to the end result where there is a preordained series of transactions (in the sense of there being no real likelihood of all the transactions in the series not being carried through) or the transactions are circular. In those cases, it is possible to ignore the transactions or deny a deduction or relief or allow anti-avoidance provisions to come into play, so as to give effect for tax purposes to the real deal.
c. The new approach is concerned with the fiscal effects of real transactions not with shams.
d. There is no general anti-avoidance test which automatically brings the emerging principle into play but an avoidance motive may be relevant in putting a transaction(s) in its context in determining the real deal. Generally, the intention of a taxpayer to avoid tax is not relevant to the decision of a tax case. The court is concerned with what the taxpayer has done and whether what he has done has attracted tax. Such an intention may be a relevant factor though in ascertaining what was done especially if the existence of a composite transaction is to be regarded as a question of fact.

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[25] Shipwright and Price (1989), *UK Taxation and Intellectual Property*, ESC Publishing, pp. 29 *et seq.*

[26] Cf. Gammie, *Strategic Tax Planning*, Division D, Professional Publishing (looseleaf), (ed. Shipwright).

e. If the tax advantage arises as part of the real deal it may be allowed to stand but if the tax advantage arises not as part of the real deal then it will not be allowed to stand.

Craven v *White*

Craven v *White* has been said to show a difference of approach. However, this may not be as great as is sometimes thought. As the editor has said elsewhere:[27]

> The Inland Revenue's initial formulation was:
>
> In applying a taxing statute to a transaction which is effected with the sole intention of avoiding tax on some other transaction then in view the former is to be treated as having no independent fiscal effect but as a single indivisible transaction with the latter, if and when the latter takes place.
>
> That formulation was unanimously rejected by the House of Lords. The Law Lords, however, divided into the majority who favoured a narrow approach to preordination and the minority who preferred a broader formulation. The difference between the two approaches is, however, not as great as might appear at first blush; even the minority were unable to accept the Inland Revenue's initial formulation and rejected the appeals. ... Both the majority and the minority were also agreed that the nature and extent of preordination in relation to any particular transactions are questions of fact for the Commissioners. On that basis, the difference between the broad and the narrow approach to preordination is to some extent a difference of view as to the weight that should be accorded to the evidence of what actually took place and, for example, of the time that elapses between the transactions. Both Lord Templeman [1986] STC 476 at 490 in respect of the broad approach and Lord Oliver (at 507) in respect of the narrow approach identified four

[27] Gammie, *op. cit.*

essential elements to their view of the new approach exemplified by *Dawson* :

BROAD APPROACH	NARROW APPROACH
(1) The taxpayer must decide to carry out, if he can, a scheme to avoid an assessment of tax on an intended taxable transaction by combining with a prior tax avoidance transaction.	(1) The series of transactions was, at the time when the intermediate transaction was entered into, preordained in order to produce a given result.
(2) The tax avoidance transaction must have no business purpose apart from the avoidance on tax on the intended taxable transaction.	(2) That transaction had no other purpose than tax mitigation.
(3) After the initial transaction the taxpayer retained the power to carry out his part of the intended taxable transaction.	(3) There was at that time no practical likelihood that the preplanned events would not take place in the order ordained, so that the intermediate transaction was not even contemplated practically as having an independent life.
(4) The intended taxable transaction must in fact take place.	(4) The preordained events did in fact take place.

What is "tax avoidance"?

One of the problems in any discussion of tax avoidance is what the discussants mean by the phrase. It seems implicit in the phrase that a comparison is to be made between what tax should have been paid and the tax consequences of what has actually be done. If it is to be of more than academic interest, then what has been done must result in a lower tax charge. If so, is this necessarily something that should not be allowed to stand? Is it the consequence of what Parliament has enacted? Why is it objectionable? Many people think that it can be but what is the rationale for this? What are the criteria for distinguishing between acceptable and unacceptable tax avoidance? Tax liability is *prima facie* a matter of law not morality or what ought to happen.

One person's avoidance of tax may be another's sensible structuring of a transaction. A gift of shares to a charity subject to an option in favour of a trust of which the donor is the settlor can be perceived either as a means of avoiding income tax on dividends or as a means of maximising the gift to the charity.[28]

- Is the description as "... any change in the pattern of behaviour that would otherwise have been adopted in the absence of tax, with a view to reducing that tax to any extent?"[29] What is generally understood by the phrase "tax avoidance"?
- What behaviour is acceptable tax avoidance?
- Is it a necessary concomitant of tax?
- Is it something that occurs where there are structural defects in the tax system? Could all be solved by getting rid of the structural defects?

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[28] Cf. the *Vandervell* litigation.

[29] Response by The Institute of Taxation to the National Audit Office Value for Money Study of HM Customs & Excise: *Countering VAT Avoidance*, November 1991, para. 1.1, published as IoT/TIR/18/92, 27 October 1992.

- Whose value judgements and views as to the purposes of the tax system should prevail?

A good thing or a bad thing ?

"An economy breathes through its tax loopholes",[30] or is avoidance an unacceptable reduction in a person's fair share of liability?

The English legal system which has been very influential in shaping the UK tax system seems to take the view that insofar as legislation does not bite there is a residual liberty to do what one wishes. The earlier approaches to avoidance seem to reflect this. If tax is the creature of statute and such statutes are the preserve of the Crown and Commons in Parliament assembled, what role do the judges have? Is it merely to apply the law in a strict way without "any equity in a taxing statute" or is it to act as a guardian of "fair contributions"? Do the judges have the authority to go further and "reveal" parts of English law hitherto not illuminated with retrospective effect and a different approach?

- Is it the duty of "... directors to take such lawful steps as are open to them to minimise the impact of tax on the company's profits"?[31]
- Would a return to strict literal interpretation solve the problem?

How should tax avoidance be dealt with ?

The possible approaches to dealing with tax avoidance are numerous. The civil system has a general "principle" sometimes called "abuse of rights" or "*fraus legis*". It has been said that the abuse of rights doctrine "is applied to cases in which one person has exercised a right with the

[30] Bracewell-Milnes, B. (1979), "Tax Avoidance can be Good News for the Tax Collector", *Daily Telegraph*, 16 July.
[31] *IRC* v *Burmah Oil* [1982] STC 30, p. 37 per Lord Fraser.

intention or purpose of causing harm to another [e.g. spite fences][32] ... [and] thereafter found its way into many other fields of law ... " including revenue law. English law, not being a civilian system, has no such general principle.

It is interesting to consider whether Community law might develop such doctrine which would then become part of the law applied in England. It is a principle which as a matter of theory could be introduced into English law, but this seems unlikely.

Arguably to frame legislation in terms that are too wide and to negate those terms by concession (with its general avoidance rubric) or ministerial statement is no more than an anti-avoidance approach.[33] Thus:[34]

> I sought to comment on the way in which the new clause would be interpreted by the Revenue in practice. It would be easier if we could define precisely not merely the circumstances dreamt up to benefit that arrangement but those that will be in the future. The need for a flexible basis in law is underlined by the fact that the Hon. Gentleman began by saying that we discussed the point two years ago in the context of dual residency, and that we are again discussing it within two years in the context of equity notes. We should try to avoid entertaining the Committee with this debate on an annual basis.

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[32] See Ward *et al.*, *The Business Purpose Test and Abuse of Rights* [1985] BTR 68 at 70, citing Andre Tunc, *The French Concept of Abus de Droit*, The Cambridge Lectures 1981, p. 151. Some Codes have articles dealing with it. It is interesting to compare some of the early English cases, e.g. *Keble* v *Hickeringill* (1705) 11 East 574n which has had much more influence in US tort law than in England and the *Gloucester Schoolmaster's Case.*

[33] See Sched 18 TA 1988 and ESC C10; HC Official Report, Standing Committee B, 23 June 1992, Cols 239 to 241.

[34] The Financial Secretary to the Treasury, HC Official Report, Standing Committee B, 30 June 1992, Col 446. The Equity Notes legislation to which this refers has subsequently been subject to an exchange of correspondence between the Inland Revenue and the Law Society in which the Inland Revenue has "explained" its view of the legislation, see [1993] *Simon's Tax Intelligence*, p. 306.

Brian J.Arnold and James R.Wilson have listed a number of anti-avoidance options or techniques in an article[35] by reference to common law approaches:

1. Judicial Anti-Avoidance Doctrines

- *Sham and ineffective transactions*: this is not what we are concerned with here relating to fraudulent and deceitful transactions.
- *Substance over form*: this is said to be that tax consequences should be determined by reference to the substance rather than its form. John Tiley has described this as "insidiously attractive"[36] but it is said "to be little more than a convenient label that is used by judges to justify their conclusions"[37] without any specific criteria.
- *Step transaction doctrine*: this "involves determining the tax consequences of a series of transactions either on the basis of its economic or commercial substance or on the basis that any steps that have no business purpose are disregarded notwithstanding that each step is legally valid".
- *Business purpose test*: this allows a transaction to " be disregarded for tax purposes if it lacks a business purpose, if the sole or dominant reason was the avoidance of tax". It is said on one approach to be part of the process of statutory interpretation. The statute is to be interpreted as applying only to transactions that have some purpose other than the avoidance of tax.
- *Object and spirit*: the Canadian Supreme Court approach in *Stubart Investments Ltd* v *R.*[38]

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[35] Arnold and Wilson, "The general anti-avoidance rule [1988]". *Canadian Tax Journal,* Vol. 36, Nos 4, 5 and 6.

[36] Tiley, *Judicial Anti-avoidance Doctrines: The US Alternatives* [1987] BTR 180, 220, 433.

[37] [1988] *Canadian Tax Journal,* p. 1137.

[38] [1984] CTC 294.

2. Legislative Anti-avoidance Techniques

- *Specific rules*: the UK legislation has many examples of these. The problems are said to include:

  (a) drafting difficulty in foreseeing all the possibilities;
  (b) legislation may itself create new avoidance techniques;
  (c) legislation is often overboard and affects legitimate activities;
  (d) it provides a "road map" for avoiders as it defines what is not caught, as well as what is caught;
  (e) much of the legislative complexity and prolixity comes from this type of legislation;
  (f) early participants benefit unless the legislation is retrospective;
  (g) "delay in implementation of specific rules may result in the loss of significant tax revenues".

- *Ministerial discretion*: This is said by some to be contrary to the rule of law.
- *General rule*: This is a general anti-avoidance rule which could be a statutory business purpose test or the like, for example, no one shall avoid the obligations the tax system seeks to impose.

3. Principles for Formulating a Statutory Anti-avoidance Approach:

   Arnold and Wilson set out 10 principles to be used in formulating a statutory approach:[39]

- a statutory general anti-avoidance rule should be broad enough to deal with all types of transactions that result in abusive tax avoidance;

[39] [1988] *Canadian Tax Journal,* pp. 1142 *et seq.*

- a general anti-avoidance rule must distinguish between abusive tax avoidance transactions and legitimate tax avoidance transactions;
- a general anti-avoidance rule should focus, if possible, on the results of a transaction rather than the taxpayer's purpose in carrying out the transaction. If, however, a purpose test is used, it should be an objective test;
- a general anti-avoidance rule should be consistent with other anti-avoidance rules;
- a general anti-avoidance rule should prevail over other, specific statutory provisions in certain circumstances only;
- a general anti-avoidance rule should minimise uncertainty for taxpayers;
- a general anti-avoidance rule should apply as a provision of last resort;
- taxpayers must be entitled to appeal all aspects of the application of a general anti-avoidance rule;
- the determination of the tax consequences of a transaction to which the general anti-avoidance rule is applied should be appropriate for the particular transaction;
- a penalty should be imposed on taxpayers who engage in abusive tax avoidance transactions.

Other issues

- How is the requirement of certainty to be reconciled with a wide anti-avoidance provision?
- For Community-based taxes, such as VAT, is anti-avoidance a matter for Community law alone?

PART I
ADMINISTRATIVE ISSUES FOR THE UK TAX SYSTEM IN THE 1990s

CHAPTER 2
The Role of the Revenue Departments

Leonard Beighton*

2.1 Introduction

My discussion of administrative issues for the UK tax system in the 1990s begins by looking at some of the relevant facets of government policy. It is not because, as a civil servant, I necessarily endorse that policy or for that matter oppose it, but because it is part of my job to explain it and the reasons for it, so far as I am aware of them. Moreover, insofar as those administrative issues which arise are likely to be settled in accordance with government policy rather than counter to it, it follows that the discussion today is more likely to be relevant if it is set within the general framework within which the Revenue Departments are working.

I say "departments" deliberately because, although I am not of course competent to discuss these issues as they affect my colleagues in Customs & Excise, they face broadly comparable pressures to those affecting us in the Inland Revenue, and doubtless have to work within the same broad parameters.

We should not overlook the importance of the DSS as one of the government's revenue collecting authorities. In the late 1960s, National Insurance contributions amounted to around 16 per cent of central government receipts; today the comparable figure is 18 per cent. And with the increase next year in the rates of Class 1 and 4 contributions, which the Chancellor announced in the March 1993 Budget, that proportion can only increase further.

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It is of course true that we in the Inland Revenue actually collect the very large majority of contributions, but equally in other tasks such as in framing regulations, determining employment status or auditing employers' records, DSS staff face many of the same issues with which Customs and Revenue staff have to grapple. One of the major deregulation reviews now in hand is yet another look at the possibilities for bringing the detailed scope of the NIC regulations more closely in line with Schedule E and PAYE (but falling short of the amalgamation of the two charges).

I will refer again later to "deregulation". For although deregulation has long been one of our major priorities, the topic as a whole was given a major push forward by the Prime Minister following his seminar in February. However the starting point for an examination of the government's approach to administrative issues today must be the Citizen's Charter. It is one of the features which clearly distinguish John Major's administration from that of his predecessor. It would be a mistake to underestimate the importance which ministers attach to the Citizen's Charter as a means of making the public sector more responsive to the needs and demands of individuals.

2.2 The Taxpayer's Charter and Independent Adjudication

The original Taxpayer's Charter, to which the Customs and the Revenue previously worked, predated the Citizen's Charter: we like to think that, with its introduction in July 1986, we led the United Kingdom public sector. But I must be careful not to claim more than that, because we readily acknowledge that we took over the idea from Revenue Canada. But so far as this country is concerned, I think that I can fairly say that we led the way in setting out our standards in public.

It may sounds a little odd to call taxpayers "customers". But only good can come from focusing on customer service and – along with the need to improve compliance – enhancing the service we provide is one of the main drivers of change in the Revenue today. We have introduced a number of surveys of what our customers want or expect from us: they have not always produced the answers we expected.

Public sector bodies inevitably lack the discipline of the marketplace which forces businesses to focus on their outputs and the service they provide to purchasers. The public sector has been more inclined to look to its inputs and to determine its approach from the viewpoint of the producer. That is not necessarily a bad thing if it leads, for example, to greater cost efficiency, but it may also result in the needs of the public being given insufficient weight, not from any deliberate attempt to place their interests below that of the organisation, but simply because that is the nature of the mindset.

And in this respect the Citizen's Charter has developed the idea which we started with the Taxpayer's Charter, by developing and subsequently quantifying principles and targets by which the organisation can be publicly tested, be it the reliability and punctuality of trains, or the length of hospital waiting lists. This idea is being developed in the subsidiary charters which Customs have produced, such as the passenger and the VAT payer's charters. In the Revenue we have published targets, for example, for responding to correspondence – targets which incidentally we are meeting comfortably.

But however effective our quantitative targets may be in focusing efforts, they run the risk of emphasising quantity at the expense of quality, and here our new codes will be of greater point. These recently published codes show how we carry out investigations and PAYE inspections, what taxpayers' rights and responsibilities are, and how they can best respond. We are working on further

codes of this nature, covering other areas of our activities, and I hope that these will soon be available. They are backed up by our code on compensation: the circumstances in which we are prepared to pay compensation for additional costs which taxpayers may have incurred because of our mistakes, or in which we will not seek tax which is properly due because, for example, we failed to take timely and proper account of information in our possession.

All this will soon be backed up by our own independent complaints machinery, the Revenue Adjudicator, to be chosen by an interview board on which Revenue officials are in a minority by the end of April 1993. So we shall shortly have in place means whereby taxpayers can get independent assurance that their affairs are being handled correctly, or redress if they have not.

Some doubts have been expressed as to whether the Revenue Adjudicator can really be independent. In the final analysis that will be for him or her. Until we see how he or she goes about the work, it is a matter which cannot be proven. But for my part I see no reason why not. While he or she will not have the powers or standing of the Parliamentary Commissioner for Administration, or Ombudsman, the role will be different and in no sense in substitution or in competition.

One area where the Adjudicator will be especially valuable will be in respect of investigations. We have had independent consideration of this before now. You may recall that the Keith Committee concluded on these "that the broad approach of Inspectors is reasonable and appropriate", and that "the instructions were well conceived and thought out and did as much as could reasonably be expected of central management to achieve a satisfactory state of affairs".

That was 10 years ago, but some of the complaints the Parliamentary Commissioner examines each year relate to investigations. It would be wrong to say that we always

emerge totally unscathed from the inquisitorial gaze of Malachy Cornwell Kelly and his colleagues. But as can be seen from the selection of reports which are published, there have been very few cases where there has been any suggestion in the report that an Inspector of Taxes has harassed the taxpayer during an investigation.

We cannot afford to be complacent, however. Because the tax system is administered by human beings, things can go wrong. But the presence of the Revenue Adjudicator will enable us to see whether my confidence that our Inspectors do a difficult task sensitively and efficiently is borne out.

2.3 Self-Assessment

Now all this is very relevant to the new simplified system with the self-assessment option which is to be introduced in 1997–98. The Chancellor described it in the March 1993 Budget speech as the most fundamental reform of the administration of the personal tax system since the introduction of PAYE in 1944. It will be integral to the new system that in the first instance greater weight will be placed on the accuracy of taxpayers' figures.

This will apply equally, whether the self-assessment option is chosen or not, because, where it is not, in calculating the tax we shall explicitly not be checking the accuracy of the taxpayers' figures. That will come later. But at this first stage the principles underlying the *Olin* decision will not apply. One particular aspect of this "process now/check later" approach which will need further consideration is the implications for 3-line accounts – an important deregulatory measure for the smallest businesses with a turnover of below £15,000.

For their part, the professional bodies will clearly need to consider whether their ethical guidelines in relation to disclosure will need amendment. This is for them and not for me; but it seems to me that the broad principles will be

unaffected. The guidelines were written, *inter alia*, with CT pay and file in mind, and simplified assessing will raise broadly the same disclosure issues in the personal tax area. Disclosure should always be made where there is a clear obligation to do so; there is also a strong case for so doing where there is any doubt. Taxpayers will get certainty beyond the period for audit only if they have properly disclosed the relevant information. I shall return to this shortly.

I hope that we shall be able to learn how the Irish have solved some of the compliance issues. Much further away, there is much to learn from New Zealand. And while I doubt if we shall see the full weight of the compliance measures which are to be found in the United States, there will have to be stricter rules than we have today where there is failure to put in returns or to pay the amount due, with provision for interest, surcharges and automatic regulatory penalties along the lines discussed in the consultative documents.

These will be backed up by powers to audit any return. This should apply to CT pay and file as well as to simplified assessing. What is intended is that the requirement based on Section 29 of the Taxes Management Act, that an Inspector of Taxes has to be dissatisfied with a set of accounts before they can be challenged, should be dropped.[1] Inspectors will be able to take up any return or account for investigation if they wish, although in practice it is likely that they will concentrate their efforts where they will be most effective, mainly that is on those accounts which *prima facie*, appear to be incorrect, or where there is information which casts doubt on the figures.

Without Section 29 there will be more scope to use the sort of computer assisted selection process of cases for investigation which John Prebble describes in Chapter 4 (see p.78). However, while we are increasingly concen-

[1] See FA 1994, s. 191.

trating on cases where the yield may be highest, we also have to have regard, as the Keith Committee pointed out, to the whole range of taxpayer activities. Yield is not the only criterion.

We hope that the dropping of the Section 29 requirement will help to reduce the confrontational aura which can surround investigations, since Inspectors will not have to play a somewhat accusatory role from the outset. The new code for investigations, to which I referred earlier, will need to be amended to make that clear: otherwise the underlying principles should remain unchanged, while becoming yet more important. The overall aim is to have a system which has ample safeguards for individual taxpayers; and for taxpayers generally as represented by the Revenue.

For their part, taxpayers will need greater certainty and greater help. First, as to certainty: I have already suggested that the application of the *Olin* decision,[2] and of the *Cenlon* decision[3] and the practices from which it grew, will be modified and at the same time made statutory. In return taxpayers will need some certainty that their accounts and returns will not be challenged, provided that proper and correct information is provided.

If a sample of only a few per cent of accounts and returns are examined each year, there must be a time limit beyond which taxpayers can be certain that their accounts have been accepted and will not later be reviewed. We are suggesting that the Revenue should have 12 months (where the return has been made on time) in which to pick up a case for enquiry.[4] In other words, taxpayers would know that, provided they kept to the time limit and except where there was inadequate disclosure, or the figures were wrong either through fraud or neglect, the Revenue would not

[2] *Olin Energy Systems Ltd* v *Scorer* (1985) 58 TC 592.
[3] *Cenlon Finance Co. Ltd* v *Ellwood* (1962) 40 TC 176.
[4] See FA 1994, ss. 180 & 183.

seek to examine more than the most recent return which they had put in.

I expect that we shall hear the views of both practitioners and academics on that, and indeed on other aspects of the proposed new system. Although the period for consultation on the latest document closed formally at the end of January 1993, in practice, as those directly involved know, the process of consultation is a continuing one. It started some 15 years ago – admittedly then somewhat sporadically – and will continue intensively until the 1994 Finance Bill has received the Royal Assent, and probably beyond that up to the time when simplified assessing is introduced and the first new-style returns are issued in 1997–98.

2.4 Rulings and Taxpayer Assistance

This leads on to the question of rulings, which can reasonably be divided into two. The issues relating to pre-transaction rulings are not affected. We have always been aware of our responsibility to assist taxpayers and we have well-publicised guidelines indicating what we will do to explain new legislation and setting out how far we can go in giving a view of how tax law relates to a specific novel or nationally significant commercial or technology development. While I can fully understand why some people would like us to go further, the advice which I gave in my letter of 18 October 1990 to the professional representative bodies remains unchanged.[5]

But there is an argument for the Revenue being willing to provide greater certainty by giving post-transaction rulings, and we are currently looking again at that issue. Under self-assessment we may wish to go further to give taxpayers a reasonable measure of certainty about how tax law works to enable them to complete their returns with confidence. However, we do not necessarily see that this

[5] *See Taxation Practitioner* (1990), December, p. 625.

need involve the kind of formal system that some countries have developed in the context of their own fiscal regime and legal systems, which John Prebble discusses in Chapter 5. We would be looking for an efficient and quick means of providing customer service in this area.

There is also the question of providing greater help, not that I wish to give the impression that we do not provide a lot of help already. The starting point of our compliance strategy is that the best – indeed inevitably the main – form of compliance is voluntary, and that one of the main ways of encouraging voluntary compliance is to provide help to taxpayers. Our customer service strategy is largely geared to this. We have nearly 400 enquiry centres around the country, as well as mobile advice centres which visit smaller towns.

We put substantial efforts into providing information in clear, intelligible language. The 1993 tax return form is an example of the lengths – an intentional pun – to which we go. Yes, it is very long, but that is a reflection of the complexity of the tax system: the provision of clear, helpful guidance does not come cheap – unlike some of the comments it has attracted.

As for simplified assessing, we have already started planning the education and guidance of taxpayers which will be needed. Substantial sums have been earmarked to ensure that, before the new system comes in, people will be aware of what it involves – including the need for those in arrears to catch up beforehand. The transitional rules will provide some breathing space for catching up, but it is not a moment too early for those who are most behind with their accounts – and their accountants – to start taking note.

When we get to the new system itself, taxpayers will need – and receive – further help. The return package may take a step-by-step approach to obtaining information and (for those who choose) taking the taxpayer through the computation. This will doubtless be at the expense of greater length, but with the aim of minimising the scope for

making mistakes. Those who choose not to self-assess will still be responsible for the accuracy of the figures they return, although we will collate the figures and calculate the tax bill for them. So either way, taxpayers will get from us the help they need.

2.5 Simplification

One of the most important aspects of this help will come from the simplification of the new system, above all getting rid of the previous year basis of assessment. One of the amazing results of the independent survey which we had done for us recently was that a few accountants actually thought that the change to current year basis would be a complication. Some years ago I gave a talk in Cambridge to a group of teachers of Revenue law in which I set a very simple example for them to work out the assessments in the opening years of a business. My recollection is that very few got them right.

The current year basis will not merely be a major simplification for everyone of the basis of taxation for businesses. It will be much fairer than the previous year basis under which people may well pay tax on less – or often more – income that they have earned over the lifetime of the business.

In addition it will pave the way for another important simplifying measure – the bringing together of all a taxpayer's income on a consistent basis with one statement and one tax bill. No longer will there be different machinery rules for each schedule of each case with tax due on different dates, with all the resulting scope for misunderstanding and confusion, quite apart from the duplication of paper, time and effort. Rather, the number of occasions on which a taxpayer with several different sources of income need get in touch with the Revenue will generally be reduced considerably to just twice a year.

The final major area of simplification – and this is one of the main areas from which the deregulatory benefits will flow – will come from abandoning the present enforcement mechanisms. To quote the Keith Committee Report again: "The measures which the Inland Revenue [are] striving to operate [are] in many respects antediluvian and quite unsuited to modern conditions."

The present system of estimated assessments, appeals, postponements, delay appeal hearings, adjustments, readjustments and so on, will disappear with very substantial savings to taxpayers, their advisers and the Revenue alike. Appeals will in future be confined largely to cases where there is a substantive dispute between the Revenue and the taxpayer. At present, some 5 million appeals are made each year: when all the procedures have been gone through, only about 5,000 of these have any contentious element at all, and of these only some 500 require a hearing involving detailed evidence and arguments. Under the new system, we might expect the number of appeals to fall dramatically. We shall doubtless return to some of the issues which arise on the handling of appeals.

Important as these simplifications and the resulting deregulatory benefits are, we should note another advantage which the government sees in this. Self-assessment will not only give taxpayers greater control over their own affairs but, as the Chancellor said in his Budget speech, it will bring out more clearly the link between public expenditure and the burden that this places on individual taxpayers. A more transparent system can only lead to more informed choice and debate, at least for the 8 million taxpayers who we are expecting to be affected, the self-employed and the 4 million or so employees who make returns.

This advantage will not arise for other taxpayers however, so that the next question is whether we might see simplified assessing eventually spread to them also, as it applies elsewhere: and as I have said before, I suspect that

experience in New Zealand may be especially illuminating.

At present, our system is designed in such a way that taxpayers may hardly be aware of their tax affairs. PAYE ensures that broadly the correct amount of tax is deducted in the course of the year so that the taxpayer has no contact with the Revenue from one year to another. This is a great advantage: on the other hand considerable intervention by the Revenue needs to be directed at employers. We need to review whether that is the most cost-effective system all round.

So were we to look for universal self-assessment, we should need to devise a very different system with, say, self-coding and perhaps a comprehensive system for tax to be deducted from benefits and expenses. I suspect also that it would greatly facilitate this sort of change if the government had already established the lower rate band of 20 per cent as the basic rate for all income and all allowances.

2.6 Inland Revenue Organisation

I have hardly looked at the organisational issues suggested by the conference agenda. They are important, but there is time to say only this. The reorganisation of the network offices of the department is fully consistent with, and will indeed support, simplified assessing. We are looking towards a three-fold structure which will overcome many of our problems from the present separation of assessment and collection. It will go a long way towards the substantial improvement to customer service which we intend as one of the major drivers of our change programme. Taxpayer service offices will be responsible for processing the whole of a taxpayer's affairs and will continue to be responsible for him or her despite changes in employment; taxpayer district offices will be responsible for investigation, technical, compliance, recovery and enforcement work in any geographical area; and taxpayer assistance

offices will provide access to help and advice for all taxpayers.

Beyond that, the continuing advance of information technology opens up all sorts of further possibilities – for taxpayers and their advisers, as well as for the Revenue. Returns and other information will increasingly be sent and matched electronically, and there will be data bases capable of being interrogated – quite possibly routinely, by both the public and private sectors. Above all our plans have to be flexible so we can constantly adapt with developing technology.

I have said less of the other drivers – the need to improve compliance and to drive down our costs. As for the former, we are looking, *inter alia*, to greater specialisation and reliance on the better provision, and matching, of information by electronic means, mentioned earlier.

As for the latter, the government's programme set out in the White Paper, *Competing for Quality* is driving us forward towards a substantial programme of market testing. If we cannot become more efficient than others, substantial chunks of the department, as of other parts of the public sector, will move into the private sector. Just how far that process can reasonably go is perhaps a matter for discussion on another occasion.

These business forces for change within the Revenue are supported by the need to care for our most important asset, our staff. Our management systems are being reorganised to shorten our communications, to delegate responsibility and to empower decision-taking at a lower level – but within an overall national tax system which has to be applied fairly and consistently throughout the United Kingdom. So we need to do even more to improve the skills of the staff – not least because of the extent of the changes which they face, along with millions of taxpayers and their advisers.

A commentator in one of our self-styled quality newspapers said recently: "The Inland Revenue is not ... a body

given to embracing reform or change. It is not in its nature." If he is correct, we must be one of the least successful organisations ever. To take just a few examples of the changes we are implementing – we have seen landing on our desks this week the longest ever Finance Bill following over 1,200 pages of Finance Act legislation in the last six years, the majority affecting the Revenue; we have introduced computerisation on a scale hardly rivalled in Europe and are now in a revolutionary move – looking for a strategic IT partner – only world-class players should apply; we have overhauled the organisation of our work; we have decentralised our management and delegated considerable responsibility and the accountability which goes with it; and we have introduced one unified Revenue staffing structure, without grades, and with our own pay system separate from that of the rest of the Civil Service.

We are now embarking on a major programme to enable us to meet the challenge of self-assessment. As I said earlier, we have been consulting all along about this, and my colleagues and I are looking forward to further discussions. These administrative issues affect us all, taxpayers, professionals and Revenue authorities alike, just as much as the policy issues which the Institute more frequently addresses. And we shall be listening for ideas for administrative and technological improvements which would help reduce costs all round and improve our service to taxpayers and their advisers.

CHAPTER 3
The Practitioner's Perspective

Roger White*

Leonard Beighton has set the scene speaking for the Inland Revenue. I follow in a UK context speaking from the position of a tax adviser, and John Prebble concludes this group of papers with an emphasis on rulings. I say nothing about the position of the tax adviser (note the complete absence of the taxpayer!) sandwiched between the Inland Revenue and academia.

There is considerable support for the recent moves by the Inland Revenue and indeed for moves still to come. There are also some criticisms. I will endeavour to strike the balance to be fair to the Inland Revenue and to put the position as one tax practitioner sees it.

John Prebble, who follows me, will be giving particular emphasis to the possibility of an Inland Revenue rulings system so, while I will be talking widely, I will give less emphasis to rulings.

Like so much else in history, the UK tax system was drawn up and entered into before others elsewhere. As a result we have inherited, over a long period, issues and problems which are not necessarily shared around the world. We have only just shaken off the collective assessment of husband and wife. The previous year basis is still just with us. We have no statutory definition of income nor, indeed, of expense. Until recently we had no statutory definition of residence. We still have today a system of appeals and assessments and review of computations with a cluttering of Commissioners' hearings. We have only recently had interest running fully on overdue tax.

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As we move out of this century so we will probably finally shake off and see the dissolution of so much of the nineteenth century which has previously shone through our tax systems so distinctly – an area of our tax code referred to as antediluvian.

If one looks backwards in time it was certainly a little surreal. It was rather like a game of cricket played according to obscure rules with the Inland Revenue almost inevitably in the shape of the District Inspector on the one side, and the taxpayer and tax adviser on the other – both participating in the game in an exceptionally gentlemanly fashion. Those overtones remain and one of my themes is the need to modernise the collection of taxation (and rather like transitional provisions modernisation will be with us for ever) against a backdrop of continuing good relations between the Revenue and taxpayers and their advisers.

Over 30 years ago Sir Alexander Johnston wrote an authoritative description of the work of the Inland Revenue. In it he said that relations between the Revenue and – as he then called it – the accountancy profession could be summed up very briefly as friendly and good. That relationship must continue to be nurtured and to be maintained.

The recent pace of change has been tremendous. As Leonard Beighton has indicated, we have seen an enormous acceleration in the reform and management of the Inland Revenue. We have also seen the emergence of Customs & Excise as a powerful force in connection with VAT. The pages of tax legislation itself have doubled over the last decade or so. A quarter of all tax cases have been heard over the last decade or so. The international arena has led to an increasing convergence of international issues amongst OECD countries and a sharp emphasis in the UK fiscal system on international issues.

We are also seeing taxpayers – particularly the larger multinationals – operating on the basis that tax is an expense to be controlled in exactly the same way as any

other business cost. I am not sure when that came about. It was certainly not present before the Second World War. In an item in *The Times* of 1932, the then Chancellor of the Exchequer, Neville Chamberlain, had said in a speech that it was the duty of the taxpayer to pay his tax and to pay it as early as he can. The headline read "Income Tax queues – widespread early payment" and it indicated that correspondents from London, Cardiff, Leeds and Manchester all reported rushes to make payment.

We look today at the balance between how our tax system should be administered, how it should be enforced and how the taxpayer should comply. The administration of the tax system assumes that we have the right legislation in the right format. As I have already said, we do not have that at the present time and, moreover, modernisation of tax continues as society itself changes.

To change our tax system does take time. Ten years elapsed between the report of the Keith Committee in March 1983 to the introduction of pay and file for accounting periods ending after September 1993. Look at the previous year basis and self-assessment. These have been considered on and off on several occasions during the last three decades. There was serious discussion in a consultative document of 1991. In late 1992 we had a further consultative document and as we now know from the March 1993 Budget the Chancellor proposes a change from April 1996 with the first self-assessment returns in 1997.

Any changes to the tax system must be by consensus. A question of consensus would clearly be raised in connection with local authorities and the Community Charge. These days a change to the tax system should not involve significant winners or losers. Indeed, the current focus on tax is much more significant than it ever used to be. The 1992 General Election focused heavily on tax proposals. We even had a Shadow Budget from the Shadow Chancellor of the Exchequer to coincide with the main Budget.

Perhaps the changes whereby tax is seen more as an expense came about in the 1970s. This was an unfortunate time for the UK economy, when tax rates were held high against a backdrop of raging inflation. That decade saw the emergence of tax planning and tax avoidance on a scale never previously seen. Although slow to emerge, we saw as a counter to it a line of cases running through *Ramsay*[1] and *Furniss* v *Dawson*[2] which led to changes in judicial interpretation.

There should be consultation on proposed changes. One of the most significant aspects of change over the last ten years or so has been the wind of more open discussion blowing through the Inland Revenue. Let me take an obvious example. In 1976 Dennis Healey indicated that he wished to consult on the question of exchange gains and losses and their treatment for tax purposes. We were proffered an eight-page paper from the Inland Revenue. The matter went away with the Chancellor's announcement that the costs were too great and gave rise to too much uncertainty. After an interesting 10 years or so – including Marine Midland in the House of Lords and a Statement of Practice first issued in draft – exchange gains and losses came forward again in 1989 with a paper of 78 pages. We have had further consultation in 1991 with a paper of 25 pages. The private sector put together a group of nine bodies who had extensive discussions with the Inland Revenue on both those two later papers and significant changes were made. We now have the draft clauses of 1993 – a document of 71 pages – accompanied by a very significant regulatory area still to be produced with a likely introduction from April 1994.

One final introductory item relates to the need for the Inland Revenue changes to be compatible with government policy. This has meant since 1979 that the following have required a high priority:

[1] (1981) 54 TC 101.
[2] (1984) 55 TC 324.

(1) a reduction in Civil Service numbers of staffing;
(2) a role for the private sector – so far as the Revenue is concerned this is already implemented in the IT field and in the secretarial support field;
(3) the role of what I might term "charterism". This extends from the Taxpayer's Charter through to the restructuring of the Revenue departments into executive agencies and even to the Revenue concept of an adjudicator.

The 1980s also saw the significant emergence of judicial review in the tax arena. This was certainly not part of government policy. Indeed, the Lord Chancellor issued a short booklet within government departments entitled *The Judge on your Shoulder.* Shifts in society have made even-handed treatment by government departments, including the Inland Revenue, of greater importance as judicial remedies are available. Although it may not be fully welcomed, I see the Taxpayer's Charter as a considerable spur to requests by taxpayers for a judicial review, although taxpayers' experience to date has not been particularly successful.

A requirement of the UK tax system is to have a yearly Finance Bill. Having seen what has happened to legislation in other territories over the years as a tax practitioner, I welcome that process. I am not so sure however that I would not rather see a better basis for the production and enactment of the Bill. The Special Committee, which comprises the dozen or so outside major representative bodies, has made a number of submissions about the shape and form of the enactment of legislation. It seeks wider consultation and the publication of draft clauses; it has suggested that the Bill might be divided between technical and policy, and generally seeks to make the process more

scientific and more open without the political debate attached to it.[3]

1993 is a year of significant change with two Budgets in the same year. The switch to the end of the year brings together a financial statement marrying income and expenditure. Whether that change will help or hinder the concern about the enactment of a Finance Bill and the way in which it is debated in the House of Commons is another matter and open to some doubt. The Provisional Collection of Taxes legislation is to be brought back from August to May, and I certainly do not share the view that this is a necessary Parliamentary requirement.

The way in which the Courts interpret tax legislation has changed significantly in recent years. I have already referred to the line of cases through *Ramsay* and *Furniss* v *Dawson* which could find a fiscal nullity or circular transactions. We now seem to be at a stage where there is a distinction between tax mitigation – which is acceptable – and tax avoidance which, whilst lawful, is not acceptable for tax purposes. It all seems a long way from the Duke of Westminster paying his "domestic employees" by deed of covenant.

1992 saw a further revolution in terms of interpretation of our tax law with the case at the end of the year of *Pepper* v *Hart*.[4] This has opened the door to litigants being able to plead the words of a sponsor of the Bill – government ministers in the case of a Finance Bill – when the legislation is enacted. This is a change which still has to work its way fully through the system but the potential for its application is significant. It will carry important practical consequences as to the role of the House of Commons and the role of statements made.

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[3] See the Special Committee of Tax Law Consultative Bodies, *Recommendations on the Enactment and Amendment of Tax Legislation* (1990), The Law Society, and *Recommendations on the Development of Tax Legislation* (1993), The Law Society.
[4] [1992] STC 898.

The combination of "pay and file" and "a simpler system for the personal tax" leads inexorably to self-assessment. For a UK tax system ingrained originally in surveying and more recently in assessing the taxable income on the basis of a return provided by the taxpayer, the change is dynamic. The steps which are being taken do not as yet clearly lead us to full blooded self-assessment. Nevertheless I see those steps rather like paving stones across a river. Once you start to walk down them it seems to me that it is inevitable that we will eventually arrive at a full-blooded self-assessment system. The only question mark which remains will be the timing for such an approach which must be linked to the acceptability to the public.

We must recall that the historic role of the taxpayer has been to display income to the Inland Revenue to the taxpayer's best advantage. Thus, the culture of the taxpayer has traditionally been to take the benefit of the doubt and to disclose that fact to the Inland Revenue. The *Olin* case[5] is interesting litigation to show the present state of the law.

Leonard Beighton talked of the importance of changes in this area. I entirely agree with him as we move inexorably towards self-assessment. Clearly there will need to be a change in legislation and in turn the tax practitioners will need professional guidance. There will also be some behavioural changes on the part of taxpayers. I anticipate we will see the emergence of a US approach of the taxpayer being obliged to have a supportable case to underpin the position which he takes on his tax return. This has implications for all parties to the transaction – the taxpayer, the Revenue and the adviser. Perhaps I could look in more detail at the role of the taxpayer and the adviser.

Life is going to get tougher for the taxpayer. We do not yet have a full-blooded system of self-assessment. We

[5] *Olin Energy Systems Ltd* v *Scorer* (1985) 58 TC 592.

have pay and file in the corporate area, which is intermediate between our former system and self-assessment, and we have the simpler system in which a taxpayer opts between the possibilities:

(1) self-assessing;
(2) disclosure to the Inland Revenue.

Part of the reason why we are moving slowly towards self-assessment is because that is not, in my judgement, good news for the taxpayer. It continues the privatisation process of a tax return completion, and does away with your friendly neighbourhood Inspector of Taxes where one can call in for a discussion or a chat.

One of the irrelevant facts which sticks in my mind is that US liquor sales peak in April of each year which is not unconnected with the 15 April filing date for US tax returns generally.

It will probably become more expensive for the taxpayer. The need to turn to external advisers may well increase. Those advisers may be full-time tax specialists, but in addition we may see the emergence of a seasonal activity on the lines of H & R Bloch in the USA. H & R Bloch provide their services prior to tax filing time in every US main High Street. It is largely staffed by students and the like, and is a short-term assignment by people who can read and are perhaps smarter than the people who are filling up tax returns.

Professional advisers also face change. Like the Inland Revenue, they have had to endure the vast changes to the taxation system of the last few years. They are also seeing changes to the professional regulatory backdrop against which they operate. There are hints of registration and suggestions of the emergence of tax as a separate profession. They are investing heavily in computers and the need to be able to produce the computations which are required and indeed the tax returns themselves in a straightforward and speedy manner.

The professional adviser is seeing the competitive marketplace for services under challenge. There is an interesting debate about the role of the accountant versus the role of the lawyer.

The professional adviser is also concerned about the professional indemnity front. Professional advisers have deeper insurance pockets than some. They are used already as a point of call on the basis that they are effectively guaranteeing or underwriting tax arrangements. Will the need to file on an appropriate basis become more the responsibility of the professional adviser? Although, luckily, tax has not seen an explosion in litigation in the same way as other areas there appears to be a steady increase in the number of claims, frequently because of a failure to comply with procedure, formalities, assessments and claims, etc. It is not a happy area in which the burden of these problems tends to be borne by the professional adviser and where the taxpayer sees this as fair game against a backdrop of the Revenue themselves strictly enforcing the whole penalty regime.

The process of self-assessment brings forward decisions about the position to be taken. If one looks to the United States one can see an increasingly aggressive attitude arising from the US tax processes between the tax adviser and the internal Revenue service.

One of the secrets of success within the UK regime will be to move forward and retain some aspects of what I have referred to as the game of cricket with obscure rules and the two sides participating in a gentlemanly fashion. Indeed let me go back to a recruiting announcement that appeared between the First and the Second World Wars for Inspectors of Taxes:

> The work is congenial to anyone of education, there is no irksome interference from unsympathetic masters, no hidebound regulations or cast iron codes; above all remuneration and leisure provide the means and the

opportunities of cultivating hobbies and favourite pastimes.

It is not for me to talk about the organisation of the Inland Revenue in any detail. You have already heard briefly from Leonard Beighton about changes. I will add only two points. First, as one looks to the future, the Revenue are still announcing significant changes to the structuring of the service. Recently they announced new style service offices for most taxpayers, and taxpayer district offices for the more specialised work in examining business accounts. This will have the consequence of merging tax districts and collection offices – the lack of co-operation and collaboration between the two being a constant complaint from the tax advisory side.

Second, as one looks ahead one can see some risk that there will be a fragmentation of the Inland Revenue by specialisations and by executive agencies. These will lead to a distinct local or operational autonomy and the traditional all-purpose Revenue may be replaced by a series of separate and perhaps distinctly managed departments. There is some risk that a mixture of centrifugal force and a manager's desire to empire-build will accentuate this process.

It is also not my remit to look at the international side, since our heading is merely the UK tax system. Perhaps however I could briefly touch on certain aspects of the UK system which have been influenced by international pressures.

There is clearly a growing internationalisation of tax. One can look at the size of multinationals, the growing development of business areas including the EC, the North American Free Trade Area and activities in the Asia-Pacific region. One can also look at the global movements of finance within business and the activities of financial institutions. Those countries that are members of the

OECD are seeing a common development of avoidance measures in areas such as:

- thin capitalisation
- transfer pricing
- hybrid and new instruments
- controlled foreign companies
- deferment

I believe that OECD member countries are having to move in a more common format in this respect than ever before and there is a need to buttress and bolster the tax collection mechanism to avoid our own territory being raided by other territories so far as tax collection is concerned.

I touched briefly on Europe and that gives rise to a significant special dimension to the UK tax code. Both the *Daily Mail*[6] and the *Commerzbank*[7] cases have entailed major litigation in the European Courts. I would not wish to pre-empt the session on international issues, but it is worth recording here that there are international issues which rebound and indeed become part of the UK domestic scene. In consequence one has to have regard to the special EC dimension of UK tax law. Those in the VAT field know it well, but to direct tax practitioners the due compliance by the UK government with the Treaty of Rome, and EC Regulations and Directives are all potentially fertile areas.

My views suggest that the UK is heading rapidly towards a system of universal self-assessment. I do not think there is too much choice in the matter and I believe we are driven in this direction by a number of the factors to which I have already referred. What I do believe is interesting are the options it gives for change in other areas of the tax code and tax regime.

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[6] *R* v *HM Treasury* ex parte *Daily Mail and General Trust plc* (Case 81/87) [1988] STC 787, ECJ.

[7] *R* v *IRC* ex parte *Commerzbank AG* (Case C-330/91) [1993] STC 605, ECJ.

The first of these is for an improvement to the tax code and its communication process so that people are hopefully as aware as possible of their obligations. This is never a simple matter and the strain between simplicity and equity represents a remarkably balanced tug-of-war. The Finance Bill 1993 suggests that equity is currently winning.

Secondly, there is the key issue of whether or not there should be a rulings system. We operate in a particularly British and cricket-like manner in terms of certain statutory clearances, and the ability at times to have a discussion with the Revenue which is satisfactory so far as comfort is concerned, but falls short of being a universal ruling system. I am sure that Leonard Beighton would say that the Revenue could not adopt a full rulings system without great expense and it would not be acceptable to the government. Nevertheless a rulings system does much to alleviate the concerns and issues that would otherwise arise with a total self-assessment system.

John Prebble, in the following paper, not only discusses the attractions of an advance rulings system, but even presents draft legislation for the UK to give effect to it. That legislation includes a proposal that a fee regime should be set for a rulings system. The New Zealand practice is to charge a fee for a binding ruling but not to charge a fee for a non-binding ruling.

A rulings system in the UK would change dramatically the whole administration and management of taxation issues. In these litigious days I can see tax advisers moving very rapidly to the wider use of a rulings system and I believe the potential publication of rulings would in itself form a code of law. It would be expensive and time-consuming and perhaps time-delaying, but nevertheless a rulings system with publicity attached to the rulings given would provide much by way of a safety valve for the concerns raised by a full system of self-assessment.

Finally there is the importance of full publicity by the Inland Revenue to their approaches and their practices. The last year or two have seen some developments in this area but if we move to a full-blooded self-assessment system accompanied by rulings, then the Revenue must go much further than in the past in explaining the tax system in simple and understandable language.

As I come to an end, urging greater publicity from the Inland Revenue, I am reminded that at the beginning of the last century in those glorious 40 years or so when the income tax system had disappeared, Brougham in 1816 moved "that the records of Income Tax should be destroyed in order to protect posterity even from hearing of it".

CHAPTER 4
Self-Assessment, Audit Efficiency and Administrative Developments

John Prebble*

4.1 Introduction

"Self-assessment" describes a system of collecting income tax in which the taxpayer calculates his or her income, and income tax, and pays tax as if the calculation is correct. The taxpayer's income tax return is not checked, but is accepted as correct, at least initially. Subsequently, the taxpayer's return may or may not be audited. Apprehension that one's return may be audited is a factor that leads people to calculate and to pay their tax correctly. Self-assessment is to be contrasted with ordinary methods of tax assessment, where revenue authorities check the taxpayer's return and issue an official assessment, which acts as a bill for tax that is due.

In adopting a form of self-assessment for income tax of companies to be known as "pay and file", the United Kingdom is following a route that has been trodden in the last few years by the revenue authorities in Australia and New Zealand. As tax laws become more complex and at the same time methods of enforcement become more effective, tax collectors seek more and more to deploy their resources with increasing efficiency. The move to self-assessment systems is a particular example of this trend.

This paper first discusses self-assessment and the kinds of developments that are likely to take place in a tax regime that adopts a self-assessment system. It then considers a

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number of other developments in the structure and administration of the New Zealand and Australian tax regimes. Some of these other developments have some relationship to self-assessment, but by and large they are not necessarily connected to or a consequence of the adoption by a government of a self-assessment system. Rather, they illustrate the kinds of moves that governments have made in the 1980s in order to promote efficiency, equity, and neutrality in their income taxation.

4.2 Self-Assessment and Efficiency in the Audit Process

Reasons for moving to self-assessment

The reasons that have prompted an increasing number of jurisdictions to move from assessment by fiscal authorities to self-assessment were usefully summarised by Trevor Boucher, the Australian Commissioner of Taxation, in 1986:

- Assessing some categories of returns costs tax authorities more than the extra revenue that is gained from the assessment exercise.
- In these same categories (the most significant example of which is probably the returns of wage and salary earners) assessing seems to have little deterrent effect in achieving compliance with tax laws.
- Assessment provides little or no job satisfaction to the staff involved.
- Assessing cannot effectively respond to an increasing trend among taxpayers to engage in disputes that are very costly to revenue authorities to conduct.
- Overall, on the grounds of cost-effectiveness there is every reason to move to self-assessment (Boucher, 1986, p. 46).

Filing requirements

When a country adopts self-assessment, the major obvious changes are within the tax department, and not among taxpayers. One expects little impact on filing requirements and procedures, and this has been the case in Australia and New Zealand. The information required is much the same as it was before the change.

The significance of the data that are filed does change in that, at least in the first instance, the authorities accept figures in tax returns at face value and collect tax accordingly. It is only later that returns may or may not be audited.

Tax office staff

For tax authorities, a move to self-assessment has much more major implications. Staff previously engaged in clerical checking of returns become redundant, or are able to be deployed to other duties, the most significant of these being auditing. With this major redeployment of resources, tax departments are able to audit a far higher proportion of taxpayers, in greater depth, than was previously the case.

The implications for taxpayers are plain enough. The implications for taxation departments are no less significant. One result is that departments are able to offer greater job satisfaction to many of their staff. A second is that recruitment and training programmes must be enhanced. Most training takes place within departments, but the Australian Tax Office has adopted the innovative course of funding Bachelor and Master of Taxation degrees at the University of New South Wales. The programmes are taught nationally on an extramural basis, with enrolment available to both tax officials and members of the public who meet entry requirements. The taxation studies department at the University of New South Wales has grown very rapidly since the courses were established in 1990, and now has about 30 teaching staff, which is as large as law faculties at many Australasian universities.

A third change within tax departments is that attention needs to be given to career paths. In common with many bureaucracies, tax departments tend to promote their best field workers into management. With the emphasis on auditing that is now possible, the Australian Tax Office (ATO) has created field positions of greater seniority than was the case in the past. Accordingly, senior inspectors who seek advancement now have a third career option, beyond management or departure for private practice. This development has the additional advantage of creating a cadre of experienced and senior officers who are able to take leading roles in the ATO large case audit programme, which employs teams of several inspectors of varying levels of seniority.

Enforcement

Broadly speaking, tax authorities have three ways of enforcing compliance: requiring tax be withheld and accounted for by a payer, matching information, and auditing. Research in Australia and in the United States seems to show that withholding and information matching are considerably more effective than auditing in promoting compliance. For example, R.F. Highfield, Senior Assistant Commissioner in the Australian Taxation Office, addressing an Australian Tax Research Foundation Conference on Taxation and the Underground Economy (Sydney, June 1987), reporting on a number of ATO research projects in the 1980s, gave these estimates of voluntary compliance in respect of different categories of income in Australia:

Unincorporated business income, such as the income of small contractors
90 per cent compliance with withholding, matching and audit.
65–75 per cent compliance with auditing only.
Salaries and wages

96–97 per cent compliance, withholding only, no matching or auditing.
Rents
80–82 per cent compliance, auditing only, no withholding or matching.
Interest and dividends
87–91 per cent compliance, matching and auditing, but no withholding.

The efficacy of withholding was graphically demonstrated in the mid-1980s when Australia adopted its Prescribed Payments System in respect of the remuneration of certain contractors. In the construction industry, between 1983 and 1985, there was an 83 per cent increase in the number of taxpayers who lodged returns and a 184 per cent increase in the aggregate tax that they paid.

Earlier research by the Internal Revenue Service showed similar, though more marked, differences among United States taxpayers, according to whether withholding, matching, or auditing was employed (*Income Tax Compliance Research: Estimates for 1973–1981*, Department of Treasury, Internal Revenue Service, July 1983, cited by Highfield, *id.)*

94 per cent	Wages and salaries (withholding, matching and audit)
86 per cent	Interest (matching and audit)
59 per cent	Capital gains (audit only)
50 per cent	Business income, non-farm (audit only)
37 per cent	Rents (audit only)

Increased information reporting and withholding

Figures such as those that are set out in the previous section lead Revenue Departments to the conclusion that withholding should be adopted wherever possible, and that information matching is an exercise that is well worthwhile. Electronic data processing makes both approaches

more feasible and efficient. Areas that appear to be suitable for either or both treatments include:

- interest-bearing investments
- farm income, at least where farmers typically sell to fairly large organisations
- rent, particularly rent collected through agents
- foreign remittances
- land transactions
- futures contracts
- dividends

In some of these areas there has already been considerable progress. For instance, New Zealand introduced a domestic withholding tax on dividends and interest in 1989. This tax has several functions. First, it frustrates evasion. Second, it brings dividends and interest into line with wages and salaries in respect of the time when tax is collected. Recipients of the former no longer enjoy a deferral until payments are due. Like pay as you earn deductions from wages, withholding tax on interest and dividends paid to residents is not a final liability, and adjustments are made when returns are filed. However, through use of coding some endeavour is made to match level of deduction with estimated final liability.

As well as the wholesale reporting that is the prerequisite for any matching system, income tax law increasingly asks for systematic information from individual taxpayers, to be supplied along with tax returns, over and above the information that is strictly necessary in order to verify the taxpayer's calculation of income. The kind of question that is asked is, "Have you sold any land in the last year?" or "Are you the settlor of any trust with foreign trustees?" Affirmative answers can suggest that it may be worthwhile for tax authorities to obtain more information from the respondent or from relations or associates, perhaps showing that the taxpayer is wrong in a belief that certain

receipts are not income. A selection of such questions from the New Zealand income tax legislation is set out in Appendix A.

Efficiency in the audit process: personnel management

Some years ago, the audit exercise ordinarily involved an individual inspector working alone at the premises of the taxpayer. Nowadays, teams of auditors are more typical, a development that is calculated to lead to improvements in efficiency, with work being shared among inspectors according to their competence and experience. Planning and systematisation also enable a good deal of work to be done at the tax office itself, by study of documents and interviews of taxpayers, a process sometimes known as a "desk audit". Certain aspects of a taxpayer's affairs lend themselves to this sort of treatment, while others are more efficiently investigated in the context of a field audit. Examples include:

Desk audit
matching of payments and receipts of dividends and interest rebates
matching of intra-group transactions among companies

Field audit
bad debts
travel
repairs
legal expenses
depreciation
bill discounts
trading stock valuations
payments between associated persons
income splitting

Among other improvements in efficiency are techniques that will enable inspectors to audit a company through its

own computers. That is, inspectors gain access to the electronic data bases of taxpayers and study information *in situ* rather than on hard copy. Furthermore, having the information in electronic form facilitates analysis and comparison, important tools in any auditing process.

Efficiency of the audit process: cost–benefit calculations

Perhaps the most ubiquitous test of the efficiency of the audit process is the test that shows the ratio of money spent to tax recovered. The relative difference in return on funds that are spent on different programmes is often remarkable to an outsider and, no doubt, to many staff of tax departments. Of course, return on money spent cannot be the only criterion: no doubt some audit programmes return rather little simply because their very existence is an efficient deterrent to evasion and avoidance.

ATO data show that, from the authorities' point of view, major and complex audits produce the greatest benefit per dollar spent:

> Special examinations (international and major domestic audits) 19:1
> General audits 8:1
> Desk audits (audits done within the ATO) 4:1
> Information matching 16:1 (Carmody, 1987).

New Zealand figures are similar. For the year ended 30 June 1991, the Commissioner of Inland Revenue reported cost–benefit ratios of 15.58:1 in respect of ordinary business investigations, and 27.82:1 for the work of the international audit unit. As one might anticipate, gearing in respect of ratios for verification of returns (interest matching and suchlike) and checking payrolls was much less marked, with figures close to 6:1. These more modest cost–benefit figures are to be expected in areas where

matching and withholding are available as enforcement measures.

A comparison of Australasian and United Kingdom cost–benefit figures shows interesting contrasts. The 1992 Report of the Board of Inland Revenue shows cost–benefit figures for most areas of audit and investigation that are similar to the Australasian figures, but an outstanding contrast is in the 138:1 result obtained by offices controlled by Principal Tax Inspectors, being offices that conduct larger and more complex audits.

On one hand, this appears to be a remarkable result; on the other hand, the result raises queries about the quality of the first-line enforcement processes of the United Kingdom tax system and about the level of voluntary compliance by taxpayers, if so much tax is collected on audit as a result of such an economy of effort.

Choice of taxpayers for audit

The increased availability of resources for conducting audits of taxpayers has gone hand-in- hand with other efficiencies. Among the most significant is the process of selection of taxpayers for audit. This process is now driven largely by cost–benefit analyses, with the benefit in question being the amount of tax expected to be recovered, rather than by notions of relative goodness or badness of the sorts of activities of which taxpayers are suspected.

Tax departments are coming increasingly to the conclusion that the largest taxpayers yield the most money at audit. Accordingly, fiscal authorities concentrate increasingly on larger businesses. Beyond this general criterion of size, in selecting targets for audit tax offices look for certain indicia displayed by taxpayers that show that they are good candidates for audit. Items that receive attention include:

- ratio of income to turnover
- quantum of certain kinds of expense items
- deviations from industry standards
- deviations from earlier years
- size of major transactions
- presence of certain kinds of transaction
- transactions with companies in tax havens
- ownership of shares in a company in a tax haven.

The selection process is nowadays computer assisted, with programmes written that identify and flag many of the indicia that have been listed. Such programmes then award points according to predefined standards, taking into account, for example, the amount by which the expenses of a particular taxpayer exceed norms for the industry. Aggregation of such points enables officials to award scores to taxpayers that, in turn, show the most promising candidates for audit. Programmes of this kind are continually refined as results come to hand.

Generic surveys

A recent development in the strategy of tax authorities is the systematic, in-depth generic survey, that is, a survey of a group of taxpayers who share some relevant characteristic: occupation, source of income, kind of wealth, for example. In one sense, authorities have used this kind of survey for many years. For example, the reported profits of cash businesses that can be expected to be similar to the profits of other businesses of the same kind (taxis, or fish and chip shops, for example) have long been compared with one another for evidence of the suppression of takings.

The modern generic survey can go much further, with a thorough study, perhaps akin to auditing, of large numbers of taxpayers who share the particular characteristic that is chosen. The objective is to discover opportunities that the taxpayers in question have to avoid or evade tax,

and to identify habits, types of transaction, or other signals that indicate that these opportunities are being exploited. That is, the survey evaluates the usefulness of the kinds of information that can be obtained about the taxpayers in question. The information gained can be integrated into computerised selection-for-audit programmes, or employed to make audits more efficient when they are carried out.

Late development of international auditing and intelligence gathering

Compared with the United States and Canada, tax authorities in Australia and New Zealand were slow to devote major resources to the investigation of avoidance and evasion where an international element is involved. In Australia, the Tax Office was heavily engaged in combating the many major avoidance schemes, and evasion activities that posed as avoidance, that flourished in the 1970s and early 1980s in the aftermath of a series of High Court decisions that rendered the general anti-avoidance rule in section 260 of the Income Tax Assessment Act ineffectual. In New Zealand a stringent system of exchange control, and overall extensive economic controls, afforded the tax base a considerable degree of protection against attack from the outside. Moreover, a series of loopholes in the company tax regime meant that it was relatively easy for larger companies to convert income into capital gains, which were and remain non-taxable. Accordingly, it was neither very easy, nor necessary, for companies to go offshore in order to minimise their taxable income.

4.3 Administrative and Neutrality Developments in Income Tax Systems

General efficiency

It has been commonplace for years for tax departments to report ratios of cost of investigation to tax recovered and, as shown above, departments have for some time been analysing these costs and benefits in order to determine the relative success rate of different audit programmes. But the New Zealand Inland Revenue department has now gone a stage further and, along with most other parts of the New Zealand public service, adopted and published goal-referenced programmes. That is, the department publishes targets, such as the number of audits of different kinds that it plans to complete each year and the revenue that it expects to generate, together with criteria by which the efficiency of its work can be judged.

Such published targets are useful for keeping work on track, but they are not permitted to become straitjackets. For example, the 1992 annual report of the department noted that work had fallen short of the year's target of 5,000 audits in the international area, with only 2,852 audits completed, but, on the other hand, extra tax assessed from these 2,852 auditors was $137 million against a budget of $80 million. What had happened is that during the year the department had realised that improvements in the effectiveness of its auditing processes were resulting in the recovery of increasing amounts of tax. Further, it made sense to devote more time to fewer, large cases than to try to cover the number of cases that had been planned.

The report also explained that the department regularly monitors the effect of its work, in order to ensure that as few resources are wasted as possible. For example, in the audit area the minimum acceptable return is $70 for every hour of officers' time that is spent. Each investigation is

assessed after 100 hours of work in order to test whether a return of at least this sum can be anticipated.

Conditions of employment of chief executives

The management techniques described above are having a noticeable effect on tax department efficiency. However, it is thought in some quarters in both the public and the private sector that reforms should go further. In many New Zealand government departments, chief executives have signed limited-term contracts with performance criteria that affect their remuneration.

One suggestion is that the government should strike an appropriate percentage of GDP (chosen after modelling the interaction of tax rates and the economy), and vary the remuneration of the Commissioner of Inland Revenue according to how close collections approach to their target. Undershooting would be penalised, as also might overshooting. Overshooting might be taken as evidence of the excessive use of the very wide powers of the Commissioner.

Earlier payment of tax

If it is primarily taxpayers who are to calculate their income and tax it becomes easy for the tax gatherer to require payment at an earlier stage. Thus, in the United Kingdom it is proposed that taxpayers subject to pay and file will pay their self-assessed tax within nine months of the end of their financial year.[1]

Although thought rigorous in some quarters in the United Kingdom, by New Zealand standards this deadline is generous. The philosophy that taxpayers should take responsibility for calculating their own assessments is a factor that has led to a requirement that business taxpayers

[1] [*Editor*: For trustees and individuals a self-assessment return will normally be required ten monhs after the end of the tax year, FA 1994, s. 178].

must estimate and pay their tax on a current year basis, in three instalments. Pursuant to Part XII of the Income Tax Act 1976, which sets out this "provisional tax" system, the first instalment is due only three months into the financial year for which the tax is payable. If final accounts, which are unlikely to be available until at least a year after the first instalment is paid, show that liability for the year as a whole was underestimated by more than 10 per cent, then interest is payable. Some flexibility is permitted, in that instalments may be of different amounts, and businesses can recalculate their liability as the year progresses, but the principle of payment of tax during the year to which the income relates is firmly entrenched.

The New Zealand system of making people primarily responsible for calculating their own tax is not the driving force behind the provisional tax system for business taxpayers. More important is the principle of neutrality, which led Parliament to the conclusion that businesses should not benefit from deferral, but should pay tax on a current year basis in the same manner as employees, recipients of interest, and others whose income is subject to withholding at source. Be that as it may, the fact that calculation of tax by taxpayers is part of the New Zealand system no doubt smoothed the path towards this conclusion.

Cash transactions

A preferred system of evading tax is to do all one's transactions in cash. Australia had made a frontal attack on this section of the black economy by the establishment of the Cash Transactions Reporting Authority, established by the Cash Transactions Reporting Act 1988.

The legislation applies to banks, bookmakers, and others who customarily receive large sums of money in cash. It requires cash transactions of more than $10,000, and outward transfers of foreign currency of more than $5,000,

to be reported to the Authority, and obliges those receiving cash to verify the identity of their depositors.

The Act has resulted in a number of enforcement actions, but one would expect that over time it will have effect more *in terrorem*, as people cease to try to evade tax by methods that entail the laundering of cash through financial institutions that have a reporting obligation.

Global income calculation and assessment: negative income tax

The United Kingdom is unusual in having a schedular system of income tax. New Zealand followed this pattern in its first income tax legislation in 1891, but, in common with most other countries, fairly soon moved to a global system.

The original reason for the schedular system, to ensure that no civil servant knew a gentleman's aggregate income, is nowadays of little importance, particularly considering the excellent record of confidentiality that tax officials have built up over nearly 200 years.

The United Kingdom is expected to move to a global system in due course. No doubt, this will make the audit process more efficient, along with the whole system of tax administration.

Another development that becomes possible or, at least more practicable, with a global system is a progressive tax scale with frequent steps, such as used to be the case in New Zealand. In fact, current thinking is that income tax rates should be as flat as possible, with few steps. Consequently, it is unlikely that the United Kingdom will take advantage of this possibility when it becomes able to do so.

In contrast, the United Kingdom may move, as New Zealand did, to use the tax system more as a vehicle for the delivery of social welfare benefits. For some years until 1991, Part XIA of the Income Tax Act (Family Support Credit of Tax) provided for employers to add credits to the

remuneration of low-paid workers. These credits were money that would otherwise have been paid through the social welfare system – a negative income tax. Employers would set the payments off against their liability to collect and return PAYE deductions to the income tax department.

The reason for the payments was to compensate low-paid workers for the regressive effects of New Zealand's Value Added Tax, which covers food and clothing and, broadly speaking, has no exceptions. Payments were made through the tax system to save people the stigma of becoming social welfare beneficiaries.

After a change of government, responsibility for the payments was shifted to the Social Welfare department in 1991. One reason given was to relieve employers of the additional computations that were necessary in order to administer the system. Be that as it may, the employment of the system until 1991 illustrates the possibility of some integration of income tax and social welfare regimes, an arrangement that would be more difficult with a schedular system.

Exchange of information and international co-operation

For many years, exchange of information clauses in double tax agreements were little more than a dead letter. Even nowadays, most such clauses are called in aid relatively infrequently. However, tax offices are adopting increasingly co-operative practices, and may be expected over the next few years to develop procedures to obtain and use information from treaty partners in an efficient and wholesale manner. Already, Australia and the United States of America exchange information on computer tapes. Presumably, it will not be long before on-line exchange is available.

In a related development, in 1992 Australia concluded its first international agreement in respect of the transfer pricing policies of a particular multinational company.

4.4 Appendix A: Disclosure Requirements in the New Zealand Income Tax Act 1976

1. Company income: return s9, form IR4

(a) All shareholders, directors, and relatives of shareholders who received remuneration from the company. Name, IRD number, number of shares held, total remuneration, value of loans, and current account balance.
(b) Payments to non-residents.
(c) Transactions concerning capital assets, form IR4T.
(d) Whether the company operates a branch equivalent tax account (relates to New Zealand's controlled foreign companies regime).
(e) Whether the company receives foreign source dividends.
(f) Were insurance premiums paid to overseas insurers not carrying on business in New Zealand? If so, is that company controlled or owned by non-residents?

2. Controlled foreign company regime: interests of any taxpayer in foreign companies s245W, form IR4G

(a) Details of taxpayer's tax practitioner.
(b) Foreign company's name.
(c) Address where accounting records are held.
(d) Principal business activity of foreign company.
(e) Control interest: method taxpayer employs to calculate control interest.

The New Zealand controlled foreign company rules mandate a variety of methods of calculating control interests, that depend on share structures. Unusual

structures, where voting, dividend, and return of capital interests do not coincide, are likely to attract attention.

(f) Income interest: where taxpayer's income interest differs from his control interest.

(g) Whether the taxpayer is a director of the foreign company.

(h) A schedule of any other New Zealand tax residents who are directors.

(i) A schedule of persons associated with the taxpayer who hold control interests.

3. Bonus shares: companies issuing bonus shares s13A

(a) Particulars of issue (some bonus issues are deemed to be dividends and are therefore taxable. S 4(1)(f)).

4. Branch equivalent tax account annual return s394ZZW, form IR3X (account of the income of a controlled foreign company).

(a) Amount and source of all credits and debits.

5. Dividend withholding payment return s394ZZC, form IR4J

The "dividend withholding payment" regime imposed a "withholding payment" on incoming dividends received by New Zealand companies. Strictly, the payment is not a tax, but is paid by the company on account of tax that individual New Zealand resident shareholders will eventually have to pay. The purpose of the regime is to achieve neutrality between residents who hold shares in foreign companies directly, and people who hold such shares via New Zealand resident companies. The regime prevents people establishing on-shore companies to act as dividend traps for their foreign investment, but is most unpopular

among New Zealand companies that have substantial foreign investment.

(a) Amount and source of all credits and debits.
(b) Amount and source of every foreign withholding payment dividend together with the amount of any foreign withholding tax paid in respect of the dividend.

6. Foreign investment fund interest s 245W

(a) Particulars of the foreign investment fund.

7. Annual imputation return: imputation credit account company ss394J, 394K form IR4J

(a) Amount and source of all debits and credits.
(b) Amount of any further income tax payable.
Where there is a debit balance in the imputation credit account at the end of the year or when the company ceased to run its imputation credit account.
(c) Particulars of the branch equivalent tax account, if kept.
(d) Amount of imputation penalty tax payable.
(e) Comparison with certain results of the previous year.
Where the fractions for certain items that make up the imputation credit accounts, for both the current and the previous imputation years, vary by more than 20 per cent, the taxpayer must disclose the variation and explain the reasons for that difference.

8. Resident withholding tax on dividends and interest: reconciliation statements ss327I, 327J, 327Y, 327ZB and 327ZD

(a) Information relating to deduction
(1) Copies of all certificates provided to recipients under s327H.

(2) Details of payments from which withholding tax has not been deducted.

Where without a valid certificate of exemption, withholding tax would have had to be deducted.

(b) Where no resident withholding tax is required (by virtue of exceptions in the Act).

(1) Details of the recipient.
(2) Total resident withholding income (consisting of interest) paid to the recipient by that payer.

(c) Transactions in financial arrangements.

(1) Details of the other party.
(2) Particulars of acquisition, disposition or redemption.

9. Financial arrangements

"Financial arrangement" is a defined term for the purposes of New Zealand's accruals regime. Broadly speaking, this regime catches all contracts where there is a substitution for interest, or a deferral or an acceleration of interest. A zero-coupon bond is an obvious example, but many credit sales are also captured. The regime recalculates "financial arrangements" and for tax purposes spreads income or expenses on a yield to maturity basis. Financial arrangements must always involve two parties, sometimes more. Thus, disclosure of details about financial arrangements can point to matters of interest in the accounts of more than one taxpayer.

(a) Interrelated arrangements, s64H(1), form IR4A

(1) Nature of the taxpayer's business.
(2) Taxpayer's tax consultant.
(3) Principal bank(s).
(4) Particulars of each related arrangement.

Name and address of the other party, and whether the other party is an associated person; if so, a full explanation of the relationship.

The amount and method of calculation of the assessable income or deductible expenditure. A reconciliation of the annual financial reports with the return of income reflecting the arrangement. The names and addresses of external parties who have given advice in relation to the interrelated arrangements.

(b) Transactions concerning capital assets s64H(1A), form IR4T

(1) Nature of the taxpayer's business.
(2) Taxpayer's tax consultant.
(3) Particulars of property sold or under option.

The means by which the price of the property was arrived at; acquisition price in the terms of the agreement; the days in which the rights are transferred; when delivery of the property is required; date and amount of each payment or the method of calculation if the exact amount cannot be determined.

10. Trusts: trustee obligations, form IR6

(a) Separate annual return in respect of every trust from which the trustee has derived income.
(b) Requirements of the controlled foreign companies regime, form IR4G or IR4H.
(c) Requirements for transactions concerning capital assets, form IR4T.

11. Trusts: settlor obligations s231

(a) Existence of trust.
(b) Details of trustees and beneficiaries.

4.5 Appendix B: Select Bibliography of Tax Administration Reforms in Australia and New Zealand (together with some related items)

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CHAPTER 5
Advance Rulings: A Proposed Procedure

John Prebble*

5.1 Introduction

For most business taxation is significant and for some it is the single greatest expense. The attractiveness, even the viability, of some transactions and business operations depends on how they will be taxed. It is thus fortunate that generally speaking the incidence of taxation can be predicted accurately. Doubts as to the tax effects of one's proposals can mean that to put them in train is to embark on a hazardous journey across a fiscal minefield, guided by maps that are misleading, or non-existent.

In many jurisdictions these hazards can be mitigated to some degree. The taxpayer can put proposals before the revenue authorities and request a ruling on their fiscal implications. However, this procedure is often deficient in one respect or another. For example, rulings can be granted in only limited types of cases; there may be discretion to decline to give a ruling; or rulings may not be binding, with the authorities reserving the right to change their mind.

In the last three or four decades, as tax systems have become steadily more complex and have demanded a growing share of the world's wealth, shortcomings in or complete absence of rulings procedures has attracted increasing comment and criticism. In 1980 the International Fiscal Association at its Paris Congress surveyed 20 countries. Of these, only Canada, Portugal, Sweden, the United States of America, and Uruguay had comprehensive ad-

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vance rulings procedures in their taxation systems. Argentina, Belgium, Greece, and Hong Kong had no provision. In the United Kingdom rulings were available only in very limited circumstances. Australia, Austria, Columbia, Denmark, France, Germany, Israel, the Netherlands, Norway and Switzerland had provision for rulings varying from limited to relatively comprehensive.

In some jurisdictions the taxpaying public simply puts up with a less than satisfactory situation. In others people try to find ways around the shortcomings of official procedures. In Belgium and France, for example, it is common for parliamentary deputies to get some sort of rulings on behalf of their constituents by ministerial questions in Parliament, though the type of case where this procedure can produce a satisfactory result is limited.

From a United Kingdom point of view probably the three most instructive models are found in Sweden, Canada and New Zealand. In the first two countries rulings procedures were instituted after proposals to that effect by commissions of enquiry appointed to report on the tax system. The Swedish procedure was instituted in 1951 and the Canadian in 1970. The New Zealand procedure was instituted in 1987 to meet the particular needs of the accruals regime, a set of rules that was added to the New Zealand legislation in that year.

5.2 Binding Advance Rulings in New Zealand

In Canada and Sweden rulings are available (with certain exceptions) in respect of income tax questions in general. The New Zealand procedure, however, applies only to issues that arise under the New Zealand accruals rules, sections 64B–64M, of the Income Tax Act 1976 or the foreign investment fund rules, sections 245R–245T of the same Act.

The accruals regime is a series of rules that, broadly speaking, are designed to prevent people from accelerating

deductions or deferring income. They apply typically to transactions that involve interest or interest surrogates, but also to many other transactions, including many sales on credit. Essentially, the rules require taxpayers to recompute affected transactions so that profit or loss can be calculated on a yield to maturity basis. That is, taxpayers calculate their income in much the same way as banks calculate profit or loss on loans and deposits.

For many taxpayers, such calculations would be difficult. Moreover, many uncertainties are likely to arise. For example, in calculating the profit or loss on a foreign exchange transaction, which of several equally valid exchange rates should one use? In order to provide for certainty, section 64E of the Income Tax Act empowers the Commissioner of Inland Revenue to make rulings on this sort of question. Such rulings are called 'determinations' in the Act. A procedure for applying for and issuing determinations was enacted in the Income Tax (Determinations) Regulations 1987. The text of those regulations was copied from a draft published in 1986 in *Advance Rulings on Tax Liability,* Institute of Policy Studies, Wellington, by the present author.

The foreign investment fund rules were inserted into the Income Tax Act in 1988 along with the New Zealand controlled foreign company regime. The rules are aimed primarily at investments by New Zealand residents in foreign mutual funds, with a view to taxing the annual increment in value of residents' interest in such funds. In order to prevent avoidance, the definition of a 'foreign investment fund' is very wide and can embrace, for example, a corporate conglomerate. The Commissioner is empowered by section 245S to make determinations as to whether particular entities are or are not foreign investment funds. The procedure for such determinations is set out in the Income Tax (Foreign Investment Fund Determinations) Regulations 1989, which are a modified version of the 1987 regulations.

At present, the subjects mentioned are the only areas where, in New Zealand, there can be binding advance rulings on tax liability. However, in her Budget of 2 July 1992 the Minister of Finance announced the government's intention that the Commissioner of Inland Revenue should be empowered to make advance rulings on income tax liability in general. Legislation was to be introduced "early" in 1993.

5.3 Reasons for Advance Rulings Procedures

It seems likely that a comprehensive and effective rulings procedure promotes respect for and compliance with fiscal laws. Certainly, an effective rulings procedure will generally promote good relations between the revenue authorities and the taxpayer. This is partly because the taxpayer will be glad to be able to find out the attitude of the revenue to proposed transactions and partly because a rulings procedure can be used to promote uniformity in the application of tax legislation throughout any particular jurisdiction. Further, the availability of advance rulings should help to minimise controversy and litigation. Taxpayers who have the opportunity of discovering in advance the opinion of the authorities will be less likely to chance their arm and fight out the results later in court.

An advance ruling procedure can also be useful in the enforcement of tax laws. Revenue authorities always face some difficulty in keeping up with the latest practices in commercial and tax planning. Formal requests for rulings on proposed operations constitute one way for the authorities to keep up to date.

The quality of the relationship between taxpayers and the revenue authorities and other factors like those mentioned in the previous two paragraphs are almost impossible to measure, but educated common sense suggests that an advance rulings procedure should promote most or all of these desirable features. Of countries with comprehen-

sive advance rulings procedures, Canada, Sweden and the United States of America have been studied for the purposes of this paper. Such empirical evidence as there is from these jurisdictions supports the commonsense conclusions advanced above.

5.4 Tax in Dispute

Several specific developments that are found in a number of countries strengthen the case for advance rulings procedures. First, governments are increasingly reluctant to allow tax to remain unpaid until disputes between taxpayer and the revenue have been disposed of. In New Zealand, from 1985 taxpayers have been required to pay one half of any tax in dispute, though refunds allowed as a result of successful objections carry interest. If the objection is not successful, interest runs against the taxpayer in respect of the half not paid. In the United Kingdom, tax deferred pending the resolution of disputes now carries interest.

While these changes bear hardly on individual taxpayers, there are grounds to suspect that in the past some tax objections were lodged to obtain a deferral of tax rather than because of any particular merit in the argument of the taxpayer. However, one result of the change is that taxpayers and their professional advisers may be expected to become increasingly restive about delays in the disposal of objections to assessments, thus causing even more work for an already hard-pressed Inland Revenue Department. To the extent that an advance rulings procedure can prevent disputes from arising in the first place it should, in the long run, minimise disputes and litigation.

5.5 Anti-avoidance Rules

A number of countries, including New Zealand, Australia and Canada have comprehensive statutory anti-avoidance rules in their income tax legislation. Where anti-avoidance

provisions are couched in general terms, the arguments for an advance rulings procedure are particularly compelling. The reason is that generally-phrased anti-avoidance provisions are often so drafted that their literal words appear to catch transactions that are entirely innocent. Taxpayers need to know which side of the line their transactions may fall. The existence of a judge-made fiscal nullity rule as in the United Kingdom gives rise to similar considerations, though since *Craven* v *White* [1989] AC 398 the area of concern is narrower than it was.

Although the United Kingdom has no general statutory anti-avoidance rule, and no comprehensive advance rulings procedure, the UK Parliament sometimes provides for special rulings procedures when it enacts anti-avoidance provisions in particular contexts. An example is found in section 138 of the Taxation of Chargeable Gains Act 1992. Section 138 relates to the relief that may be afforded to shareholders under section 137 of the same Act in respect of tax on gains that would otherwise be chargeable as a result of corporate mergers or reorganisations. As a general rule an exchange of shares to effect an amalgamation is not classed as a disposal for purposes of tax on chargeable gains. However, this general rule does not apply unless the "reconstruction or amalgamation in question is effected for bona fide commercial reasons and does not form part of a scheme or arrangement of which the main purpose ... is avoidance of liability to capital gains tax or corporation tax" (section 137(1) of the Taxation of Chargeable Gains Act 1992).

Consequently, UK companies contemplating a merger will be concerned to know whether the revenue authorities will accept that their proposed actions are "for bona fide commercial reasons" and not for the avoidance of taxation. Section 138 provides that companies in this position may obtain an advance ruling or "clearance" from the revenue authorities. There are several similar examples in other parts of the United Kingdom tax legislation.

Section 138 of the United Kingdom Taxation of Chargeable Gains Act 1992 applies only in respect of corporate reorganisations. In contrast, section 99 of the New Zealand Income Tax Act renders void for income tax purposes any arrangement that has the purpose or effect of tax avoidance. Literally, this provision might even apply if a taxpayer makes a gift to charity in circumstances where the donation will result in a rebate. There are many other cases which may, or may not, be vulnerable to section 99. Similarly, although the fiscal nullity doctrine is nowadays more circumscribed in its operation than some people originally thought, its full ambit is by no means clear. This is a situation that could be alleviated by a procedure whereby taxpayers can clear their proposals with tax authorities in advance.

5.6 Commissioner's Discretions

Thirdly, it is a feature of the New Zealand Income Tax Act that many of its provisions are couched in terms not of clear rules but of discretions conferred upon the Commissioner of Inland Revenue. In "Objecting to discretionary determinations by the Commissioner of Inland Revenue" (1981)*Victoria University of Wellington Law Review,* No. 11, p. 125, Patricia Reddy identified upwards of 400 separate discretions conferred by the Act upon the Commissioner. Reddy wrote in 1981. Doubtless the total is now a good deal higher, because since 1981 the Act has at least doubled in size.

An important example is found in section 108(1) of the Act. There, it is provided that where depreciation of a capital asset cannot be made good by repair, "the Commissioner may [subject to certain specific rules in the Act] allow such deduction as he thinks just". These few words underpin almost the whole of the depreciation schedules of the New Zealand tax system. Schedules of allowances that will be approved are published by the Commissioner and

may be relied upon by the taxpayer. A formal procedure affording an opportunity to obtain advance rulings on depreciation questions for which the schedules do not adequately cater would have clear benefits. Likewise, binding rulings should be available in respect of other matters that are subject to administrative discretion.

Other jurisdictions, including the United Kingdom, tend not to leave so many matters to the discretion of the Commissioner of Inland Revenue or to other fiscal authorities. But to the extent that such discretions exist, they strengthen the case for an advance rulings process.

5.7 Non-binding Rulings

In common law countries, and in the absence of specific statutory provision, the rules whereby tax is calculated and levied are found in legislation. The Act imposes tax, and therefore from a strictly jurisprudential point of view it is not possible for revenue authorities to give binding rulings on questions of tax liability. If a tax authority gives a ruling and later decides that it was wrong, it is obliged to make its assessments of the taxpayer according to the rules as it now understands them. If there is a dispute, it is for the courts to decide the true effect of the law. The decision of the court cannot be governed by a ruling that may have been made earlier. In effect that ruling is no more than an expression of opinion.

Despite their inability to give binding rulings, tax authorities in some countries are willing to give opinions on proposals submitted by taxpayers or their advisers. An official who has given such a ruling is naturally reluctant to change his mind, but this does happen from time to time.

The practice of the New Zealand Commissioner of Inland Revenue in this respect is set out in his *Public Information Bulletin,* No. 117, June 1982. Taxpayers may apply to their district offices for rulings on transactions that they propose to undertake. Generally speaking the ruling

is made within the district office, acting under authority delegated from the Commissioner. Difficult cases are referred to regional offices or to the head office.

Salient features of the system, which inquiries suggest is similar to a number of others that operate in common law countries, include the following:

- The Inland Revenue Department does not consider itself obliged to issue rulings, though it endeavours to do so. One type of case where the Department may not give a ruling is where there is some doubt about the applicable law.
- There is no appeal from unfavourable rulings. The taxpayer may carry on regardless if he or she wishes and challenge the view of the department when a return has been furnished and an assessment issued.
- The department emphasises that its rulings are expressions of opinion and are not binding. Of course, the ruling may be revoked if it is subsequently discovered that the facts are not as stated by the taxpayer. However, changes in the law or its interpretation will also cause the department to correct its ruling.
- Application for a ruling is by letter setting out the facts of the case together with drafts of relevant documents.
- The department will not give rulings on proposals that involve or could involve tax avoidance, hypothetical situations, a series of alternatives to the same transaction, or proposals where the names of the taxpayers are not disclosed.

In New Zealand requests for non-binding rulings appear to have declined in number over the last 10 years or so. This development is probably attributable to several factors. First, the expertise of New Zealand tax advisers has improved markedly. Consequently tax advisers are more willing to give their advice without reference to the Inland Revenue Department.

Secondly, there may have been a misapprehension among less expert members of the professions that rulings were binding. If so, this impression was dispelled by the 1982 Public Information Bulletin, not to mention several celebrated cases that came about following a change of mind on the part of the Commissioner. A leading example is *CIR* v *Challenge Corporation Ltd* (1986) 10 TRNZ 161, where, incidentally, the Privy Council first disclosed the concept of tax mitigation.

Thirdly, it is believed in some quarters that the Inland Revenue Department is these days more ready to reverse rulings that it has given than it was in the past. Accordingly a ruling is not as worthwhile as it was.

A fourth reason is sometimes suggested. This is that tax planners are nowadays less willing to disclose their proposals to the Inland Revenue Department than they used to be. It is unlikely that this view is correct. Tax planners have always had to decide between disclosing their hand to the department in the hope of receiving a favourable ruling and keeping their plans confidential.

5.8 Significance of Whether Rulings are Binding

Probably the major shortcoming of advance rulings systems like that just described is that rulings are not binding. This is not to say that rulings should be binding in all circumstances. Any rulings system must provide for revocation or modification (or, simply, a vitiation of binding effect) if it is discovered that there was a material omission or misrepresentation in the application by the taxpayer. Further, if there is a retrospective statutory change it would seem fair that a taxpayer should not be able to rely on a ruling. Otherwise he or she would be in a more favourable position than other taxpayers. Thus in Sweden, for example, where advance rulings are in other respects binding, there is an exception for cases where a change results from retrospective legislation. However, contrary court deci-

sions, much less reinterpretations by the revenue authorities, do not lead to the revocation of a ruling.

The remainder of this paper addresses the questions of the features that one might hope to find in a system for binding advance rulings, the appropriate scope and limitations of such a system, appropriate procedures for settling and issuing rulings, and the manner in which a rulings procedure might be adopted in a common law country.

5.9 Ongoing Courses of Action

Rulings in respect of courses of action that are to be continued or repeated for some time raise more difficult questions than rulings on single transactions. Justice appears to require that modifications of rulings should not be retroactive. But is it fair to the general body of taxpayers for someone to take advantage of an erroneous ruling for a number of years? In the end, the answer is probably, yes. Suppose that a taxpayer obtains a ruling about a proposed contract for the extraction of minerals. The ruling may relate to the assessability or otherwise of the remuneration of the taxpayer's employees. If the contract is to last for, say, five years it would seem only reasonable that the taxpayer should be able to rely on a ruling in respect of the assessability of the remuneration of his staff throughout that period. Arguably, if a case is sufficiently serious to warrant the revocation of a ruling obtained after full and faithful disclosure by the taxpayer, then this should be done by retroactive legislation, or possibly by appropriate court proceedings, but not by administrative action.

The problem of changes in the interpretation of the law can to some extent be mitigated by providing for time limits within rulings themselves. For example, a transaction may be ruled non-assessable if it is carried out within, say, 12 months. Or, say, the tax implications of a certain course of action, or of a certain investment vehicle, may be ruled upon, the ruling to be effective for, say, four years.

The transactions and business operations of taxpayers are so various that there would be no merit in fixing a specific duration to be applicable to all rulings. But a practice of making rulings subject to appropriate limits decided on a case-by-case basis has obvious advantages.

5.10 Binding Effect on the Taxpayer

It is sometimes suggested that if advance rulings that are favourable to the taxpayer are to be binding on the revenue authorities, then rulings that are unfavourable to him should be binding on the taxpayer. This suggestion comes from a misconception of the role of a rulings procedure. As far as is known, no jurisdiction that provides for advance rulings makes unfavourable rulings binding on the taxpayer. The justification for this approach differs depending upon whether rulings are given by the revenue authority itself or by an independent authority.

Where rulings are made by the revenue authorities, as is the case in most jurisdictions, one starts from the position that there are two persons: the taxpayer, who argues that the proposed transaction is not taxable (or taxable at a low rate); and the revenue authorities, who represent a conflicting interest, though not necessarily a conflicting point of view. If the revenue agrees with the taxpayer it is simply saying that its view of the law is the same as the individual's. But the revenue authorities will be bound to this view because the taxpayer proposes to act upon it. On the other hand, if the revenue authorities disagree with the taxpayer they are doing no more than saying that their opinion is different from that of the taxpayer. It follows that the taxpayer should be permitted to carry out the proposed transaction if he or she wishes, and to object in court to the assessment of the revenue authorities in due course.

If the rulings authority is independent, there is perhaps a stronger argument for saying that if the revenue authori-

ties are bound, so also should be the taxpayer. To allow the taxpayer to disregard the ruling of the rulings authority and to have a second argument before the tax court appears to give the individual two chances, whereas the revenue authorities have only one chance in cases where the ruling is favourable to the taxpayer. But even here a useful analogy can be drawn with the legal doctrine of estoppel. Broadly speaking, this doctrine states that where someone changes position on the basis of the representation of another he should be able to rely upon that representation. In cases involving advance rulings it is the taxpayer who changes position, by going ahead with proposals that have been ruled upon. The position of the revenue authorities is not changed. Accordingly, it is not unfair that the revenue authorities should be bound by rulings adverse to their interest, but that the taxpayer should be free to disregard them should he or she so decide.

5.11 Subject Matter of Rulings

Most rulings procedures provide that there are certain types of cases in respect of which rulings will not be given. No doubt, there are some cases that reasonably should be excluded from a rulings process. In Sweden it is required that the matter in question should be of marked importance to the taxpayer. In practice this stipulation is applied leniently and few requests for rulings are denied for unimportance. However, it does seem reasonable that there should be at least some significance in the taxpayer's request. The primary purpose of such a rule should be to exclude vexatious or frivolous applications. Secondly, most jurisdictions that lay down detailed rules will not provide advance rulings in cases where the question of law involved is currently before the courts, either in respect of another taxpayer or in respect of the same taxpayer in relation to an earlier year. This seems a reasonable limitation, though one should bear in mind that one of the

advantages of a rulings procedure is that it should be more rapid than typical judicial proceedings. It is not reasonable to hold up the transactions of the many while a particular case is waiting to be heard. One possible remedy would be to provide for expedited hearings of cases that are expected to have wide significance.

The essence of revenue rulings is that the rulings authority pronounces upon a set of facts presented by the taxpayer. Accordingly, the Canadian authorities indicate that rulings will not be granted where the issue is primarily a question of fact. This approach is unexceptionable. It would hardly be appropriate for rulings authorities to make determinations of fact on the basis of information supplied only by the taxpayer. The alternative, to add investigating duties to the role of rulings authorities, would be significantly to change their role.

A study of the provisions of advance rulings procedures of different jurisdictions reveals a miscellany of other cases that for one reason or another will not be entertained. Generally speaking there is less obvious merit in these limitations that in those mentioned above.

5.12 "Hypothetical" Cases

Most revenue authorities, including that of New Zealand, state that they will not rule on what they call "hypothetical" cases. But what is meant by "hypothetical"? In one sense any proposed transaction is hypothetical in that it is a proposal rather than a fact. On the other hand, if by "hypothetical" one means "unlikely" it should not be difficult in most cases for the taxpayer's advisers so to draft his or her application that the proposal at least looks possible.

The word "hypothetical" has a pejorative air about it. One has the slight feeling that draftsmen of codes of advance rulings procedures say to themselves, "We can't have any hypothetical cases," as if this is an obvious truth,

write it down, and go on to the next point. Be that as it may, in the end one is forced to conclude that the exclusion of hypothetical cases probably has little significance, and probably does not do much harm.

5.13 Avoidance

In Canada, the revenue authorities will not rule on transactions that are not clearly bona fide or that are designed primarily to reduce tax. Similarly, the New Zealand Inland Revenue Department declines to issue even non-binding rulings on proposals that involve or could involve tax avoidance. In New Zealand it is hard to see why there should be no rulings in such cases. If a scheme has the purpose or effect of avoiding taxation it is void for tax purposes by virtue of section 99 of the Income Tax Act. If this is the view of the Commissioner he should rule against the taxpayer, citing section 99 and giving reasons why the scheme is caught by the provision. Indeed, as mentioned earlier, the existence of a general anti-avoidance rule is a reason for establishing a rulings process.

5.14 Completed Transactions

In some jurisdictions, notably Canada, it is not possible to obtain a ruling in respect of completed transactions. In others, including the United States of America, one can obtain rulings on completed transactions but they are not binding on the Revenue. The rationale is that the transaction was not entered into in reliance upon the ruling and it is thus not unfair for the ruling to be modified.

This reasoning ignores the fact that a taxpayer may have relied upon such a ruling in entering other transactions. For example, a taxpayer receiving a ruling agreeing that he has suffered a deductible loss may decide in the same year to sell some land in circumstances such that the sale produces assessable income, income that he can set off against the

loss. Were it not for the favourable ruling the taxpayer might decide to defer the sale of the land for a year or two until it can be sold without tax consequences. In such circumstances it appears unfair that the ruling should be able to be modified.

Another important reason for allowing for rulings in respect of completed transactions is self assessment. One result of the pay and file system of self-assessment that is to be introduced in the United Kingdom is that taxpayers will be uncertain, sometimes for long periods, whether the calculations that they have filed, and the assumptions that they have made, are accepted by the Revenue authorities. If the taxpayer finally turns out to be wrong, very large sums of back tax, including interest and, possibly, penalties may prove to be payable in respect of financial years that are long past. Rulings on completed transactions would constitute a procedure whereby taxpayers could accelerate decision-making in areas of doubt. A system that permitted appeals would be particularly valuable in this context. (The question of appeals is considered later in this paper.)

5.15 Alternatives

Most ruling authorities will not entertain applications in respect of cases involving several alternatives. One has a similar reaction to this restriction to one's reaction to the exclusion of so-called "hypothetical" cases. The expression "series of alternatives" by itself tends to create an unfavourable impression. One might conclude without much thought, "of course the taxpayer should not be allowed to burden a rulings authority with a series of alternatives". But this opinion does not stand up to close analysis. There are numerous cases where it is not at all unreasonable for a taxpayer to submit alternatives in his or her application. An example is where there are several

ways of making distributions from a company that is being wound up, some of which may be taxable and others not.

Another reason for reluctance to grant rulings on several alternatives is the question of time. How long should Revenue authorities spend on an application by any one taxpayer? This reservation may be met by requiring full-recovery fees for rulings.

5.16 Revenue or Capital

In Canada, the authorities will not rule on the question of whether a particular receipt or expense is revenue or capital. The reason appears to be that ultimately these matters are usually questions of fact. It is relatively difficult for the authority to become appraised of all the relevant facts. The New Zealand Inland Revenue Department makes no similar reservation in respect of the non-binding rulings that it issues. It is suggested that the New Zealand position is to be preferred. One must bear in mind that the onus is on the taxpayer to put all the relevant facts correctly before the authorities. If it later turns out that the application was misleading the ruling may be revoked and the taxpayer has only him or herself to blame.

In practice, the New Zealand Inland Revenue Department appears to be reasonably experienced in ruling on questions of capital and income. For example, in the period up to 31 August 1981 the DIC Ltd, a listed public company, incurred expenditure of $2,869,750 in strengthening its Wellington department store to comply with local bylaws. The earthquake resistance of the building was markedly improved by the installation of a skeleton of massive steel girders. The Commissioner of Inland Revenue allowed the total sum as a deduction on revenue account, as noted in the 1981 annual report of the company. In the opinion of the present writer the correctness of that ruling is questionable, but it does seem to have been an appropriate case for a ruling, in that the ruling gave the company some certainty

as to the provision that it needed to make against tax liability. Had the ruling been binding, the company would have been in an even better position, knowing for certain that no provision was necessary in respect of the transaction in question.

5.17 Taxpayer's Identity not Disclosed; Applications from Trade Associations

Most jurisdictions will not entertain requests for advance rulings where the name of the taxpayer is not disclosed. There is perhaps some justice in this rule in general principle. If one of the justifications of a rulings procedure is that the intelligence-gathering of the Revenue authorities is enhanced it may be an unreasonable advantage for a taxpayer to be able to obtain a ruling (no doubt via a professional adviser) without revealing identity. On the other hand, there seems no reason in principle why trade associations and trade unions should not be able to obtain rulings on behalf of their members. In practice this does occur. For example, New Zealand trade unions used to get rulings from the Department of Inland Revenue that, say, expenditure on clothing or equipment will be allowed as a deduction up to a certain level, though these rulings are apparently not regarded as being made pursuant to the procedure laid down in the 1982 circular. (This particular kind of ruling is no longer requested because, by virtue of a 1988 amendment to section 105 of the Income Tax Act 1976, New Zealand now disallows any deductions in respect of expenditure incurred in gaining income from employment.)

Sweden stipulates that only the individual taxpayer may apply for a ruling. The effect of this is avoided by trade associations supporting the application of individual members in order to create a precedent. There seems no particular reason to prevent trade associations, trade un-

ions, and similar organisations from obtaining rulings that will be applicable to their individual members.

The New Zealand Society of Accountants regularly obtains rulings for groups or categories of clients in respect of such matters as depreciation allowances and rules relating to the recognition of income. There is no reason to abandon that sort of informal dialogue between the tax agents and tax authorities. But at the same time there may be advantages in allowing the accountants' associations, or similar applicants, to obtain formal rulings should they so wish.

5.18 Opinions on Commercial Practices

In Canada the authorities may decline to give a ruling that requires an opinion as to generally accepted accounting or commercial practices. The reason for this limitation is not clear. Ultimately, tax liability is a question of law. An accounting or commercial practice may be helpful in settling the law. But there seems no reason for revenue authorities to hesitate to state their view as to whether accounting or commercial practices are in accordance with the law, either generally or in the context of an advance ruling for which there has been a formal application.

5.19 Interpretation of New Legislation

Another category of case in which Canadian authorities will not act is where the requested ruling would require an interpretation of new legislation on which Revenue Canada has not yet adopted an official position, or where the department is currently in the process of reviewing its position on existing legislation. In fact neither this reason, nor, indeed, the reason mentioned in the previous paragraph, is frequently a cause for Revenue Canada to decline to give a ruling that has been requested. By and large one would hope that the need to interpret new legislation or to

review existing legislation should not prevent the issue of rulings, though a certain delay might not be unreasonable in these circumstances.

5.20 Who Should Make Rulings?

In New Zealand the current non-binding rules procedure is administered on a district basis. While the evidence is largely anecdotal, this system appears to suffer from certain shortcomings. Most tax practitioners have stories of differing rulings on similar sets of facts from different district offices, or even from the same office but from different personnel. It is surely significant that the three jurisdictions with the most developed rulings systems, Canada, Sweden, and the United States of America, all centralised their procedures many years ago. Apart from promoting uniformity, centralisation helps to create a body of knowledge and experience that enables rulings to be given speedily and accurately.

The New Zealand Inland Revenue Department has taken account of these considerations. During the early part of 1993 it embarked on planning and recruitment for the rulings unit that it will need when Parliament enacts provisions for issuing binding advance rulings. The unit is to be centralised.

A more difficult question is whether the ruling authority should be an office within the department of state that is responsible for collecting taxes, or an independent or semi-independent organisation. In most countries, and in common law jurisdictions in particular, rulings are handled within the tax department.

5.21 Swedish System

Sweden provides an interesting exception. In that country the functional decentralisation that is a leading feature of all public administration in Sweden is also a feature of the

tax administration. Regional administrative boards act independently within the limits laid down by tax laws and government instructions. There are about 3,000 assessment boards, each as a rule handling between 1,500 and 3,000 taxpayers. The chairman of each board is appointed by the country administration. Other members are elected by municipal assemblies in the district concerned. Thus a considerable measure of political control of the tax administration is delegated to a local level.

There is also the Riksskatteverket (RSV), the National Tax Board. Broadly speaking, the function of the RSV is to promote the uniform application of all taxes throughout the country. It is an advisory and co-ordinating authority but has no directive power over the provincial and local tax authorities.

An important function of the RSV is to make rulings on the application of individual taxpayers. This function is delegated to the RSV's committee for legal matters. Rulings of this committee are binding on local assessment committees when the taxpayer files a return. Thus in Sweden rulings are administered independently of the revenue administration, centrally, and at a reasonably high level.

An appeal lies from a decision of the RSV direct to the Supreme Administrative Court of Sweden, which is Sweden's highest judicial authority in taxation matters. A direct appeal to such a superior court might appear strange to readers familiar with Anglo-American judicial systems. However, there are no questions of fact involved and the rulings authority, the RSV, is itself a body of considerable eminence.

The Swedish system has its attractions. The object of having an independent rulings authority is to promote public confidence. One would expect there to be a similar effect in other countries. The Swedish provision for appeals is also attractive. Indeed, the grounds for providing for appeals are probably even stronger in jurisdictions

where rulings are administered within a department of state. One problem with appeals to judicial courts is the question of delay. This difficulty is overcome in Sweden by giving rulings appeals priority. They are dealt with by the Supreme Administrative Court within six or eight months, which compares with a delay of some years for appeals in ordinary tax cases.

5.22 Procedure for the United Kingdom

It may be that if the United Kingdom were to establish a binding rulings procedure it would be appropriate to adopt the better features of both the Canadian and the Swedish systems, together with some of the procedures of the New Zealand system. The United Kingdom has no official body like the Swedish RSV, though neither is its tax department monolithic in the mould of tax offices in most Commonwealth countries. There may be an analogy between the supervisory functions of the Board of Inland Revenue and the tax inspectorate, on the one hand, and the RSV and the Swedish district tax offices, on the other. If so, the Board would seem an entirely appropriate institution to take responsibility for rulings in the United Kingdom.

Be that as it may, some case can be made out for an independent national tax advisory board, though that is beyond the scope of this paper. If there were such a board the issuing of advance rulings could usefully be one of its functions.

Whether a rulings unit is established independently or within the Board of Inland Revenue, one would expect that most cases could be dealt with by letters between the taxpayer or advisers and the rulings unit, the taxpayer's district being invited to give its views on the application and possibly also on a draft of the proposed ruling.

5.23 Conferences between Taxpayer and Rulings Authority

Some cases would merit an interview or conference between the taxpayer and the staff dealing with the case. In some jurisdictions a taxpayer asking for a ruling may request one conference as of right and may be granted other conferences in the discretion of the authorities. In the United Kingdom it would probably not be necessary to lay down rules about numbers of conferences. Rather, one could see how the procedure operated for a year or two. If it seemed that taxpayers were imposing unduly upon the time of the staff of the rulings unit some rules could be laid down.

5.24 Appeals

An appeal should lie from decisions adverse to the interests of the taxpayer. It would seem appropriate that the appeal should be to the Special Commissioners, with a further appeal to the High Court. If the rulings authority were established as a body of sufficiently eminent status, appeals direct to the High Court might be appropriate.

The question arises as to whether there should be a further right of appeal to the Court of Appeal. Given that the papers and arguments in the case would have had to be prepared for the High Court it should not be unduly time-consuming for an appeal to be taken further, to the Court of Appeal, particularly if priority could be given in rulings cases as is done in Sweden.

In many cases, going through an appeal procedure flies in the face of an important reason for having advance rulings at all: to enable taxpayers to get reasonably prompt and certain answers to queries that they have about official opinion as to transactions that they propose. However, the *existence* of an appeal right poses no problem in this respect. It is only the *exercise* of the right that causes delay.

If an advance rulings authority is part of the tax administration of the jurisdiction in question, there is no occasion for an appeal by the revenue authorities. Whether to lodge an appeal is a matter for the taxpayer. Often, time constraints will dictate that the exercise is pointless. But sometimes it will be worthwhile. The taxpayer should have that opportunity.

Where the advance rulings authority is independent of the tax administration an appeal system would certainly seem to be required, if only for the sake of the Revenue authorities.

5.25 Reliance by Third Parties

The questions of whether and to what extent one taxpayer should be able to rely on a ruling obtained by another raises a number of difficult issues. On the one hand, fairness, in the sense of the uniform application of the tax rules to taxpayers in similar circumstances, is an important objective of any tax system. In the present context this objective is fairly compelling. It would appear unreasonable that one taxpayer should be treated more generously than another simply because the first happened to have obtained a favourable advance ruling about his tax liability.

On the other hand, the staff of a rulings authority are only human, and a mistake by an officer in settling a ruling could lead to huge losses of revenue if not only the applicant could rely on the ruling but also anyone else who chose to do so. If only applicants can rely on rulings, one solution for third parties is to make applications themselves, citing the existing ruling. If and when enough consistent rulings have been issued for the tax authorities to be satisfied of their correctness, a general ruling could be issued, to make further individual application unnecessary.

The better solution is probably to decide that only applicants can rely on rulings that are issued. However, if

it is accepted that taxpayers in general should be able to rely on rulings given to individuals, certain consequences follow. First, one must be particularly concerned as to the quality of the rulings process. If mistakes are made that affect the affairs of one taxpayer it is bad enough. But if a body of taxpayers is able to take advantage of a ruling mistake the loss to the Revenue authorities could be very significant. This consideration leads one to the conclusion that a rulings office must be staffed by people of high qualifications and considerable expertise. Secondly, there is the question of revocation. How should revocation affect third parties who have relied on a ruling given to someone else? This question is considered in the next section.

5.26 Revocation: Effect on Others

If the rulings authority decides that a ruling should be changed, it seems reasonable that taxpayers who have not yet taken advantage of the ruling should not be able to do so in the future. But, in a system where non-applicants can rely on rulings given to others, what of taxpayers apart from the original applicant who have put in train transactions or business systems that rely for their viability on the original ruling? If those transactions or systems are terminated by the time the revocation or modification is announced there is no problem. But a taxpayer may have arranged his or her affairs in the expectation of being able to rely on a ruling for several years. Should that taxpayer be able to continue to rely on the ruling even after it is modified?

Fairness might suggest that the answer should be, yes. In practice this principle could lead to an unacceptable loss of revenue. One solution may be to provide that if a taxpayer wishes to rely upon a ruling granted to someone else he or she must give notice to that effect to the tax office. Such a procedure should not be particularly oner-

ous for either the taxpayer or the authorities. Indeed, income tax legislation often contains provisions requiring notice if the taxpayer wishes to take advantage of them. A notice requirement of this nature would enable rulings to be monitored in order to gauge their effect on the collection of revenue. If necessary the authorities could review the position to determine whether the ruling was correct. If not it could be modified or remedial legislation could be proposed.

5.27 General Rulings and Statements of Practice by Revenue Authorities

As mentioned in Section 25 of this paper, in the opinion of the author it is better to have a rule that only the original applicant can rely on a ruling granted to him or to her. If large numbers of taxpayers apply for similar rulings, then the appropriate solution is for the revenue authorities to issue a general ruling that covers the problem.

In the United Kingdom there is already a practice akin to the issuance of general rulings, whereby statements of practice are published from time to time by the Board of Inland Revenue. Perhaps the most specific and formal are extra-statutory concessions.

Extra-statutory concessions and other statements of practice that may or may not be in accordance with the law (or with what the law is eventually held to be) have no statutory basis. If the United Kingdom were to adopt a statutory advance rulings procedure for applications by individuals there would be something to be said for integrating in the same statute a set of rules for the issuance of general rulings. These rules could codify procedures for determining what is, and what is not, a formal general ruling that is binding on the authorities. The rules could also set out what reliance taxpayers could place on general rulings, and stipulate what, if any, procedures taxpayers should follow in order for a general ruling to bind the

revenue authorities in respect of their tax returns. One procedure that might be expected to be helpful to the administration of a tax system would be to require people who rely on a general ruling to give notice to that effect in their tax returns.

An alternative is to leave the question of the binding effect of general rulings to the courts to work out as the rules of administrative law are gradually developed by the judges, which is more or less what is happening in the United Kingdom at the moment (see *R* v *Commissioners of Inland Revenue* ex parte *MFK Underwriting Agencies & Ors* (1989) 62 TC 607, discussed in Section 32 of this paper).

That solution is better than nothing, but it has two shortcomings. First, remedies that are appropriate in other areas of administrative law may not be the most appropriate in the field of taxation, if only because taxation has its own procedures already in place for dealing with objections to assessments. Secondly, if one comes to the conclusion that an administrative system for the issuance of individual and general rulings is desirable, then it makes sense to work that system out as a global, integrated set of rules, rather than to let it develop sporadically, on a case-by-case basis. Some aspects of law reform may be best left to the common law process of accretion as and when there is a relevant judgment, but it is hard to think that the development of codes of procedural rules for administrative action could be one of them.

5.28 Publication of Rulings

As a matter of fairness between taxpayers, and in order to give all citizens access to sources of law and to knowledge of how the law is applied, some form of publication of rulings is necessary, subject to the deletion of details that would identify the taxpayer concerned or his or her commercial secrets.

In New Zealand, proceedings before the Taxation Review Authority, a tribunal that is the initial forum for hearing objections to assessments of tax by the Commissioner of Inland Revenue, are held in secret. However, judgments of the Authority are published. They are supplied to publishers with identifying material intact, and publishers' editors purge the judgments as necessary before they are printed and circulated. A similar system could work effectively with advance rulings. Alternatively, and probably better, identifying material could be purged before rulings were supplied to publishers.

An alternative is for rulings to be edited, published, and sold by the Board of Inland Revenue or by HMSO. Experience with both private and government publishers leads the present author to prefer private publication.

Experience in jurisdictions where rulings procedures have existed for some time suggests that many rulings are of little or no general importance but are highly specific to the applicant. In some jurisdictions the practice is not to publish such rulings. The question therefore arises as to whether a decision not to publish should be made by the authorities or by private publishers. It is suggested that the publishers should make the decision. Admittedly, they would almost certainly err on the side of publication rather than non-publication. However, so long as this practice did not involved the Revenue administration in any expense, no great harm would be done. In fact to leave the decision to publish up to private enterprise should reduce costs for the Revenue authorities by eliminating the need to make a judgment as to the publishability of each ruling.

Rulings that have not been published should remain open to inspection. One would not anticipate many applications to see such rulings. They would need to be edited before being made available to members of the public.

No doubt before long, questions of selecting rulings for publication on paper will become unimportant, and unlim-

ited material of this kind will be available economically on electronic data bases.

Not every taxpayer who applies for a ruling would want anonymity. Some might be indifferent. Others might welcome publicity, such as a finance house that seeks a ruling as to the tax consequences of a new kind of investment structure that it wishes to promote. To save the trouble of purging rulings where the taxpayer has no interest in having that done, it would be sensible for rulings procedures to provide that taxpayers should ask for anonymity should they desire it.

5.29 Documentation and Drafting

One part of a rulings process that takes a good deal of time and energy is drafting. It is one thing to think of the correct answer to the taxpayer's question. It is another to draft that answer in a manner that correctly covers the issue but that does not inadvertently rule on some other matter as well, perhaps erroneously.

Attention to procedures can enable difficulties in this area to be mitigated. One possibility is to require taxpayers to accompany their applications with a draft of the ruling that they hope to see. The draft may be amended, or wholly rejected, by the rulings authority. But in many cases a good deal of time will be saved. Where applicants want to keep secret their identity and any commercial information that is disclosed in their application, they could be asked also to lodge purged drafts, with identifying information removed.

5.30 Fees

In Sweden and Canada taxpayers are charged fees for rulings that they request. There are no fees in the United States: rulings are provided as a service to the public. The New Zealand binding rulings procedures are subject to

fees, set by the Commissioner of Inland Revenue. The Income Tax (Determinations) Regulations 1987, regulation 11, requires the Commissioner to ensure that as far as possible the fees that are set cover both fixed and variable costs of administering the rulings system. There are no fees for non-binding rulings in New Zealand.

One problem with fees is that, if rulings are published and are relied upon by other taxpayers, it may be thought unfair that the person who obtained the ruling should bear the whole cost. However, it should be borne in mind that this is effectively what happens with tax litigation. Test cases are frequently fought out by individual taxpayers at considerable expense, to the ultimate benefit of the taxpaying public in general or, at least, of certain sectors of it. The cost of obtaining a ruling would be unlikely ever to approach the costs of even relatively simple tax litigation.

During the mid-1980s there was some discussion in New Zealand as to whether it is appropriate for a government department to charge fees to taxpayers for giving them its opinion on the law under which the department operates. This question is no longer an issue in New Zealand, and it may be expected that the general rulings process that is to be instituted in 1993 will be on a full-cost recovery basis.

5.31 Establishment of a Rulings System: Administrative Action

If it is accepted that a procedure for giving binding advance rulings should be grafted onto a tax system, the question arises as to how this should be done. There are two alternatives: legislation and administrative action. The Canadian rulings system was instituted by administrative action. In response to recommendations by the 1966 Royal Commission on Taxation, Revenue Canada determined unilaterally to put in place a rulings system. Rules of practice and procedure were drawn up and distributed to

the taxpaying public and their advisers by departmental circular.

5.32 Constitutional Foundation of Systems that Depend on Administrative Action

The original legal basis of the announcement by Revenue Canada was not strong. Strictly speaking the Canadian law as to advance rulings is the same as the law in the United Kingdom and New Zealand. That is, the liability of a taxpayer is set by legislation. The function of revenue officials is simply to quantify that liability. Consequently, officials cannot be bound by their prior expressions of opinion whether or not those expression are stated to be rulings.

Be that as it may, as a matter of practice if the revenue chooses not to reverse its prior rulings they will simply stand. Accordingly, the authority of the Canadian system is based on an announcement by Revenue Canada that rulings once given will not be reversed, save in cases of certain specified exceptions. These include retrospective legislative changes and a discovery that the taxpayer has misrepresented or suppressed relevant facts in obtaining a ruling.

The public acceptance in Canada of a system based on rulings that are in the end unenforceable may well have been influenced by the fact that a similar system already existed and worked reasonably well in the United States of America. The shaky theoretical basis of the Canadian system does not appear to have caused significant problems.

Nowadays, the foundation of advance rulings systems that are based on administrative statements, policy and practice is, jurisprudentially speaking, becoming increasingly sound. This development has come about since the House of Lords held in *Preston* v *Commissioners of Inland Revenue* [1985] AC 835 that the evolving doctrine of

administrative law that unfairness that amounts to an abuse of official power is subject to judicial review applies in tax cases as well as in other areas of official action. *Preston*'s case has since been followed in *R* v *Commissioners of Inland Revenue* ex parte *MFK Underwriting Agencies & Ors* (1989) 62 TC 607, which involved an attempt to hold the Revenue to a ruling that it had allegedly issued. The attempt failed on the facts, but the court was clear that in a suitable case the court had a discretion to restrain the Revenue from a change of mind. Recently, there has been a suggestion that the New Zealand courts might similarly enforce a ruling, at least where it amounts to something akin to a contract with the taxpayer concerned: *Brierley Investments Ltd* v *CIR* [1993] 15 NZTC 10,075 McGechan J.

In the *MFK Underwriting* case, the court specified the context and preconditions that have to be met for a ruling to be binding on the Revenue: the ruling must have created an expectation as to the Revenue's future conduct, and the Revenue would have to have so conducted itself that it would be an abuse of its powers and unfair not to give effect to the legitimate expectation that had arisen. In such circumstances the courts could, in their discretion, grant relief by way of judicial review. In order to rely upon a statement of the Inland Revenue, a taxpayer must give full details of the specific transactions and the nature of the ruling sought from the Inland Revenue. The inquirer must also make it plain that a considered ruling is sought and an indication should be given as to the use to which the ruling will be put. The ruling or statement relied upon should be clear, unambiguous and devoid of relevant qualification.

The facts of the *MFK Underwriting* case were held not to satisfy these tests but most, if not all, rulings issued pursuant to the processes ordinarily followed by Revenue Canada would do so. *Preston* and *MFK* would no doubt be most persuasive authorities in Canada; so it is possible that what started as a voluntarily binding system is now in fact

binding in law. If the United Kingdom were to establish an advance rulings procedure by administrative act, one would expect that the rulings to be issued would be similarly binding.

5.33 Legislation

Likewise, it would be possible for the New Zealand Department of Inland Revenue to adopt the same approach as Revenue Canada. In fulfilment of the government's policy mentioned above and announced in the 1992 Budget, the Commissioner of Inland Revenue could simply announce that henceforth he will be bound by advance rulings obtained pursuant to a procedure that he would specify. Be that as it may, the better course is for a binding rulings procedure to be established by legislation, and that it is the course that is to be followed. There are several reasons.

First, New Zealand has a strongly established history of judicial statements of the principle that the Commissioner of Inland Revenue cannot bind himself for the future, probably more so than has been the case in either Canada or the United Kingdom. Since 1985 these statements must be read in the light of *Preston* v *Commissioners of Inland Revenue*, but it would be a major step to base a systematic programme of administrative rulings on developments in judge-made law. Further, there is the Commissioner's reiteration of the principle that he cannot be bound by his rulings in his *Public Information Bulletin* published in 1982, referred to earlier in Section 7 of this paper. Consequently, it is likely that an advance rulings system established simply by administrative action would not immediately command the same respect in New Zealand as in Canada.

These factors are not so strong in the United Kingdom as in New Zealand, but they should be taken into consideration. Second, and more important, however, there are

serious questions of constitutional principle involved. It is undesirable for departments of state to be seen to be acting contrary to the law (that is, in this case, making and cleaving to rulings that turn out to be wrong) even though they may do so for the benefit of members of the public. It is far better for the law to be changed by legislation. The institution of a binding advance rulings procedure is a significant constitutional change for any tax system. Such a change should be made by Parliament.

Another significant advantage of legislative rather than administrative action is that administrative action could not confer a right of appeal. Appeal rights would enhance the acceptability and quality of a rulings procedure. It would be regrettable if a procedure were established without such rights. Further, if it were decided that rulings should be made in the first instance by an independent authority and not by the Board of Inland Revenue, legislation would be necessary to establish that authority. The appropriate form of the necessary legislation would probably be an additional part inserted into one of the taxation Acts.

Finally, arguments in favour of an advance rulings procedure apply also to liability for capital gains taxes, estate duty and other capital transfer taxes and value added tax. If an advance rulings procedure is instituted for income tax the same procedure should be extended to other taxes. This could probably be achieved more elegantly, and could certainly be achieved with more constitutional propriety, by legislation than by separate administrative decisions.

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CHAPTER 6
Compliance Costs: The Need for Reappraisal

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6.1 Introduction

Compliance costs have been defined as those costs which are associated with complying with the requirements of a tax system, over and above the actual payment of tax. Sometimes described as the "hidden costs of taxation", they can be incurred directly by a taxpayer, or indirectly by a third party. They do *not* include the administrative costs of taxation: these are public sector costs which are borne by the taxation authorities. Despite this fact, compliance costs can be substantial and it is increasingly being recognised that they should be accorded serious consideration when evaluating any changes to the tax system.

An important and at times overlooked aspect of compliance costs are the fees that are paid to tax practitioners for the professional advice that they provide. These individuals are often, although not always, taxation specialists who may belong to one or more of the professional bodies, such as The Chartered Institute of Taxation or the Tax Faculty of the Institute of Chartered Accountants. Their numbers include lawyers, accountants and ex-Revenue employees. They act as agents for taxpayers and negotiate with the Revenue authorities on behalf of their clients. Indeed, such is the complexity and length of our current tax legislation that it has become increasingly common for larger companies to have their own in-house tax departments, staffed by tax practitioners.

The purpose of this discussion is to outline the initial results of a research project which aims to identify any

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unnecessarily high non-discretionary costs of tax compliance associated with the UK tax system. The research has been sponsored by the Research Board and the Tax Faculty of the Institute of Chartered Accountants in England and Wales, and a full report of the findings will be published towards the end of 1993 (Green, 1994). As part of the project, a detailed questionnaire was sent to all the tax practitioners who were members of the Tax Faculty. Some interesting results have emerged and the main findings are discussed below.

6.2 The Survey

Most surveys relating to our tax system have concentrated on the views of taxpayers as opposed to their agents. By addressing our questions to tax practitioners, we were able to draw on their specialist knowledge of tax law and computations and to ask them detailed questions about the impact that both technical aspects of the legislation and the administration of the tax system have on compliance costs. We were also able to ask the respondents to consider the effects that potential changes to the basis of assessment of UK taxation might have on the compliance costs that they pass on to their clients. The detailed responses that we received suggest that the practitioners were successful in being able to apply their experience of our current tax system to assess the potential impact of these changes in a way which it would have been difficult for the average taxpayer or "the man in the street" to do. The initial findings have been fully discussed with the Inland Revenue and the Contributions Agency, whose sustained interest in the project has been very encouraging.

The questionnaire, which was 64 pages long, was sent out in the Autumn of 1992. The response rate was 25 per cent, with some 1,500 completed surveys being returned for analysis. An indication of the degree of concern that is currently felt by practitioners about the magnitude of

compliance costs is given by the number of unsolicited extra comments appended to many of the questionnaires. These gave many detailed examples of instances where unnecessarily high compliance costs were incurred. Indeed, on a number of occasions, it was claimed that these additional costs were considered to be so unjustified that they could not be fully billed to taxpayers, but had to be written off by the professional adviser.

Profile of respondents

One of the factors which gives weight to the findings of the survey is the profile of the population who were questioned. All of the individuals who completed the questionnaire were qualified Chartered Accountants who had joined their Institute's specialist Tax Faculty, and 20 per cent of them were also members of The Chartered Institute of Taxation. The level of experience of those who responded was impressive: two-thirds said that they had specialised in taxation for more than 10 years and 85 per cent were employed at the level of a Senior Manager or a Partner in a professional firm. Eighty-five per cent of the respondents said they enjoyed their work as tax specialists, but 70 per cent stated that they were now finding it more time-consuming than previously in keeping up to date with technical changes.

Comments on the overall tax system

There was general support for the Revenue's current proposals to issue just one statement of income for each taxpayer and to enable each taxpayer to deal with only one tax office: 80 per cent and 89 per cent of the respondents respectively stated that they thought these changes would reduce compliance costs. Many practitioners felt that compliance costs are unduly high at present when a client's affairs are dealt with by officials in more than one location,

or when they are transferred to a new district. As one of the respondents commented:

> The transfer of files from one tax office to another is fraught with problems and adventures. Routine matters are treated like hot potatoes with each district denying responsibility. This often creates expensive, time-consuming telephone calls and costs cannot be passed on to clients. You can spend all day just getting a district to accept that it is responsible for a case.

Moreover, two-thirds of the respondents said they felt that the restricted set-offs of income from different sources (i.e. the existing loss relief rules) increased compliance costs; and 73 per cent said the same about the various bases of calculation that exist under the schedular system for different sources of income. These figures are important as there are currently no plans to abolish the schedular system which underlies the UK tax legislation so that, despite the moves towards an administrative system which is based on self-assessment, it seems likely that these features of the legislation will persist, together with the associated relatively high compliance costs.

Detailed questions were asked on the tax practitioners' views about Inland Revenue staff. On the whole, the results were encouraging, with 84 per cent of the respondents saying that they thought the staff were helpful and 88 per cent saying they thought they were polite. However, there is clear room for improvement as only 36 per cent found them to be efficient and only 38 per cent felt they were sufficiently knowledgeable about technical issues. Of course, these findings may reflect the Revenue's own difficulties in keeping all levels of their staff up-to-date with the complexities in the tax legislation, a problem which the tax practitioners themselves have readily acknowledged.

Questions were also asked about dealings with different levels of Revenue personnel, and once again a clear picture

emerged, with particular concern being expressed about the technical competence of those below Inspector grade, together with the Collectors of Taxes and the staff from the Accounts Offices in Shipley and Cumbernauld. One respondent commented that, "things are so bad that dealings with the staff at Shipley often reach the stage of harassment".

Indeed, 74 per cent of the respondents said that they did not feel that there is satisfactory communication between the Inspectors and Collectors of Taxes at present. Given these findings, it is encouraging to note that this problem has now been acknowledged by the Inland Revenue and it is intended to merge the Revenue's collection and assessment functions, even though it may take up to 10 years to achieve this. It is certainly the case that the pilot experiments that have been carried out have been generally well received by the respondents to the survey.

Practitioners have also welcomed many of the other attempts by the Revenue to reduce compliance costs. The 28-day turn-round target for post, the introduction of the *Tax Bulletin* and the increase in pre-legislative consultation were all acknowledged as being particularly helpful for tax practitioners, while the simplification of Revenue forms and the use of mobile tax enquiry centres were considered to be of direct help to taxpayers in reducing their compliance costs.

Specific questions about personal taxation

This section of the survey was completed only by practitioners who frequently dealt with personal taxation. In general terms, the compliance costs associated with the particularly complex areas of Schedule D Cases I and II were identified as being relatively high for both sole traders and partnerships, with 72 per cent and 87 per cent respectively of the respondents stating that this was so.

More detailed questions showed that over 80 per cent of the respondents felt that compliance costs could be reduced if the legislation dealing with the interpretation of office or employment were to be modified or simplified, in the context of determining whether a taxpayer is assessable under Schedule D or Schedule E. Similarly, the interpretation of the rules governing the taxation of benefits in kind, the definition of plant and machinery for capital allowance purposes and the deductibility of expenses under Schedule E were all heavily criticised as being far too complex. Eighty-six per cent of the respondents said they thought the wide range of time limits, which currently applies to different areas of the personal tax legislation was unnecessary, and 69 per cent said they thought compliance costs would be reduced if this range could be reduced.

Of further interest in this part of the survey was the response to a question about the Revenue's specific attempts to reduce compliance costs for the smaller business. These have included such moves as the introduction of a PAYE starter pack and allowing quarterly payments of tax due. Fifty-nine per cent of the respondents said that they did not think these changes had actually reduced compliance costs. The following comments were typical of those received: "The small business changes are a mere sop to political conscience. Businesses are still expected to get it right without reward and are heavily penalised for failures"; and "The moves that have been introduced were designed to help the tax offices and not the taxpayer".

Given that many researchers have shown the incidence of compliance costs to be regressive and taking into account the priority that the government is currently placing on deregulation, this is clearly an area of concern for the Revenue authorities. Even if they *are* successfully reducing the burden of compliance that is borne by the

smaller business, our findings suggest that they are not perceived as doing so by the majority of tax practitioners.

Specific questions about corporate taxation

Once again, this section of the survey was completed only by those practitioners who said they spent a significant part of their time dealing with corporate clients. The general level of satisfaction with the Revenue's corporate tax staff was relatively high, both in terms of their overall efficiency and technical competence, and when compared with staff who specialise in personal tax cases. However, many respondents gave examples of time-consuming and, in their opinion, unnecessary negotiations about complex areas of accounting practice and commented that they felt some Inspectors were out of touch with commercial reality. This was perceived as particularly problematic where tax offices were geographically distant from the practitioner's client. There was a widely held view that, "Remote districts are not successful – they are not sympathetic to local conditions".

These factors were seen as giving rise to high costs of compliance which were then billed to clients. However, as with personal taxation, it was the complexity of the underlying tax system which was felt to account for the major share of unnecessary compliance costs. The rules governing Schedule D Cases I and II were again identified as having relatively high costs associated with them, as was the legislation concerning advance corporation tax and time spent in dealings with the Share Valuation Office of the Inland Revenue. There was strong support for the suggestion that compliance costs could be reduced if agents were to be allowed to sign elections on behalf of their clients, although many respondents acknowledged that they would not automatically take advantage of this, due to the potential problems associated with professional negligence claims.

Specific questions about National Insurance

The 550 respondents who completed this section of the survey were particularly critical of the unnecessary compliance costs which they frequently pass on to their clients. These were associated with technical factors, such as the current differences between income tax and National Insurance (NI) definitions of earnings and expenses and with the current administration of national insurance contributions. This is the responsibility of the Contributions Agency (CA), which has now been in existence for two years. The Agency's aims include ensuring compliance with the law relating to NI contributions, maintaining NI records for individuals, and providing an effective service for both individuals and government departments. It is in the areas of administration and staff competence that the CA came in for most criticism, with frequent comments such as: "in general, the level of competence in DSS offices has remained pitifully low" ; and "the quality of staff is too low to deal with what is expected of them ..." . Eighty-three per cent of those who responded said that they thought the collection of NICs now relies too heavily on DSS practice. The main method of communication for this practice is via the *Green Book* (NI 269). The practitioners felt that CA staff rely far too heavily on this publication, so that any queries that are not dealt with explicitly within its covers are often left unresolved, or are answered inconsistently from one CA office to another.

Once again, many made the point that compliance costs could be substantially reduced if more consultation could take place before changes are introduced. Particular problems occur because the Agency seems reluctant to deal directly with tax practitioners, so that the following comment is typical: "We still have the recurrent problem that they insist on writing to our client rather than us. This causes delay and frustration".

In contrast to the Agency, the Inland Revenue should be relatively pleased with the outcome of this section of the survey. Many of the respondents added comments referring to their relative efficiency and it has even been suggested that the administration of National Insurance could be moved over to the Revenue in order to bring about a saving in compliance costs. As one practitioner said:

> The Agency concept itself has had no impact so far. What is needed is a staff who know the law and are able to interpret it reasonably and flexibly. Why not abolish the Agency, save the salary costs and let the more efficient Inland Revenue do the job?

The move towards self-assessment

While there was overall support for the introduction of pay and file for companies, many practitioners also voiced concern about the potential impact of such a change on compliance costs. No real problems were anticipated with the time limits incorporated in the pay and file system, either in terms of audited accounts being available by a company's filing date or the corporate tax liability being estimated by the payment date. It was widely acknowledged that: "For the slow and inefficient clients pay and file will necessitate a significant change of attitude" but this seems to be welcomed by the majority of practitioners, who perhaps see an opportunity to improve their clients' systems and hence charge them an additional fee! However, widespread concern was expressed about two points, both in the specific context of pay and file and in relation to the more general questions that were asked about self-assessment. The first of these was in relation to the potential imposition of penalties, where the following comments was typical: "I fear that standard penalties will be levied without discretion for error cases, as with VAT".

The second reservation again comes back to the underlying complexity of our tax system. Many practitioners

expressed concern about their clients incurring penalties as a result of genuine misunderstandings or ambiguities in the legislation. As one said:

> The Consultative Document [on a Simplified System for Assessing the Self-Employed] did not include any proposals for agreeing difficult items of income and expenditure which may or may not be taxable. It assumes tax is black or white. There will be enormous compliance costs if a subsequent enquiry treats as taxable an item which the taxpayer had honestly assumed was not.

In summary, the potential move to a system of self-assessment was generally welcomed in principle, with almost unanimous support expressed for the removal of the current assessment system. Many saw the introduction of self-assessment as an opportunity to increase "the public's awareness of their tax position", commenting that most UK individuals have "little or no knowledge of our tax system at the moment". However, this enthusiasm was tempered with caution on the basis that "Self-assessment is incompatible with the present complex and largely illogical UK tax system".

6.3 Conclusion

The importance of compliance costs is often underestimated, especially when tax reforms are under consideration. It follows that such costs are especially relevant at the moment, given both the introduction of pay and file for companies and the proposals to introduce simplified assessing for individual taxpayers. Taken together, these changes clearly herald a move towards self-assessment and they must be among the most fundamental reforms to our tax system this century. However, their effect on compliance costs is, to say the least, uncertain and many of the practitioners who completed our survey suggest that these costs may increase. This is especially likely if the

problems which arise from the underlying complexity of our legislation, together with the legislative process itself, are not imminently addressed.

As one tax practitioner commented, "Most MPs have no understanding of the tax legislation which they support. My feeling is that the whole of the legislative process needs revising before any real savings of compliance costs will be possible".

This view is significant when we consider the ever-increasing complexity of our tax law. The 1993 Finance Bill was once again unacceptably long and, despite the Revenue's efforts to undertake increased pre-legislative consultation, the drafting of many of its clauses still gave rise to widespread criticism from tax practitioners. Two obvious examples of the sorts of ongoing problems are found when we consider the recent introduction of new legislation on foreign gains and losses and the Revenue's intention to legislate in the January 1994 Finance Bill to allow a new class of international holding company to pay dividends from foreign source income without having to account for ACT.

The apparent haste to enact legislation in such cases, without allowing sufficient time for full consultation with tax practitioners about draft clauses, can only result in continuing problems. This is immediately obvious when tax practitioners and taxpayers try to apply the new rules to a practical situation. There is uncertainty as to their correct interpretation, with the result that many taxpayers will be unsure where they stand until further, clarifying regulations have been issued. This situation can only increase the costs of compliance and, in the extreme, may lead to commercial transactions being postponed or abandoned altogether.

We have heard much about the pressing need for introduction of some form of advance rulings to coincide with the moves towards self-assessment. We have also heard about the Inland Revenue's laudable attempts to

rationalise its own operations in order to enable it to administer the tax system more efficiently. If successful, these changes will hopefully have the indirect effect of reducing some of the compliance costs that are incurred by taxpayers. However, administrative changes such as the merging of the collection and assessment functions, and the introduction of the executive office structure, cannot go far enough on their own. It is only if we attack the more fundamental problems which stem from the complexity and uncertainty of our legislation that we can be sure that the ongoing reforms will have a beneficial effect on the overall costs of tax compliance.

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PART II
INTERNATIONAL ISSUES FOR TAX ADMINISTRATION AND ENFORCEMENT

CHAPTER 7
Europe and the Growth of Multinational Enterprises

Donal de Buitleir*

7.1 Introduction

The development of Irish tax policy has been substantially influenced by the work of the Institute for Fiscal Studies, perhaps not as much as I would have liked but at least in ways that have proved beneficial for both the Irish economy and the Irish taxpayer. The theme of the conference is "Striking the Balance", which I think is particularly appropriate. The logo of the Irish Revenue Commissioners features the statue of Justice (blindfolded) overlooking Dublin Castle. This reminds our administrators of their objective and possibly of the difficulty of attaining it!

7.2 Background

I have been asked to speak about international issues for tax administration and enforcement. As economic integration increases these issues become more relevant. At present, the foreign trade ratio (exports plus imports as a per cent of GDP) is 115 per cent for Ireland and 50 per cent for the UK. It is clear that these ratios will grow over the next decade and that more and more firms will be involved in cross-border activity. As a result, the impact of tax administration and enforcement will be affected to a greater degree by a combination of European Community regulations and the tax systems of the many jurisdictions, both European and non-European, involved.

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International tax issues are more significant for small countries than for larger ones. Clearly a UK-based business can grow to a much larger scale without becoming involved in cross-border activity than an equivalent and competing Irish business since the UK economy is over 20 times larger.

Small countries and trading nations have a great interest in creating a genuine European Single Market. In this environment, the UK may need to look more than it has in the past to Europe to protect its interests in the international trading system. As the EC comes closer to a true single market through progressive erosion of physical, technical and fiscal barriers, tax distortions which remain become increasingly important. This makes the topic of this conference particularly timely.

7.3 Administrative and Compliance Issues

The Ruding Committee noted that the existing tax differences between Member States also have administrative implications in a single market. The most important problems arise in the areas of compliance costs and uncertainty.

Compliance costs

The greater the difference in the tax rules of each Member State, the higher the overall costs of compliance. These can be onerous for small and medium-sized businesses as well as for small investors, thus discouraging them from making cross-border investments.

On the other hand, the empirical evidence arising from the survey of European business conducted on behalf of the Ruding Committee suggested that compliance costs were not an important determinant of investment location decisions, though they did have a greater impact on companies' financial and legal structures. Eighty-seven per cent of respondents replied that compliance and tax plan-

ning costs are less than 3 per cent of domestic source income, and 85 per cent also replied that such costs for foreign source income were less than 3 per cent of such income. As a result, the Ruding Committee concluded that, "The costs of complying with the complexities of international taxation are not substantially greater than the costs of complying with domestic taxation. This strongly suggests that there would be relatively little gain in economic welfare from simplifying international taxation just in order to reduce such costs".

This picture did not vary very much with the size of the firm of the respondent. Although there is some indication that compliance costs represent a slightly lower proportion of income for larger companies, the differential between compliance costs on foreign-source income and domestic-source income is roughly constant across different sizes of firm.

This does not mean that compliance costs are not important. Taking a 33 per cent tax rate, a compliance cost of 3 per cent of income represents a compliance cost of 9 per cent of tax collected. If we assume an effective tax rate of 20 per cent, the cost rises to 15 per cent. These figures are not negligible and suggest that economic welfare would be increased significantly by changing to simpler tax systems.

Certainty

Perhaps a more important problem for business is the lack of certainty surrounding Member States' tax rules (Smith's *Second Canon Wealth of Nations,* Book 5, Chapter 2, Part 2). This arises not only because of frequent changes in tax law and its interpretation but also as a result of the interaction between taxation and inflation and differences in inflation rates among countries. An additional source of uncertainty with respect to cross-border activities is the fact that Member States can unilaterally adjust transfer

prices on intermediate products and services flowing across borders within a multinational firm and that these adjustments may not be offset by a corresponding change by another Member State. The EC Arbitration Convention is designed to address this problem.

7.4 Transfer Pricing

Transfer pricing is a major international issue. I use the term in a neutral way merely to describe the fact that transfers of goods and services between related parties have to take place at some appropriate price. Because the goods and services are transferred from one body to another under the same control there is scope for manipulation by some taxpayers on one side and for adjustments by tax authorities on the other. While precise figures on the volume of transfer pricing are not available, the Ruding Committee suggested that the volume of transfer pricing between EC countries might amount to £250 billion with a further £350 billion between the EC and the Rest of the World. To this amount must be added payments for service, interest, royalties, licences and know-how fees. Finally, transfer pricing investigations often have to consider missing factors, for example, the price of an interest-free loan or the failure to contribute to research and development costs.

The arm's length principle, which is the main principle governing transfer pricing practices, is not always easy to implement in practice.

Arm's length versus formula apportionment

Under the arm's length approach, the objective is to arrive at what would have been the price paid between unrelated enterprises; under formula apportionment, the view is taken that with certain integrated transactions between multinational enterprises, traditional arm's length meth-

ods are not feasible from a technical point of view, and the formulae therefore seek to fix transfer prices by reference to predetermined formulae based on the respective costs, turnover, employment or various combinations of these factors.

The Ruding Committee considered the issue of adopting formula apportionment for transactions within the Community while continuing to use the arm's length principle for transactions with non-EC countries. It concluded that there is no case for introducing a system of formula apportionment within the Community in the foreseeable future, and rejected the use of formula apportionment, except in the relatively rare case where no arm's length price is available or could be ascertained by traditional methods, for example, in the case of unique intangibles or global trading arrangements. This robust conclusion was arrived at under the guidance of the Chairman who was particularly concerned about the possible abuse by certain elements of the US Congress of a more measured conclusion. However, the Committee did suggest that the introduction of an allocation system on an optional basis for enterprises might be reconsidered when a much higher level of integration between Member States is achieved, in particular, when group treatment has been introduced for enterprises located in different Member States. It is clear that this is some way in the future.

Transfer pricing as an issue will therefore grow and so will disputes between companies and Member States. This is a great waste of resources of intelligence and enterprise in what is a classic zero-sum game. The solution put forward by the Community is the adoption of the Arbitration Convention.

The Ruding Committee urged all Member States to ratify the Arbitration Convention and recommended that the EC Commission, together with Member States, take action to establish appropriate rules or procedures con-

cerning transfer pricing adjustments by Member States (phase 1).

The EC Commission has endorsed both these recommendations. At present only Denmark and France have ratified the Arbitration Convention. Although it was initially intended that the Convention would come into force on 1 January 1992, this has not been achieved. The Convention will come into force on the first day of the third month following that on which the instrument of ratification is deposited at the Office of the Secretary-General of the Council of the European Communities. For that reason it may take a considerable time before the Convention will enter into force.[1] To avoid a long delay it would be useful if those Member States which have ratified the Convention could agree on a mechanism to bring it into effect to cover transactions between them. This would put firms operating in countries which have not ratified the Convention at a disadvantage and generate pressure to speed up the ratification of the Convention.

7.5 Advance Rulings

The problem of double taxation arising from transfer pricing disputes could be alleviated if EC Member States instituted a procedure of advance rulings which could be extended to cover inter-firm pricing of centrally incurred costs.

A system of advance pricing agreements has been introduced in the United States. While these are at an early stage, experience suggests that the compliance costs may be high and that such agreements are suitable only for large companies.

Another possible solution would be for national tax administrations to consult each other through an ad hoc

[1] [*Editor*: The Convention came into force as between the then 12 Member States of the Community on 1 January 1995].

procedure prior to any profit adjustments. This could be facilitated by the development of simultaneous and joint controls of related enterprises. Such procedures would reduce the uncertainty as well as double taxation arising as a consequence of such adjustments.

Another possibility is that we draw on the experience of an economic and monetary union with which we are all familiar; that of the United Kingdom and the Republic of Ireland between 1922 and 1979. Under that union there was a joint tax administration known as the Conjoint Office. This was established in London and was staffed on an equal basis by Irish and UK officials. Its purpose was to resolve, under double tax arrangements, the tax affairs of persons who for a particular year or years were resident in both countries. Under the double tax agreement concluded in 1976, the concept of double residence was eliminated and the Conjoint Office was phased out.

The question arises as to whether or not we should consider establishing a similar type of office at European level, staffed by tax inspectors from the Member States, to resolve difficulties regarding the tax affairs of multinationals with pan-European operations.

7.6 Thin Capitalisation

Most corporation tax systems do not treat debt and equity equally and this provides an incentive for firms to load the financial structure of their foreign subsidiaries in favour of debt (the interest on which is tax deductible) and against equity (the dividends on which are not allowed for tax purposes). If unchallenged, this artificially reduces the foreign tax below what it would be if the enterprise were an independent entity.

Tax administrations are now looking critically at the issue of capitalisation of companies and may disallow a deduction for interest on shareholder loans in excess of

certain limits. This creates a degree of uncertainty which is undesirable.

The Ruding Committee considered that there should be some rules to define thin capitalisation. The EC Commission has endorsed the recommendation of the Committee, inviting it to take action to co-ordinate a common approach to the definition and treatment of thin capitalisation with the Member States (phase 2). The implementation of this proposal would be very useful for business in that it would allow much greater certainty than exists at present. In addition, greater uniformity in both defining and dealing with thin capitalisation would level the playing field within the Community.

Thin capitalisation can be the issue that gives rise to transfer pricing adjustments. Early guidelines on this would be very beneficial and lead to the smoother operation of procedures under the Arbitration Convention by reducing areas of uncertainty and dispute.

7.7 Protection of Tax Revenue

As long as there are restrictions on the movement of people, goods, services and capital, governments find it easier to protect tax revenue. When factors are free to move, the position alters radically. Governments become much more constrained in the taxes they can impose and collect.

This is particularly true in relation to capital. Imposition of taxes on capital may induce a flight of capital unless there are similar taxes in alternative jurisdictions. It is argued that until there is wide international agreement about the taxation of interest – at least between the economies with regulations to protect the investor – there cannot be a common withholding tax in the EC without damaging the European economy.

The alternative to deduction at source is exchange of information. If the tax authorities can find out that money

is invested in other countries, they can at least pursue the taxpayer. However, "confidentiality" can provide competitive advantage as one jurisdiction vies with another to attract capital. Agreement on this issue may be even more difficult to achieve than on a withholding tax on deposit interest.

Despite all this, EC Member States have certain common interests, however much they compete with each other. The first is that the removal of barriers, desirable for political, social and economic reasons should not lead to a massive haemorrhage of tax revenue from any Member State. Second, the abolition of frontiers should not confer even greater advantage on criminals, including perpetrators of tax fraud. Third, the regulatory systems imposed to deal with the first two situations must not be so complex, restrictive and opaque that they handicap genuine European business in its international trading or force it to transfer the bulk of its operations outside the Community.

7.8 Taxation of Capital Income

Following the German government's decision to abolish their 1989 withholding tax of 10 per cent on deposit interest paid to residents because of a flight of capital to places such as Luxembourg, the EC Commission's proposal for a 15 per cent withholding tax on such interest has been informally "laid to rest", although not actually withdrawn. Even if agreement could be reached at EC level, it is not clear that this would be effective in that the result could be to precipitate a flight of capital to non-EC countries.

Despite the Commission's willingness to reduce the rate to 10 per cent, the prospects of an agreement at EC level on a common withholding tax are remote.[2] The prospect we face is that taxation of interest will become a

[2] [*Editor:* The attempt at progress in this area was effectively abandoned in 1994.]

voluntary payment in the absence of effective exchanges of information by tax authorities. This has serious implications for both the equity and administration of the tax system. Tax administrators since Addington have appreciated the great advantages of deductions at source. While I believe that taxation of nominal interest payments is unfair, particularly when other parts of the tax system are indexed, it clearly goes too far to have little or no taxation of interest if we continue to aspire to comprehensive taxation of income. The virtual elimination of interest income as a source of tax revenue leads inevitably to higher taxes in other areas or lower public spending, or both.

7.9 Exchange of Information

Most double taxation agreements include an article allowing exchange of information between the tax authorities of the two countries. Exchange of information articles are always restricted so that there is no requirement on the states involved to do things which are not covered by their national laws or administrative practices, nor to supply information which is not obtainable in the normal course of their administration. There is no requirement to provide information which would disclose commercial secrets or give information if this would be contrary to public policy.

Tax authorities are not normally under any obligation to inform the taxpayer concerned when information is exchanged. Thus, despite the restrictions on the information which may be passed to another tax authority, a taxpayer is, in practice, unable to enforce these restrictions when he or she is not given details of the information disclosed. While tax authorities may refuse to pass on commercial secrets, they may not always be in a position to recognise when information of this nature is being requested.

Traditionally, Revenue investigations of taxpayers often invite the taxpayer to reconsider the accuracy of returns

and suggest that the Revenue is in possession of unspecified information which shows that these have not been wholly accurate. This approach works in that taxpayers often reveal facts about their affairs of which the Revenue were not aware. Despite this I believe that the time has come to review the practice of not informing the taxpayer when information about personal affairs is being supplied. The context in many societies has changed and citizens are becoming increasingly concerned about the amount and accuracy of information maintained about them by organisations in both the public and private sectors.

The Irish Commission on Taxation in its Fifth Report recommended that:

(1) tax authorities should institute a procedure to inform the taxpayer when they are requested to pass on to foreign revenue authorities information which they hold;
(2) the taxpayer should have the opportunity of stating either that the information may be passed on, or that such information is commercially secret (supported by reasons for so regarding it); and
(3) where a dispute arises between the taxpayer and the tax authorities as to whether information is commercially secret or not, it should be decided on appeal.

It seems to me that these are sensible and reasonable proposals.

We should not always assume that it is in the interests of countries and tax administrations to co-operate fully with each other. In a world of free capital movements, unacceptably high levels of unemployment, increasing competition for internationally mobile capital investment and greater pressure on national budgets, competition between tax systems in different countries is increasing. In these circumstances tax systems and their administration become one weapon in the armoury of countries to attract

and retain resources. Other weapons include direct grants and subsidies or the promise of government contracts or banking secrecy laws. It is not easy to see how the conflicting interests in this area can be reconciled, but it is important to recognise that they do exist.

7.10 Effective Enforcement

Effective enforcement of tax laws is essential to protect the compliant business from unfair competition. Tax laws which are not enforced or are unenforceable must be changed.

There is some concern that the initial so-called "transitional arrangements" for VAT, which will allow for the free circulation of zero-rated goods in commercial trade within the Community, will create new opportunities for fraud and evasion and lead to a fall in VAT revenues. The increased risk to VAT revenues from fraud will be faced by all EC governments. It arises from the fact that for a transitional period, which will last at least until 31 December 1995, goods involved in intra-Community trade will, as is the case under the present arrangement, continue to be zero-rated on export from one Member State to another and be fully taxed in the country of destination.

Since 1 January 1993, there have been no frontier controls and checks on intra-Community trade to ensure that VAT is paid in the country of destination. Under the pre-Single Market VAT regime for intra-Community trade, an exporter in one Member State could zero-rate (i.e. not charge VAT and reclaim from the VAT authorities any VAT charged on inputs) sales of goods to traders in other Member States provided that the transactions were cleared through customs controls. On arrival in the Member State of destination, the goods were again checked through customs and arrangements were put in place (in some cases at point of entry) to charge them at the appropriate rate of VAT. The goods exported were therefore subject to tight

fiscal controls in both the countries of origin and destination.

In the Single Market these controls on intra-Community trade no longer apply. This results in new opportunities for fraud. For example, a fraudulent trader selling goods on the home market, by declaring that the goods have been sold and delivered to a trader in another Member State, can then attempt to sell them on the home market free of VAT. To counter this and other threats, new arrangements have been agreed for increased mutual assistance and systematic exchanges of information between revenue authorities in the EC.

The so-called "transitional arrangements" for VAT contrast with the original proposals made by the EC Commission in 1987. These involved the abolition of zero-rating for intra-Community trade. Goods sold from one Member State to another would bear VAT in their home country and VAT registered traders would be entitled to claim a refund from their "home" VAT authorities of the input VAT charged to them even though this may have been paid in another jurisdiction. The Commission had also proposed that a clearing mechanism would be set up to ensure that tax receipts would eventually accrue in the Member State where the goods were finally consumed. This basically formed the outline of the "origin" scheme proposed by the Commission. Its main advantage from the point of view of creating the Single Market is that businesses selling goods to other Member States would apply the same VAT procedures to them as they would to goods sold on their home national market, i.e. the goods would be sold at a VAT-inclusive price, rather than being zero-rated as is the position at present. The Member States are committed to consider moving over to this scheme in 1996. This commitment is not absolute, however. If the Member States fail to agree unanimously to an "origin" scheme, the "transitional" scheme will continue in force.

One of the major obstacles to securing agreement on the origin scheme was that the Member States lacked confidence in the ability of the clearing mechanism to allocate tax revenues correctly among the Member States in line with their consumption patterns and trade flows. No ready solution to this problem seems to be in sight. If this remains the case, the main future obstacle will continue to be doubts about the ability of the clearing system to distribute VAT revenues in proportion to consumption and tax rates in the individual Member States.

7.11 Relief of Double Taxation

An important objective of tax administrators in the Single Market must be to reduce the compliance costs of foreign investment to a level where they do not exceed those incurred on domestic investment. Only in such circumstances can a genuine European capital market be created.

The compliance costs associated with taxation may be illustrated by the experience of my own firm AIB in relation to its US Preference Share issue. This was an issue targeted at US individual shareholders to whom it was thought to be attractive because of the provision in the US/Irish Double Taxation Agreement which enabled such shareholders to receive the benefit of the Irish tax credit. In order to do this it is necessary to aggregate the cash dividend received and the tax credit when reporting gross dividend income for US federal income tax purposes and elect to credit all foreign income taxes as a foreign tax credit.

To assist shareholders to obtain the benefit of the credit, AIB prepared explanatory material which contained detailed guidelines on what forms were to be filed, and how. While it is difficult to be certain, the judgement of AIB advisers in the US is that many shareholders have not claimed the benefit of the tax credit.

7.12 EC Institutional Development

Tax systems are an element of the competitive environment in which business operates. In an increasingly competitive world, speed of reaction to changing circumstances will confer a competitive advantage to countries and their businesses. The existing unanimity rule which governs decisions on taxation in the Council of Ministers has serious disadvantages. First, it slows down the process and delays the reaching of agreements which in many cases would increase welfare in the Community as a whole. Second, it promotes a tendency towards lowest common denominator type agreements. It becomes virtually impossible to secure the optimum result from the viewpoints of efficiency and effectiveness as long as even one Member State feels, even mistakenly, that it has an interest in protecting some national anomaly. The present system puts a very high premium on the competence of national advisers and the understanding of national politicians. If any one Member State is less than satisfactory in either of these areas, all Member States suffer the consequences. Third, the existence of the veto tends to increase the power of the large countries which one would expect would be more willing to use the power. Whatever the legal position, there is a limit to the frequency with which a small country can use or even threaten to use such a power without severely eroding its goodwill among other Member States. As a result, progress on many desirable developments is held up by whatever country (or its Treasury) is being most obstructive on the particular issue. In my view, it is time to review this rule and move to qualified majority voting.

The extension of majority decisions in the Council of Ministers would, of course require an increase in the powers of the European Parliament (see appendix) to avoid the extension of the "democratic deficit" which now exists.

7.13 Conclusion

How do we strike the right balance between tax administrations and taxpayers in the international arena? In an increasingly interdependent world, tax administrations should co-ordinate their efforts to minimise tax compliance costs of international trade and investment and to take more account of the impact of their decisions on actions by other tax administrations which ultimately affect taxpayers. Enforcement will also be more difficult but necessary if compliant taxpayers are to be protected from unfair competition.

The idea that business people, administrators and policy-makers should consider the efficiency of the fiscal system as an essential element of good economic performance and social stability is worth pursuing. This is true at a national level and even more true in the jungle of international competition. If the European Community can strike the right balance, it will confer a tremendous competitive advantage on all its members.

Appendix: Powers of the European Parliament

Democratic deficit

The introduction of majority voting in the Council of Ministers under the Single European Act (1987) has reduced the influence of national parliaments. On certain matters relating to the completion of the Single Market, national governments can now be outvoted in the Council. However effective national parliamentary control may have been previously, this control is now lost. The extent to which this loss of national parliamentary control has not been compensated for by increased powers in the European Parliament, is said to have created a "democratic deficit".

Powers

The Treaty on the European Union empowers the European Parliament to operate five distinct procedures. These are co-operation, co-decision, assent, consultation and the budget.

The *co-operation procedure* was introduced in the Single European Act to complement the consultation procedure which existed previously. Under the co-operation procedure, which covers such fields as the Single Market, social policy, economic and social cohesion and technological research and development, the European Parliament was effectively given the opportunity to debate the European Council's common position and the Parliament's views now carry more weight. The Parliament was also given a role in assenting to the accession of new Member States and association agreements. This significantly increased its powers concerning the enlargement of the European Community itself and, indirectly, its foreign policy.

The new *co-decision procedure* in the Maastricht Treaty provides for a process of conciliation between the Council and the Parliament. However, the Council may adopt a disputed text even if it fails to reach agreement with the Parliament, unless the Parliament rejects the text by an absolute majority of its members within six weeks.

The *assent procedure* has been extended to cover new types of agreements, notably international agreements, a uniform electoral system, citizenship, rules governing the Structural Funds and amendments to the protocol dealing with the European system of central banks. The right to set up committees of enquiry and to receive petitions is recognised in the Treaty and the Parliament may appoint an Ombudsman to deal with complaints from any citizen of the Union concerning "instances of maladministration in the activities of the Community institutions or bodies". The Ombudsman's formal powers are limited. He has no

power to compel an institution to change its practices or to award compensation to an aggrieved party. However he reports his findings to both the European Parliament and the institution concerned.

In general, the powers of the Parliament are growing; their extent and impact will be determined in practice by the manner in which the Parliament chooses to exercise them. This is not the forum in which to explore the evolution of democracy. However, it must be noted that history supports the view that a directly elected assembly strengthens its mandate and gradually extends its powers by exploiting the relationship between its members and their electorate. This aspect of the European Parliament is more noticeable in some Member States than in others but there is an increasing flexing of the Parliament's muscle throughout the EC and the new powers will increase its leverage over the Commission and the Council. Given the vital importance of the EC budget and the implications of fiscal arrangements for economic and social policy generally, it is difficult to argue that tax matters can be left entirely to a Council of Ministers working under a unanimity rule.

CHAPTER 8
Indirect Taxation and the Single Market

Leonard Harris*

When I last attended this Conference some 10 years ago, I remember that *Accountancy Age,* with an accuracy it doesn't always display in reporting indirect tax matters, referred to me as "the diminutive Harris". My stature hasn't changed much over the past decade, but the taxes for which I have been intermittently responsible over that period have, and what I want to do first is to look at some of the ways in which UK indirect tax policy and administration has been adapting to developments in the EC – particularly, of course, the Single Market – and then look forward to where we might be going over the medium term. I shall concentrate on VAT, but I shall also have something to say about excise and, much more tangentially, customs duties.

There is a vague idea in some quarters that the Single Market was invented by the DTI at some time in 1990 or 1991, that British industry woke up on 1 January 1992 expecting Europe to be open for business, and that when they found it wasn't went back to sleep again and, in some cases, very nearly missed the real starting date of 1 January 1993. The true history is, of course, much longer and much less simple than that.

The idea of the Single Market has been an essential element in Community thinking from the very beginning. The Treaty of Rome in 1957 had as its prime objective – I quote from Article 2 – "establishing a common market and progressively approximating the economic policies of Member States", and Article 99, in its original form, laid

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down that the Commission were to bring forward proposals for harmonising legislation "concerning turnover taxes, excise duties and other forms of indirect taxation ... in the interest of the common market".

I have no doubt that some of the architects of the Treaty of Rome had at the back of their minds an orderly progression under which you first established a customs union, then removed other barriers to trade, harmonised indirect tax rates and structures, and then moved on to full economic, monetary and, eventually, political union – indeed, the preamble to the Treaty commits the heads of state to laying "the foundations of an ever closer union among the peoples of Europe". Whether the founding fathers saw tax harmonisation as an instrument of wider integration or vice versa is an open question. And the dream of removing all physical checks at the borders quietly overlooked the fact that the frontier is the natural place to exercise non-fiscal policing operations in relation to drugs, pornography and so on, particularly where the border is clearly delineated by seas or mountains.

But the founding fathers were realists first and idealists second. In spite of the firm statements of principle at the beginning of the Treaty, there are references scattered all though it to "approximation" and to harmonising to the extent necessary to achieve particular objectives. In other words, they left the door open for the Community as it developed to adjust the grand design in the light of political and economic imperatives as it went along; and that is very largely the history of the evolution of the indirect tax side of the Single Market.

The first step towards VAT harmonisation came with the First Directive on VAT in 1967 which focused on the adoption of VAT by all Member States as a means of eliminating distortion of competition in intra-Community trade, but also looked forward to abolishing the imposition of tax on importation and the remission of tax on exportation in trade between Member States. That became the

ultimate aim, at least as far as the Commission was concerned, of most of the later substantive VAT proposals. But the most important piece of Community VAT legislation between 1957 and 1991 – the Sixth Directive – was driven as much by the need to establish a partially harmonised VAT base for the calculation of Member States' budgetary contributions as it was by the vision of eliminating fiscal frontiers.

For a long time, it was tacitly assumed that getting rid of fiscal frontiers necessarily implied full harmonisation – not "unification" or "equalisation" – of all indirect tax rates and structures, or at any rate very close approximation of them. Otherwise, it was argued, scrapping border tax adjustments would lead to intolerable distortions of competition as final consumers shopped across borders to benefit from the lowest rate in the Community for particular goods and services. This was the approach implicit in the Commission's White Paper, *Completing the Internal Market.*

Unfortunately, there are two pretty massive snags to this scenario.

The first is the political reluctance of Economics and Finance Ministers – not just in the UK – to give up their freedom to tailor their fiscal regimes to the social and economic priorities of their individual Member States. This is not just an abstract constitutional principle; it is a matter of how far it makes sense to impose an artificially harmonised tax system on 12 economies which are still a long way from being harmonised. The UK's consistent approach has been not to oppose tax approximation in principle, but to argue that it should be achieved naturally as a result of competition and economic convergence.

The second practical objection to the purist approach to a Community tax regime indistinguishable in all major respects from a domestic one is that trade imbalances would mean that tax ended up in the wrong place.

Under the so-called destination system which operates for commercial movements at the moment, a French manufacturer who supplies goods to an English retailer zero-rates the supply. The retailer accounts for acquisition tax, but immediately claims an input tax credit. When he sells the goods to the final consumer, he collects the tax on the full sale price. The UK Treasury gets the lot; the French Ministry of Finance gets nothing.

Under the alternative origin system, goods always move tax paid. So, in the same example, the French exchequer would get the VAT up to and including the tax on the sale to the English retailer. The retailer would again be able to claim an input tax deduction from the UK VAT authorities, and would charge VAT on the whole of the price to the final consumer; but the Chancellor's net take would be limited to the tax on the value added by the retailer.

The end result would be that the tax revenues of Member States who were net exporters would rise at the expense of the rest. The Commission's answer to that was the Community Clearing House, which would – eventually – redistribute tax revenues between Member States so that they would end up more or less where they would have been had the basic reform not taken place. The prospect of inventing two bits of bureaucracy to cancel each other out was not an immediately appealing one.

Meanwhile, in 1987, Member States had signed up to the Single European Act which reaffirmed the commitment to the Single Market, but which significantly modified Article 99 of the Treaty of Rome so that instead of referring to indirect tax harmonisation almost as an end in itself it now talked about harmonisation *to the extent necessary* to ensure the establishment and functioning of the internal market within the time limit laid down in Article 8a – in other words, by 31 December 1992.

This shifted the focus away from the Platonic ideal of a minutely detailed harmonisation towards the construction

of a more practical model which would have most of the advantages and few of the drawbacks of the White Paper proposals.

The solution eventually adopted for VAT in 1991 after a two-year negotiating marathon was a modified destination system with some limited further rate and structure harmonisation instead of the Commission's fully-fledged origin system, subject to review at the end of the transitional period in 1996.

For the excise duties, the destination system remains for commercial transactions on a permanent basis, with a tight control of the intra-Community movements of duty-suspended goods which mirrors the close controls which most Member States already exercise over movements of these goods within their borders. This has been accompanied by the setting of minimum rates for excise duties which has not compelled the UK or most other Member States to change their existing rates.

Inevitably, the Single Market arrangements which have emerged are something of a compromise. Although the UK was not convinced of the need for further VAT rate and structure changes, we agreed to a minimum standard rate of VAT of 15 per cent for four years; the chances of the Chancellor wanting to go below that in the next four years are, of course, slim. We agreed to the abolition of higher VAT rate bands, which we don't have; and we accepted a restriction on the range of items which Member States can include in their reduced rate bands, though we don't have those either. More importantly, we protected our right to retain our existing zero-rates. So in policy terms we conceded very little of practical importance.

As far as the mechanics of Single Market VAT goes, we had four main objectives:

- keep it simple;
- reduce the burden on business;

- combat fraud; and
- get it up and running by 1 January 1993.

Again, there had to be some compromises. Getting rid of frontier controls and the associated paperwork was a plus for business, but it left the system wide open to fraud. Member States differed on what new safeguards needed to be introduced, but on the whole the UK's minimalist approach prevailed. The original proposal was for every trader making zero-rated supplies to traders in other Member States to produce monthly lists of every single purchase and sale for cross-checking between tax authorities. We got this down to quarterly aggregated lists, with further simplifications for small traders. We also need proof that the goods have left the UK and have gone to a trader registered in another EC country. This means that the supplier now has to quote his customer's VAT number. This is admittedly an extra burden on traders, but Customs have offered to help suppliers check on the validity of the numbers and, again, it is far simpler than the original proposal to make suppliers produce certificates from the tax authorities in their customers' Member States.

Other problems emerged in the course of negotiations, some so arcane that we had to spend valuable negotiating time making the Commission and our partners admit that there was a difficulty, let alone getting them to agree on a solution. One such *cause célèbre* was triangulation, where a middleman in Member State A orders goods from a supplier in Member State B for delivery to a final customer in Member State C. Under the normal VAT rules, the place of supply by the middleman is in Member State C, so he ought to be registered there. This requirement was normally waived under the pre-January 1993 system because the VAT could be accounted for in C by the customer at importation. But no fiscal frontier equals no importation tax point, so the onus falls on the supplier. We achieved a solution at the eleventh hour by securing agreement that

the middleman could nominate his customer to account for VAT, but even then disaster loomed when the Spanish failed to implement on time. In the Community ballroom, it takes two to tango, but three to triangulate, and often all twelve to complete the dance.

I won't describe in any detail the special arrangements for cars, or gold, or distance selling, or personal purchases by individuals, which is the only bit of the new system where the origin rather than the destination principle applies. Nor do I have time to enthral you with the so far unfinished business on the treatment of works of art and secondhand goods. But I think it is worth mentioning two of the most recent examples of the influence of the Community on UK tax administration, because they illustrate what may become a new dimension in the way we run our own system. They concern the VAT treatment of bloodstock and holding companies.

The details don't matter but, in the case of bloodstock, disparities in the rates of VAT levied on horses in the UK, Ireland and France, and which had previously been more or less sorted out at the border, became a real threat under the Single Market VAT regime to the continued existence of the UK bloodstock industry, at least on its present scale. One solution was to allow owners in this country to register for VAT so that they could reclaim their VAT on their expenses, in the same way as, allegedly, many French owners can. The trouble was that as racing is at present organised in the UK we had no doubt that most owners did not satisfy the business test for registration, which is fundamental to the UK and EC VAT model. As the Chancellor announced in the Budget, we eventually reached agreement with the industry that the Rules of Racing would be changed to provide opportunities for owners to earn money from sponsorship and the like so that we could then treat them as being in business and allow registration and recovery of input tax.

In the case of holding companies we concluded, partly on the basis of the European Court of Justice ruling in the case of *Polysar* v. *the Dutch Government,* that most holding companies were not in business for VAT purposes and were therefore not entitled to recover VAT on their inputs. We have since agreed in the light of some fairly powerful lobbying to put off implementation until 1 October 1993, and to review the whole position, not because we think we are necessarily wrong in law, but because other Member States appear to be adopting a less rigorous interpretation than we have.

What these two cases illustrate is that neither my Department nor our customers any longer have the luxury of sorting out our differences on a purely bilateral basis – or trilateral basis, if you include the VAT Tribunals and the UK Courts. There will be increasing pressure to avoid interpreting Community law in a way which disadvantages UK businesses. I do not want to suggest that we shall be forced to go for the lowest common denominator in every case, much less that we shall bend the law when we believe it to be clear and unambiguous. But I do believe that where there is room for manoeuvre, we may sometimes have to give greater weight to the business interest as opposed to the pure revenue interest than we have sometimes done in the past. It goes without saying, of course, that I know that we can rely on the professional advisers to respect the limits of any flexibility we show, and not to try to edge the frontiers ever further back.

Where next? In 1994 the Commission is due to produce proposals on the definitive VAT regime in time for the Council to decide in 1995 on the regime to apply after 1996. Senior Commission officials have already made it clear that they want an origin system. Ministers will have to decide nearer the time whether they are prepared to go in that direction. If the transitional system has bedded down and is working reasonably smoothly by then, businesses across the Community as well as governments will

need to be convinced that another upheaval will produce benefits commensurate with the disruption. We shall certainly need to be sure that the clearing house arrangements can be made to work efficiently and fairly, that an acceptable degree of fiscal sovereignty, including the right to keep our remaining zero-rates, can be retained, and that the principles of subsidiarity are respected. An ideological commitment to harmonisation and change for its own sake is no longer the flavour of the month, even in most Commission circles, and the Community will have to test any new proposals on the same cost–benefit basis as national governments and their professional and business communities.

1994 will also see the first biennial review of the minimum duty rates for alcohol, oils, and tobacco to see whether the wide differences in rates between Member States is causing distortions of trade in the Single Market. It is also supposed to take account of the "wider objectives of the Treaty" on things like health (in the case of tobacco) and the environment (in the case of oil). Our negotiating position here is a complex one. The UK drink and tobacco manufacturers and retailers understandably fear a major loss of business through legitimate cross-border shopping and bootlegging (except at the Irish Land Boundary, where the situation is reversed), and would like to see some convergence of duty rates. But a downward convergence would involve a loss of tax revenue to the UK which is likely to be less than welcome to the Chancellor in the foreseeable future, while an upward convergence would force up duty rates in many other Member States to the detriment of some important British exports. And, particularly in the case of tobacco, the structure of the duties can be as important as the rates in ensuring that British producers are not needlessly disadvantaged.

It is all too easy to make a description of Community negotiations sound like an elegant poker game between professional bureaucrats. If it ever was, the advent of the

Single Market must surely have made it plain that the future lies in a much greater degree of consultation at Community and national levels, both before and after proposals are brought forward. We shall keep up the momentum we established last year in consulting on draft primary and secondary legislation, and we shall look for opportunities to share in wider thinking with business and professional bodies. Occasions like this are an important element in the equation, and I am grateful to the Institute for inviting me to try to give some of the flavour of what we shall be about as the Single Market unfolds.

PART III
THE ROLE AND ATTITUDE OF THE COURTS TO TAX LAW AND PRACTICE AGAINST A CHANGING ADMINISTRATIVE BACKGROUND

CHAPTER 9
Judicial Approaches to Revenue Law

Lord Oliver of Aylmerton*

That I am deeply honoured to have been asked to address this conference goes without saying. But I am not convinced, and you, I think will be unconvinced when you have heard me, that a member of the judiciary, whether serving or retired – or, at any rate, one who was not himself a tax practitioner at the Bar – is an ideal person to undertake the task. There have been very few judges of the High Court appointed from the tax Bar in recent years – the late Lord Donovan and Lord Justice Nolan are the only two that I can immediately call to mind. Those few have been assigned to the Queen's Bench Division so that, apart from the odd judicial review such as the *Woolwich* case,[1] they are seldom called upon to adjudicate upon cases directly involving the interpretation of taxing statutes until they reach the level of the Court of Appeal. The fact is that judges on the whole – there are a few honourable exceptions whom it would be invidious to name but amongst whom I certainly do not include myself – know very little about tax as a coherent subject. They are called upon from time to time to examine under a microscope isolated points arising under particular sections of taxing statutes but few, if any, of them have any comprehensive knowledge or understanding of revenue law. The case of the *Queen* v *the Attorney-General* ex parte *ICI*[2] over which I had the misfortune to preside at the end of 1985 is a case in point. It concerned the petroleum revenue tax. I certainly – and, I am tolerably certain, both my colleagues – had never

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[1] *Woolwich Equitable Building Society* v *IRC* [1992] STC 657.

[2] (1987) 1 CMLR 72.

before heard of petroleum revenue tax. I am not sure that I understood it then, though *they* may have done; but in any event I have never had to refer to it since; and I hope that I never shall. So what can I say that is going to be of any assistance to a gathering of experts whose knowledge of and familiarity with revenue law so greatly exceeds any that I have or am ever likely to have?

What I can usefully do is to provide from the inside, a bird's-eye – and necessarily subjective – view of the shifts of emphasis that have taken place in the judicial approach to statutory interpretation (and to the interpretation of taxing statutes in particular) and of the position at which we have now arrived.

The starting point necessarily lies in the judge's perception of the function that he has to perform when he is confronted with a legislative code. This perception is to a large extent universal but almost of necessity (because judges are human beings, not computers) is also to some extent individual, though one only has to look at the careers of Lord Denning and (in the taxing context) Lords Diplock and Wilberforce and now Lord Templeman to see how a powerful intellect and a strong personality can convert an individual perception into a universal one. Law is all about the rules which society imposes upon its members for the regulation of their conduct. Elementary fairness dictates that if rules are to be imposed in an area in which there is no universal moral imperative to aid understanding, they shall be clear and unequivocal, so that the subject may know with certainty what he or she may and may not do and what are the legal consequences of any projected course of action. So the judge's initial perception of his function is that of standing between the citizen and the state to ensure that the former is not prejudiced by rules which are unclear, uncertain or unpromulgated and, particularly by administrative activity which makes up its own rules as it goes along. Hence the severely literalist approach to interpretation which has characterised the English judiciary up to the

middle of this century. The judge simply puts himself in the position of the citizen and looks at the words which the legislature has chosen to use. The citizen is to be held entitled to regulate his conduct by what the words say and by nothing more. The approach is semantic and has little or nothing to do with what an intelligent speculation might surmise that the legislature was trying to achieve. This is, of course, an approach which, in turn, provokes a predictable legislative response. As there is no room for speculation as to legislative intent, the intent has to be spelled out in greater and greater detail so as to cover every conceivable situation.

Now nowhere is that more apparent than in fiscal legislation. Take, for instance, income tax. You start with the elementally simple formula expressed by Lord MacNaghten in 1901 that "income tax is a tax on income".[3] But so simplistic an analysis cannot possibly last because nobody likes to pay a tax, even an elementally simple tax. Edmund Burke, in his speech on American Taxation in 1774, remarked that "to tax and to please, no more than to love and to be wise, is not given to men".[4] And since paying tax is just a shade more unpopular than paying lawyers' and accountants' bills to help avoiding the payment of tax, greater and greater ingenuity is devoted to making the simple complicated and more and more detailed rules are enacted to circumvent such ingenuity. The *Duke of Westminster*'s case[5] in 1935 is the paradigm and it was not, at that time, a matter of concern, much less of moral censure, that the citizen should seek to preserve his individual economic wellbeing by what one might have thought was (and what Lord Atkin, at any rate, thought to be) an

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[3] "Income tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else." *Attorney-General* v *London County Council* (1901) 4 TC 265 at p. 293.

[4] 19 April 1774.

[5] *Duke of Westminster* v *CIR* (1935) 19 TC 490.

obvious fiddle. Indeed, the legislature's failure to produce verbal formulae apt to fulfil its fiscal intentions is remarked upon almost with satisfaction. In 1933, for example, Parliament sought to levy income tax upon the annual surpluses of mutual insurance companies resulting from transactions with their members and it did so by a formula which equated them with surpluses arising from transactions with non-members, which were assumed to be taxable. In fact they were not and although the intention of Parliament was as plain as a pikestaff, the House of Lords held, in the case of the *Ayrshire Mutual Insurance* in 1946, that the words used were simply not appropriate to effect that intention, Lord Macmillan observing (with apparent satisfaction) that "the Legislature has plainly missed fire".

At this stage, there is no perception of any moral stigma attached to the artificial arrangement of a citizen's affairs in such a way as to avoid or to mitigate the fiscal burdens which the legislature has sought to impose upon him. If he can take himself outside the letter of the law, the best of British luck to him. It is no part of the judge's function to come to the aid of the revenue. And what is interesting is that, on the other side of the Atlantic, the precise reverse is happening. As early as 1921 (in *U.S.* v *Phellis*, 257 U.S. 156) the Supreme Court had determined an approach in tax matters which was the precise reverse of *Westminster*. It looked not at the legal results of the form of the transaction selected by the subject but at the "substance" (which I think means the practical end result) of the transaction. And in *Gregory* v *Helvering*[6] in 1935, the same year as *Westminster*, we find the Supreme Court enunciating the same "business purpose" doctrine which was to be imported into English law half a century later.

Well, one asks, why did the infection not spread to England at the same time? I think that the answer lies partly in the very conservative habit of thought of the

[6] 293 US 465.

United Kingdom judiciary in relation particularly to the imposition of taxation, which dates back to *Partington* v *the Attorney General* in 1869,[7] in which Lord Cairns observed that "if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute" – even more pithily expressed in that classical aphorism "there is no equity in a tax". But partly also it is due to our legal insularity in the years before we went into Europe – an event which opened up a whole new vista in statutory interpretation. Private international law was one thing, but comparative law is a study that has only grown up in England in the latter half of this century. You would not have got very far citing American cases in 1935.

It is quite interesting to see the emergence of the change, which begins to manifest itself through a judicial mouth (but even then tentatively and extra-judicially) in the 1960s and was not finally precipitated until the introduction of capital gains tax and the sheer weight of income taxation up to a level of 98 per cent had produced a veritable industry of manufacturing and selling extremely ingenious, but wholly artificial, schemes off the peg and that had grown to such proportions as to become almost a scandal.

In his presidential address to the Holdsworth Club in 1964, Lord Justice Diplock (as he then was) disclaimed having any interest in reforming tax law in these words: "It no more lies within the field of morals than does a crossword puzzle. I would rather do a crossword puzzle than try a revenue appeal. It calls for much the same mental agility and the solution is more rewarding". But although making this proclamation – and he was later to become something of a reformer (if that is the right word) – he nevertheless went on to deplore Lord Macmillan's statement in the

[7] LR4 HL 100.

Ayrshire Mutual Insurance case[8] as "judicial legislation at its worst" and he expressed the view that "if ... the Courts can identify the target of Parliamentary legislation, their proper function is to see that it is hit: not merely to record that it has been missed". That suggests a frankly interventionist approach to construction and, in the light of subsequent developments, seems to have been prophetic.

What may, for convenience be called "the new realism" begins to emerge during the mid-1970s. And it takes two forms. First, it takes the form of a realistic analysis, not so much of statutory provisions, as of interconnected transactions to see what they really do and are intended to do in the final result and then a consideration of how that result fits the statutory words. But, second, it takes the form of a "purposive", rather than a literal, construction of words in taxing statutes. Perhaps the pioneer of the former was Lord Templeman (then Mr Justice Templeman) in *Chinn* v *Hochstrasser in* 1977.[9] But it was not something which caught on all of a sudden, because two years later we find the House of Lords (admittedly with some powerful dissenting voices) adhering to the strictly *Westminster* approach in the case of *Plummer*[10] and deciding in the taxpayer's favour in the case of an obvious fiddle (in the sense of a "device") which left the taxpayer exactly where he had started. What we do find, however, in that case is the dissenting voice of Lord Diplock not only urging the need for a purposive construction of fiscal legislation but also enunciating a legitimate business purpose test as the touchstone of whether a transaction falls within the statutory words, though the test is advanced as, in itself, a matter of statutory construction. He postulated the question, "can Parliament really have intended to tax this particular kind of transaction by the wide words which the draftsman has used?" and went on, "That question when asked about a

[8] *Ayrshire Employers Mutual Insurance Association Ltd* v *CIR* [1946] 1AllER 637.
[9] [1977] STC 468.
[10] *IRC* v *Plummer* [1979] STC 793.

transaction which not only falls within the literal meaning of the words used in the section but has no other object than to enable the settlor to avoid a liability to surtax on his income which he would otherwise have been obliged to pay, so far from inviting the answer, No, invites the answer: 'Whatever kind of transaction Parliament may have intended to exclude it cannot have been this one' ".[11]

And so we find that, within another two years, the conversion has taken place. In 1981 a unanimous House of Lords restored the first instance decision in *Chinn* v *Hochstrasser*,[12] which had been reversed by the Court of Appeal. Lord Templeman, by this time Lord Justice Templeman, had already pointed the way again in the Court of Appeal in *Ramsay*,[13] but on a pure point of statutory construction as to whether the fabricated loan in that case was a "loan on security". Whilst the decision on this point was upheld, the House went for the much broader approach of analysing the chain of transactions as a whole – the first facet of what I have called "the new realism" – to determine whether, giving the word its ordinary and literal meaning, a "loss" had been sustained. What is interesting about this case is how the House continued nevertheless to pay lip-service to the *Westminster* decision (described as embodying a "cardinal principle") and slid quietly over the inconveniently inconsistent case of *Plummer* by distinguishing it on the somewhat specious ground that in that case the taxpayer had actually paid out some money (although he got it back immediately). The subsequent history is familiar. The *Burmah Oil Company* case in 1982[14] carried the new realism a stage further by importing, through the mouth of Lord Diplock, the legitimate business purpose test, thus paving the way to the

[11] *IRC* v *Plummer* [1979] STC 793 at p. 810.
[12] *Chinn* v *Collins* [1981] STC 1.
[13] *W T Ramsay Ltd* v *IRC* [1979] STC 582.
[14] *IRC* v *Burmah Oil Company Ltd*, 54 TC 200.

concept that anything done for the sole purpose of minimising a tax burden is to be treated as a "fiscal nullity". This was, I think, the first time that this had emerged in terms as part of a substantive decision. It is interesting incidentally to note that although not referred to in speeches in the House in *Ramsay, Gregory* v *Helvering* was prayed in aid by the Crown to support its argument; and that case was, of course, relied upon again, and in this case cited in the speech of Lord Bridge, in *Furniss* v *Dawson*. By a curious temporal coincidence, only four months after that case, the *Gregory* v *Helvering* approach was decisively rejected by the Supreme Court of Canada in *Stubard Investments* v *The Queen*[15] – another interesting example of divergent judicial trends in different jurisdictions.

And so we come to *Furniss* v *Dawson* itself,[16] which perhaps may be considered the high water mark of the new realism. But it was, of course, the new realism with a difference, because it really did rest upon the *Gregory* v *Helvering* legitimate business purpose test and upon the introduction not simply of a realistic analysis of connected transactions but upon the introduction into the law of a doctrine of fiscal nullity dependent solely on motive. Whereas *Ramsay* rested upon an analysis of the end result of what the taxpayer actually *intended* to do, *Furniss* rested upon a restructuring process which ended up with foisting upon the taxpayer the fiscal results of a transaction quite different from that into which he had intended to enter. And that, whatever else it may be, is not realism.

Now it would be quite wrong for me, of all people, to engage in a critique of *Furniss* which, as I must, I loyally accept. At the same time, it embodies principles and leads to results which, if extended beyond the confines of its particular facts are, in my opinion, potentially very dangerous. I, and those of my colleagues in *Craven* v *White*[17] who

[15] 84 DTC 6305.
[16] [1984] STC 153.
[17] [1988] STC 476.

were of like mind, have been charged with emasculating *Furniss.* And to an extent the charge is well founded. A general doctrine of fiscal nullity dependent upon the motive for which a transaction is undertaken leads inevitably to great uncertainty. It leads, perhaps even more importantly, to taxation by Revenue discretion – as indeed *Furniss* did. The Revenue – often a much misunderstood body – are not slow to take advantage of an opportunity to undertake the taxing role of Parliament – as indeed they attempted to do in the *Woolwich Building Society* case.[18] So where do we now stand? Perhaps your guess is as good as mine – indeed probably better.

Well, clearly *Ramsay is* here to stay; and quite right too. Any lingering doubt engendered by *Plummer* has now gone with the recent decision in *Moodie,*[19] although the House still displays a curious reluctance to say that *Plummer* was just plain wrong or to bury the largely defunct corpse of the *Duke of Westminster*'s case. At the same time, the *Ensign Tankers* case[20] establishes both that a paramount purpose of mitigating a fiscal burden is not fatal and that, insofar as a doctrine of fiscal nullity exists in relation to taxation-inspired transactions, it does not justify the ignoring of the fiscal advantages to a taxpayer of genuine expenditure incurred in the course of the transaction. And, of course, we await with bated breath the pending decision of the House in the *Fitzwilliam* case,[21] one interesting feature of which may be the question of how far the new realism approach to tax avoidance may co-exist with specific anti-avoidance provisions. If you succeed in avoiding the pitfall of the latter, may you still be entrapped by the former – a question upon which there are conflicting decisions in the Federal Court of Australia.[22] The point

[18] *Woolwich Equitable Building Society* v *IRC* [1992] STC 657.
[19] *Moodie* v *IRC* [1993] STC 188.
[20] *Ensign Tankers (Leasing) Ltd* v *Stokes* [1992] STC 226.
[21] *Fitzwilliam (Countess)* v *IRC* [1993] STC 502.
[22] *Lair* v *Federal Commissioner of Taxation* [1984] 84 FTC 4618 and *Oakley Abattoirs* v *Federal Commissioner* [1984] 84 ATC 4406.

may be material in the *Fitzwilliam* case, because the Revenue, having itself given a very limited operation to the associated transaction provision of section 268 of the Inheritance Tax Act 1984, chose there to base itself on the *Ramsay* principle.

And, finally of course, there is *Pepper* v *Hart*.[23] This may be a very present help in time of trouble for the taxpayer as it was to the Governors of Malvern School. But it has to be borne in mind that it is a two-edged weapon which, when allied to a purposive construction of fiscal legislation, is capable of working also in favour of the Revenue in an appropriate case of real ambiguity.

I have so far adverted only to what may be considered the growing willingness of the judiciary to lend itself overtly to defeating the avoidance by the subject of those fiscal burdens which the legislature has sought to cast upon him. That is the route which the Revenue has, in recent years at least, chosen to explore and has explored, on the whole, very successfully. But there is, of course, another route – that of express statutory anti-avoidance provision. The constraints of time compel me to slide over this even more sketchily; but even the most cursory consideration of the history of such legislation will disclose the reason for the Revenue's preference, for the history is, on the whole – though not universally – one of failure and of judicial resistance. Such legislation takes two forms, the specific (or "sniper") type and the generic (or "scatter-gun") approach. As regards the former, its initial failure was, of course, much influenced by the literalist approach to construction. That which is aimed with specificity invites, even in these days of retreat from *Westminster,* construction with specificity. And so you finish up with an almost endless succession of amending provisions as the ingenuity of practitioners discovers loopholes which require to be blocked. Perhaps the paradigm is to be found in the

[23] [1992] STC 898.

apportionment provisions of section 21 of the Finance Act 1922. Avoidance was simple and was partially remedied by section 32 of the Finance Act 1927. But that too proved too easy and so you find first of all section 41(4)(a)(ii) of the Finance Act 1938 and then, shortly afterwards, section 13(3) of the Finance Act 1939. The outbreak of hostilities with Germany did not bring about a cessation of hostilities between subject and Revenue; and a stinging blow was delivered by Lord Howard de Walden in 1948,[24] which was followed by further amending legislation in what subsequently became section 651(1)(b) of the Income and Corporation Taxes Act of 1988.

And we find the same sort of pattern repeated, though perhaps a little less dramatically, with dividend stripping.

This is all very well as far as it goes but it does result, firstly, in legislation of horrifying complication and complexity and, secondly, in amendments which become wider and wider in scope until they are in danger of catching transactions which were never intended to be subject to them. But it has not been entirely ineffective and judicial dissatisfaction has been directed (fiercely in some cases) to the obscurity and complication of the legislation rather than to any point of principle.[25] In fact the dividend-stripping provisions were the signal for an increasing judicial willingness to give wide meanings to general

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[24] *Howard de Walden* v *IRC* (1948) 30 TC 345.

[25] [*Editor*: See, e.g., Lord Diplock: "The modern practice of parliamentary draftsmen in preparing for adoption by Parliament legislation to effect a change in the existing law ... is to express the changes to be effected in the form of amendments to the language of particular provisions in earlier statutes dealing with the same subject-matter. This method of drafting becomes progressively more cryptic as amendments to previous amendments follow one another in succession. The need to refer to and from and back and forth between ever increasing numbers of different statutes in order to discover what a particular provision of any of those statutes means reaches a point at which the difficulty of finding out what the law is may have the practical consequence of depriving the citizen of his right to know in advance of a decision of your Lordships' House, which must needs be *ex post facto*, what the legal consequences will be of a course of conduct which he contemplates adopting", *IRC* v *Joiner* (1975) 50 TC 449].

expressions. On the whole, therefore, this type of anti-avoidance legislation has proved to be not only reasonably effective but also not too universally unpopular and is considerably ameliorated if it is accompanied by an effective clearance procedure such as that provided in section 707 of the 1988 Act.

The more general "scatter-gun" approach, in the form of a perfectly general provision such as that introduced in Australia and New Zealand, and more recently Canada, is a very different matter, and we probably owe our relative immunity not simply to the Royal Commission on Taxation in 1955 but to the effectiveness of the *Ramsay* principle in checking the worst excesses of the tax-avoidance industry. We have experienced it in the shape of the wartime legislation enabling the Commissioners to "adjust" liability in the case of attempts to avoid excess profits tax. That really was fierce and highly objectionable legislation which endured into the 1960s but is happily no longer on the statute book. Nor has Parliament since tried to impose a wide catch-all provision aimed at the avoidance of tax generally. Possibly the Australian experience has provided a deterrent. There the Courts have largely emasculated the provision by holding in effect – and I have to say in my opinion not unreasonably – that if the subject is doing, in relation to his or her tax affairs, that which the taxing statutes say that it is open to him to do, he cannot be said to be "avoiding" tax. At the same time the presence on the statute book of legislation of this sort has led the Federal Court, in the *Oakley Abattoir* case, to reject the *Ramsay* principle as having any application in Australia. I have to say, however, that if the legislature were to take it into its head to introduce similar legislation in the United Kingdom, the case of *IRC* v *Challenge Corporation*[26] provides no ground for optimism that a similar result would be achieved here.

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[26] [1986] STC 548.

Well, where do we stand at the end of all this? I have never, for myself, made any secret of my dislike of the legitimate business purpose approach. That is principally because I have never been able to understand why, if the making of profits is a legitimate business purpose, the amelioration of the tax burden on those profits is not equally a business purpose. Nor have I made any secret of the fact that I regard *Furniss* v *Dawson* as lying at the outer limit of the judicial power to "restructure" transactions which has, after all to be undertaken, if undertaken at all, in a way which is intellectually defensible. *Craven* v *White* and the two associated appeals were examples of the Revenue attempting to push their luck beyond acceptable limits. *Ramsay,* however, was, a salutary and respectable principle and it is plainly here to stay. I do not think that the public interest needs more. If I have a criticism of *Ramsay* it lies only in the resuscitation of the dissenting judgment of Eveleigh LJ in *Floor* v *Davis,*[27] which was thrown out as an unsolicited bonus to the Revenue without any analysis at all and without any consideration either of the statutory provisions or of the findings of the Special Commissioners upon which the decision of the majority was based. People had learned to live with *Ramsay.* What they found difficulty in living with was *Furniss* v *Dawson* which introduced a highly undesirable climate of uncertainty and the conferment on the Revenue of what was in effect a discretionary power to determine, without any Parliamentary sanction, what transactions should be taxed and what should be permitted to take place without the imposition of fiscal burden. I hope that *Craven* v *White* and subsequent cases may have done something to alleviate this. If I may express a personal preference, from a vertical point of view I have to say that I marginally prefer a statutory anti-avoidance framework, at any rate if it is accompanied by an efficient and easily intelligible clearance procedure. I

[27] [1979] STC 379.

think that I would prefer it even if it is taken out of the province of the High Court and committed to a special tribunal subject only to judicial review. Statutory provisions have at least the merit of being immediately inscribed in a more or less intelligible form to which the citizen can refer. What, it seems to me, the Courts have succeeded in doing is to trespass into the legislation field by creating, almost arbitrarily, two categories of tax avoidance; permissible tax avoidance and impermissible tax avoidance. And they have done it without at the same time establishing any reliable criteria for distinguishing between the two. Pre-ordination is no sort of criterion because no commercial transaction is undertaken without a measure of pre-ordination.

"Business purpose" is no sort of criterion, because the saving of money from tax mitigation in order to have it available for a business must itself be a "business purpose". So the citizen and the Courts themselves are left without any readily intelligible reference points.

But I am bound to say that, in the field of tax avoidance, whether counteracted by statute or by judicial intervention, there is inevitably going to remain an area of uncertainty. Perhaps that was what led the late Frank Sullivan to remark, "To produce an income tax return that has any depth to it, any feeling, one must have Lived – and Suffered".[28]

[28] See Flesch, R. (1959), *The Book of Unusual Quotations.*

CHAPTER 10
The Role of the Tax Tribunals

Stephen Oliver, QC*

10.1 Introduction

I shall start with some facts about the present tax appeal system. I am referring to first instance appeals, as that is where I play a part as Presiding Special Commissioner and President of the VAT and Duties tribunals. After 10 years of separate existence these tribunals now have their headquarters in Bedford Square; they are staffed by the same personnel and to the untrained eye they are a single institution.

The Special Commissioners owe their origins to the 1842 Act. For over 100 years their role was that of both tax assessors and appeal tribunal. When the Special Commissioners were not raising and issuing assessments they were hearing appeals from their own assessments and from assessments raised by other Inland Revenue departments. All that changed in 1963 when the Income Tax Management Act exonerated the Special Commissioners from all assessment functions: from then on they operated exclusively as an appeals tribunal – but still as a department in the Inland Revenue. They were finally disestablished in the late 1970s and have been under the Lord Chancellor ever since. They are, according to the commitment in the Taxpayers' Charter, an "independent" tribunal. But the Inland Revenue still, as you will hear, plays a significant part in moulding the jurisdiction and the procedures of the Special Commissioners. The Special Commissioners are the appeal tribunal in all direct tax appeals (income tax,

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corporation tax, capital gains tax, petroleum revenue tax, inheritance tax and some aspects of stamp duty). In some areas they have concurrent jurisdiction with the General Commissioners: but generally speaking they hear the larger and more difficult appeals. They are now 15 Special Commissioners and Deputy Special Commissioners. Most of them are VAT tribunal chairmen as well. The jurisdiction of the Special Commissioners extends to Scotland and Northern Ireland.

The VAT tribunal was established by the 1972 Finance Act. Their rules are contained in a statutory instrument drawn up in May 1986 by Customs & Excise. The making of rules, since July 1986, has been transferred to the Lord Chancellor. There are now around 45 chairmen of the VAT tribunals of which three are full-time in England and Wales: there are Vice-Presidents in Northern Ireland and Scotland.

The Special Commissioners hear less than 100 appeals a year, a figure that has been steady for the last two or three years. There has been a marked drop in the amount of direct taxation litigation over the last 10 years. This may be attributable to the fact that the rates of tax on income are now more or less the same as the rates of tax on capital gains; it may also be attributable to cases such as *Furniss* v *Dawson* which have significantly reduced the extent of tax avoidance schemes.

The VAT tribunals, by contrast, received some 5,400 appeals in 1992 (a growth of 600 over 1991 and five times the number of appeals received in 1987) and issued just under 2,000 decisions in the same year (a growth of 600 over 1991). Rather less than half of the appeals received and decided related to penalties for non-compliance and for "serious" misdeclarations.

VAT, unlike the direct taxes, is an EC-based tax. Leaving aside penalty appeals, half the appeals I hear have a Community Law point and some of the appeals relate almost entirely to Community Law issues.

We aim to be able to deal with all VAT cases within three months of the receipt of the Notice of Appeal. In the South of England, Wales, Scotland and Northern Ireland we can and do meet this target. In the North of England we have fallen a long way behind. This is something we are trying to tackle now. To keep up our capacity to handle VAT appeals speedily we are heavily dependent on part-time chairmen. That has produced an infusion of great strength into the system over the last three years. Full-time Special Commissioners and VAT chairmen are not well paid: they are in fact paid less than the stipendiary magistrates who sit only four days a week. Recruiting full-time chairmen and special commissioners is, as a result, difficult. The system is therefore reliant on and thrives on its part-time chairmen, some of whom are lawyers of great distinction: we have ex-heads of government legal departments, an ex-Director of Public Prosecutions for Northern Ireland, a Registrar of the European Court, a senior member of the Parliamentary Commissioner's staff and a member of the Keith Commission, et cetera.

10.2 Are the Tax Tribunals Effective in the Sense of Being Speedy and Reliable?

Time is of the essence, especially in VAT assessment appeals, when a taxpayer has to pay or deposit the tax in dispute. This is also the case in direct tax appeals where repayment supplement only starts to run after a year has passed from the due date for the payment of the tax. It is of the essence to taxpayers who need to know the tax consequences of a particular course that they are about to take, such as whether their supplies are standard-rated or exempt from VAT. We are very conscious of this and to maintain our target level of having the hearing within three months of the Notice of Appeal, we operate a time-frame, particularly in VAT cases. Once an appeal has been notified to the VAT tribunals by a taxpayer, Customs &

Excise have 30 days in which to lodge their Statement of Case and in some cases the appellant has a further 30 days to serve his defence. We are reluctant to allow extensions. We assume that once Customs have assessed they will know why it was raised in the first place and, therefore, what is to go into their Statement of Case. Recently we have actually been striking out Customs & Excise cases and allowing appeals where the delay on their part has not been justified. The Court of Session is about to rule on whether it was proper of the VAT tribunal to have done so.[1] Direct tax appeals are not subject to specific time constraints. The procedures are entirely different: it is usually up to the Inland Revenue to say when a case is ready for hearing, though a taxpayer can apply to the Special Commissioners if he or she wants to take the initiative. And with Inland Revenue cases – as distinct from VAT appeals – we have no sanctions such as fining or striking-out to ensure compliance. In that respect I see the Special Commissioners' powers as deficient.

Are the tax tribunals providing a reliable service? It is hard to measure this when a large number of the appeals involve exercises of judgment in relation to which there is, in practice, no review: I am referring to appeals against the penalties for failure to submit returns in time and for serious misdeclarations and where the appellant aims to demonstrate that there is a reasonable excuse. However, if appeals to the High Court and the Court of Session are any guide, my rough research shows that in the two years 1990 and 1991, one in 35 VAT decisions were appealed against and, of those, 1 in 3 decisions of the tribunal were reversed. I cannot say for 1992 because there has been a great increase in work and a corresponding, though not necessarily related, backlog of appeals in the English High Court.

[1] *Customs & Excise Commissioners* v *Young* [1993] STC 394. [*Editor:* The Tribunal's right to allow the taxpayer's appeal given the Commissioner's delay was upheld.]

10.3 The Independence of the Tax Tribunals

The three key ingredients in independence, when one is talking of a court system, are (1) independence of establishment, (2) independence of the judges and (3) independence in the way the proceedings are conducted.

We are established on a reasonably independent basis. In common with all the courts our budget is dictated by the Treasury after consultation with the administrative staff of the tax tribunals. I am not accountable for the making of the budget or for keeping within it, though I am consulted to a generally acceptable level. We are, I think, well looked after and, as an establishment, we are reasonably independent.

The Special Commissioners and Deputy Special Commissioners are appointed by the Lord Chancellor (in consultation with the Lord Advocate); the chairmen of VAT tribunals are appointed by the Lord Chancellor, the Lord President and the Lord Chief Justice (Northern Ireland). Those appointments are completely independent of both Customs & Excise and the Inland Revenue and of representative bodies of taxpayers. Also, I believe they are, as a body of individuals, conspicuously independent.

Procedural independence is not, however, a state that we have achieved despite the fact that the Special Commissioner Rules have, since 1984, been the responsibility of the Lord Chancellor. Within certain limits a court or tribunal must have power to make its own rules of procedure. These can affect the substantive rights of the subject. It is essential that the tribunal and not the Inland Revenue (who are invariably parties), have the right to accept for hearing a case in circumstances where the statutes provides that an appeal lies. The Inland Revenue, for example, cannot be left with the opportunity of allowing only such cases to be heard as suit them. It is essential that the court or the tribunal has, as I remarked earlier, the means of enforcing compliance with their directions. It is essential

that the court or the tribunal has the power to publish its decisions so as to ensure consistency.[2] It is also essential in my view that hearings are heard in public unless the matter at issue is exceptionally sensitive in which case the tribunal should have the right to direct that it be heard in private. In those ways justice will be seen to be done (and it will not seem to be done where the Inland Revenue knows of all the decisions ever reached by the Special Commissioners and the taxpayers knows of none of them, except for the relatively small minority that have been taken on appeal to the High Court or the Court of Session): in those ways there can be an external check on our consistency and our independence.

The present position of our Special Commissioner Rules is a matter of concern. The Inland Revenue have, with the best of all possible motives I have no doubt, been given by the Lord Chancellor the task of making the Special Commissioner Rules. Eighteen months ago the Inland Revenue published draft Rules of Procedure for both the Special Commissioners and the General Commissioners. There was no consultation whatsoever at that stage. These draft rules reserved to the Inland Revenue the exclusive right to decide when a case should be taken on appeal. There were no powers to enforce time limits against the Inland Revenue and no powers to call for witnesses or documents from the Inland Revenue. All hearings were to be in private, with no option for a public hearing. The Special Commissioners submitted their own rules 14 months ago; and various professional bodies made representations. Last September we held some discussions with the Inland Revenue about points which they planned to include in our Rules of Procedure. We were told that the Rules are to be implemented in September or October 1993: they will, therefore, have to be laid before Parlia-

[2] [Editor: Decisions of the Special Commissioners are now published, *Special Commissioners (Jurisdiction and Procedure) Regulations 1994/1811*, Reg. 20.

ment in June 1993 at the latest. We were given to understand that there would be sufficient time for consultation and, in particular, we (the Special Commissioners) would have the chance to comment and make suggestions well before the new draft rules were released to the professional bodies and to the public for their consultation. Nothing has happened. It is far too late for any useful comment to take place. Unless the professional bodies react now, the Inland Revenue draft will go through by default.[3]

The reason for the delay is, I understand, because the Inland Revenue and the Treasury ministers have more immediate Budget and Finance Bill commitments on their minds. But they are quite the wrong people to be involved in making procedural rules. It is, I believe, wrong that the Inland Revenue should have been allowed to take on the task of drafting the rules. It does not look good and there is a clear conflict between their interest as a litigant and their duty to provide clear and evenhanded rules. Most fundamentally, it is at odds with the spirit and the words of the Taxpayers' Charter: "You can appeal to an *independent* tribunal".

I am convinced that the Inland Revenue should be removed from the "occasion of sin". The *vires* for making the Special Commissioner Rules and the VAT tribunal Rules should be removed from the Taxes Management Act and the VAT Act. The Treasury ministers and the Inland Revenue should play no part in making the rules. There should, I suggest, be an entirely different legislative procedure for statutes dealing with "dispute resolution" between the Inland Revenue and Customs & Excise on the one hand, and taxpayers on the other. All provisions which have anything to do with appeals and appeals procedures should be taken out of the "Finance" Acts. They should all

[3] [*Editor*: In the event the Special Commissioners (Jurisdiction and Procedure) Regulations, 1994 were made on 6 July 1994 and came into force on 1 September 1994.]

be contained in a separate Revenue Appeals Act which should be the exclusive responsibility of the Lord Chancellor.

I also consider that the time has come to consider setting up a tax tribunals users' committee. This would be a forum, attended by representatives of the main users of the Special Commissioners and the VAT tribunals, at which could be discussed and debated the Procedural Rules and any other material topics. It is relevant to mention, in this connection, that the Special Commissioners may, if the Rules as envisaged by the Inland Revenue come into existence, have the obligation to publish some of their decisions. How the reporting is done and what cases are to be reported will be a matter of public concern. The enabling Act gives the President the choice as to what is made public. The users' committee would be a useful source of advice on matters relating to the publication of Special Commission reports. But, most important, a user's committee would police and reinforce the independence of the tax tribunals.

10. 4 Is the Tax Appeal System Effective?

There are two obstacles to be confronted by any aspiring appellant in a direct tax appeal. The first of these is that costs cannot be awarded to a successful appellant before the Special Commissioners save where the Inland Revenue has acted frivolously![4] An appeal to the Special Commissioners need not be expensive: but if professional representation is used the costs are bound to be significant. Unlike the Special Commissioners the VAT tribunal has the power to award costs to successful appellants and does so. The Customs & Excise, if successful, seldom asks for costs. I can see no justification for putting the Inland

[4] [*Editor*: The requirement is that the party has acted "wholly unreasonably" in connection with the hearing, Special Commissioners (Jurisdiction and Procedure) Regulations 1994/1811, Reg. 20(1). For an application against the Revenue, see *Homeowners Friendly Society Ltd* v *Barrett* [1995] STC (SCD) 90.]

Revenue in the privileged position of being practically immune from costs at first instance. The inability to recover costs is a deterrent to taxpayers who would otherwise appeal and it ought not to be allowed to continue. Having said that, I would like to put on record our clear impression that the Inland Revenue rigorously review cases before they commit themselves to an appeal to the Special Commissioners. *Pepper* v *Hart* apart, the legal and practical implications of direct tax appeals will usually have been clearly identified well before the appeal starts and the costs start to mount.

The second obstacle to the aspiring appellant is the delay and expense that can result from the onward appeals into the High Court, the Court of Appeal and the House of Lords. There is now a 20-month waiting time in the High Court for VAT appeals before they can come on for hearing: the waiting time for Special Commission cases which go to the Chancery Division is somewhat shorter. Another 18–20 months pass before the Court of Appeal can hear appeals from the High Court. And if the case is one of sufficient public importance to go to the House of Lords, there is at least another year to wait.

Take Mr Hart's appeal as an example. I am referring again to the House of Lords decision in *Pepper* v *Hart*.[5] He was celebrating winning Magnus Magnusson's Mastermind when a brown envelope arrived with a Schedule E assessment taxing him on the benefit of the education provided by Malvern College at 20 per cent of the normal fee for his son. He and other members of the staff consulted me in 1985: their appeal was heard by the Special Commissioners in 1986 (successfully): they were then put to the uncertainty and expense of the appeal ladder (at High Court and Court of Appeal level) involving a repetition of argument until 1992 when the House of Lords broke the mould and decided their appeal by interpreting the statute

[5] [1992] STC 898.

on the basis of the minister's explanation in Parliament – rather than by adopting my attempted analysis of the statute.

Six years is a long time for a taxpayer, especially a schoolteacher, to have to wait in a state of financial uncertainty. The same goes for VAT cases. There are at present 82 appeals awaiting hearing in the High Court. Some are of great importance to us, the VAT tribunal. The case of *P & O Ferries*[6] is an example. This concerns the effectiveness of the serious misdeclaration penalty regime. We have had to defer a large number of penalty appeals until the *P & O* decision is finally resolved in the House of Lords.[7]

A thorough reappraisal of the appeal system needs to be made. This is especially so in tax cases which, almost by historical accident, have four layers of appeal inserted into the system. It is doubtful whether it is either sensible or good sense economically for there to be an appeal to both the High Court and the Court of Appeal. (There are leapfrog opportunities but they are seldom used.) The decision has to be taken as to whether the costs to the legal system, to the taxpayer and to the revenue authorities are usefully spent on what I understand to be the most elaborate tax appeal structure in the world. This is an area being explored by the Law Commission now and I hope that the voices of the professional bodies will make themselves heard. Representations are invited by the end of June 1993.

10.5 Can the Tribunals do More for the System?

I turn finally to three questions. Should the tribunals take on a wider role as a review body? Can they, as presently

[6] *Customs & Excise Commissioners* v *Peninsular and Oriental Steam Navigation Co.* [1992] STC 809 (Ch.D).

[7] [*Editor*: The case was heard by the Court of Appeal in December 1993 and judgment was given in the taxpayer's favour in January 1994 ([1994] STC 259). The case has not gone further.]

constituted, provide a tribunal for reviewing "rulings"? Here I take up from John Prebble's paper on a Proposed Structure for Advance Rulings. Are the tribunals the appropriate body to hear Excise Duty and Customs Duty appeals?

As things are the VAT Act gives the VAT tribunal a much wider review jurisdiction than that given to the Special Commissioners by the Taxes Act. There are some situations where we have the power to review, in VAT cases, and if appropriate to quash a decision of Customs: examples are Custom's decision to impose as a condition of registration, that the trader provides security for VAT payable in the future. We also have power to review their conduct in dealing with input tax repayment claims and, where appropriate, to award a form of repayment supplement to the claimant who has suffered delay. There are some cases where we intervene on our own initiative because there has been a procedural irregularity on the part of Customs. Examples are found in the area of civil penalties: we would quash a penalty if a Customs officer had failed to exercise a discretion in imposing a penalty. It is also significant that the VAT Act allows taxpayers to bring appeals to the VAT tribunal on a much wider range of topics than are available in the direct tax appeal system.

We hear appeals not just against assessments and claims (as with income tax and corporation tax) but against decisions of numerous sorts on respective liabilities. Decisions by Customs & Excise on the exercise of most of their powers relating to the non-criminal side of VAT are reviewable in that sense. That perhaps accounts for the minimal number of High Court judicial review proceedings against Customs & Excise.

By contrast our review jurisdiction of Inland Revenue decisions is virtually non-existent. I can think of only two special Appeal procedures against refusals to allow relief.

These are in cases of amalgamations and reconstructions[8] and in relation to the Inland Revenue's refusal to grant BES Certificates.[9] The result is that the Inland Revenue are exposed on a much wider front to judicial review proceedings.

It is perhaps a consequence of the limited role of the Special Commissioners that there have been roughly 10 times the number of judicial review applications in Inland Revenue matters than in Customs and Excise matters.

Where then could the Special Commissioners play a fuller role in this "holding of the balance"? I think we have the capacity to hear appeals against certain administrative decisions. Here are some examples:

(1) appeals against notices requiring the production of accounts, books and other information[10] are well within the competence of the Special Commissioners;
(2) appeals against the legality of information seeking notices[11] (e.g. section 770) should be within our competence;
(3) we could review decisions of the Inland Revenue and Customs & Excise which a taxpayer claimed went outside the scope of a Press Release, an extra statutory concession or a Statement of Practice;
(4) we might be able to review decisions taken in pursuance of double taxation treaties. Before the Inland Revenue exchange information with the Revenue of a foreign country about a taxpayer's affairs, there could be a right of review here, to ensure that the information was being sought for a proper purpose.

The great advantage of using the tax tribunals for these types of cases are their speed and relative informality. The review jurisdiction, unlike the appeals procedure proper,

[8] TCGA 1992, s.138.
[9] ICTA 1988, s.306.
[10] TMA 1970, ss. 20A,20B.
[11] E.g. ICTA 1988, s.772.

could involve private hearings – subject always to a taxpayer's right to have his affairs heard in public.

10. 6 Could the Special Commissioners Become a Rulings Tribunal?

I have no reason to doubt that the Special Commissioners could fulfil this role. We would, I think, need to recruit more specialists in direct taxes to bring us to the required level of expertise. And I see a case for bringing into the tribunal members outside the legal profession. I am involved in the Section 705 tribunal. It is well served by the expertise and knowledge of the commercial world drawn from members of the accountancy profession and from banking and from other business backgrounds. I would certainly press for tax practitioners to become members of any Rulings tribunal. Generally, I think, it would be a speedy and reliable tribunal of sufficient flexibility to meet the wide range of demands that will be placed on it.

10. 7 Could the Tax Tribunals Handle Excise Duty and Custom Duty Appeals?

I understand that EC legislation requires there to be a civil appeals system in place for customs duties. The decriminalisation of the excise duty system and the installation of an appeal system for that is another likely development: Customs & Excise recently published a discussion paper on the point. I have no reservations whatsoever that the tax tribunals could easily adapt themselves to handle these areas of appeal. These could, I suspect, cover a wide range such as appeals against penalties, appeals against refusals to register or against the imposition of conditions for registration as "registered excise dealers" on assessment appeals.[12]

[12] [*Editor*: An appeals system was enacted by the FA 1994 and the Tribunal is now known as the VAT and Duties Tribunal.]

Finally, I think it would be in the interests of a harmonious relationship between Schedule E and the National Insurance contribution provisions if the Special Commissioners became the appeal tribunal in National Insurance contribution matters.

CHAPTER 11
Responses to Tax Avoidance

Brian J. Arnold*

There has been an "internationalisation" of tax in recent years. It is almost as though there were international fashions in tax matters. Countries tend to copy the developments of other countries regardless, sometimes, of whether they are good or bad. Although my paper deals with the Canadian experience in dealing with tax avoidance, I cannot resist making a few general remarks on recent developments in tax administration.

Tax departments throughout the world seem to be adopting private sector management techniques and technology. One can hear Revenue department officials refer to a "continuous learning culture" (which seems to mean they have some internal training programmes) and "strategic visioning" (which translates as management trying to decide what it will do tomorrow). "Empowerment" has become the "buzz" word of the moment. The idea has developed of the Revenue Department as a "customer led" service department. This approach envisions tax collection as a service and the development of a "take a taxpayer to lunch" philosophy. In this Alice in Wonderland world taxpayers become clients or customers rather than payers. This is a misuse of language.

The Revenue's main job is to collect taxes fairly and efficiently. Tax authorities and their officials will never be loved; it is not and should not be their function to be loved; attempts by the Fisc to become loved by the public are misplaced and misconceived.

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This "service mentality" can be taken too far in the tax context. For example, in Canada, Revenue Canada has recently introduced a programme to allow taxpayers to file returns electronically because it is cost–effective and environmentally friendly. However, supporting documentation and information such as receipts for charitable donations cannot be filed in this manner. Most electronic filing is done by taxpayers claiming refunds of tax. There was a ministerial commitment that such refunds would be made within 14 days of electronic filing. In fact, this target was exceeded and refunds are now being made on average within eight days of filing. However, the necessity to service clients quickly made it impossible to require them to file physical receipts to support their claims. Moreover, if those filing electronically no longer had to file receipts, it was considered unfair that those filing in a conventional manner should have to submit supporting receipts. Consequently, the income tax legislation was amended to provide that nobody will have to file supporting receipts. This does not appear to be a sensible step for tax collection. It will inevitably lead to less compliance by taxpayers and widen the scope for fraud.

Turning now to the question of how to deal effectively with tax avoidance, as you probably know, Canada has recently adopted a statutory anti-avoidance rule. It has to be accepted at the start that a statutory rule is not necessarily the best way of dealing with tax avoidance in the Canadian context, let alone elsewhere. Thus, the Canadian experience may be interesting and useful to other countries, provided it is remembered that the rule was developed and operates in the Canadian context. International tax comparisons are interesting and often helpful, with the *caveat* that they must be used with caution. The Canadian approach is the product of Canadian experience which is not the same as, say, the UK experience.

The Canadian general anti-avoidance rule was adopted in 1987 as part of a general tax reform which involved a broader tax base, lower rates and the introduction of broad-based value added tax. A few years before the tax reform exercise commenced the Supreme Court of Canada had specifically rejected the "business purpose" test in the *Stubart* case.[1] There was also a shift in the administrative approach away from aggressive attacks on tax avoidance. Added to this was a tension between the Canadian Department of Finance and the Department of National Revenue about tax collection.

I was a consultant to the Department of Finance during the tax reform exercise and I worked as part of a team on the development of the anti-avoidance rule. Naturally, we looked at other countries to see what approaches they had taken to tax avoidance including, as one would expect, the US and the UK. The US courts had adopted a purposive approach to statutory interpretation and a business purpose test which had recently been rejected by the Supreme Court of Canada. The UK courts had adopted an adventurous approach in *IRC* v *Ramsay*[2] and *Furniss* v *Dawson*[3] which was not taken up in Canada. As is to be expected in Canada the civilian approach was also considered. The Continental doctrine of *abus de droit* under which transactions that are artificial and carried out solely for tax avoidance are disregarded, was thought to be unsuitable for a state with a common law tradition which had not embraced the doctrine in other parts of its law.

A review was also undertaken of the statutory anti-avoidance provisions that had been adopted in other countries, in particular Australia and New Zealand. The overall conclusion was that all the countries looked at had some

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[1] *Stubart Investments Ltd* v *The Queen* [1984] CTC 294; 84 DTC 3605.
[2] (1981) 54 TC 101.
[3] (1984) 55 TC 324.

general statutory or judicial protection against tax avoidance.

Various techniques have been adopted for dealing with anti-avoidance in Canada and elsewhere. These include:

(1) the doctrine of sham transactions which is too limited;
(2) the substance over form approach which is label to disguise fuzzy thinking as to what should be acceptable and what should not;
(3) the business purpose test which was rejected by the Canadian Courts; and
(4) the step transaction doctrine which, although quite well developed in the US, is underdeveloped in Canada and did not fit easily into the Canadian context.

It was concluded that reliance on a judicial approach was not appropriate for Canada primarily since the Canadian courts had rejected the opportunity to play a vigorous role in controlling tax avoidance.

Accordingly a statutory solution to tax avoidance was sought. The next question was whether the anti-avoidance legislation should be specific or general in nature.

Specific avoidance legislation was thought to be deficient. It adds complexity and because by definition it is specifically targeted, it could generate its own tax avoidance opportunities and so add to the problem. Moreover, tax administration and legislation always tend to lag behind developments in tax practice which could itself cause inequities, for example, between those who used a successful avoidance technique early as compared with those involved later.

Consideration was also given to the possibility of ministerial discretion being used to deal with tax avoidance. However, this type of administrative discretion is regarded as completely unacceptable in Canada, as giving too much power to the tax administration and as offending the Rule of Law, even if it might be an acceptable solution in other countries.

As a result of this analysis, it was concluded that a statutory general anti-avoidance rule was the only viable approach. Not surprisingly, there was enormous opposition among tax practitioners to the proposal to have a statutory general anti-avoidance provision. The quality of the arguments against the rule was generally pathetic. It was suggested that, if the rule were enacted, commercial life as we knew it would come to an end, it would be impossible to give a legal opinion on a proposed transaction, and that the provision was a violation of the rule of law. Controlling tax avoidance is extremely difficult but it should be possible to discuss the different methods of possible control and how to distinguish acceptable from unacceptable avoidance in rational tones without an emotional or knee-jerk reaction to the subject.

The next step was to seek to enunciate some principles for a general anti-avoidance rule. (These are summarised in Adrian Shipwright's introductory note for the conference, see p. 37). The most difficult aspect of this task was how to distinguish acceptable from unacceptable avoidance. Whether one describes this distinction as the difference between acceptable and unacceptable, legitimate and illegitimate, artificial and non-artificial, or abusive and non-abusive avoidance, the criteria used to make the distinction must be made clear. If the criteria cannot be enunciated, it is impossible to have a meaningful standard which can be applied by taxpayers and the tax authorities. The words used to describe the distinction are conclusory and do not provide any basis for making the distinction. It was concluded that "artificial" was not the right term or criterion as some artificial transactions are acceptable for Canadian income tax purposes.

Accordingly, various alternative approaches were considered for dealing with this problem. Should the test be whether avoidance was the dominant or sole purpose for the transaction? This did not seem to be the right solution as some transactions which do have a dominant purpose of

tax avoidance are quite acceptable and indeed may be encouraged by the government as is the case with tax incentives. Three further approaches were then considered:

(1) specific exemptions for legitimate transactions – i.e. a general anti-avoidance rule subject to specific exceptions. The problem with this approach is that the drafters would not be able to anticipate all the transactions which ought to be included in the list of exceptions. Transactions not included in the list would likely be considered as objectionable, which would not necessarily be the case.
(2) a purpose clause – the general anti-avoidance rule could contain a clause stating that "The purpose of this section is to counter abusive tax avoidance". In fact, the draft version of the rule contained a similar purpose clause. Practitioners did not like this approach because it did not exclude legitimate transactions from the rule with sufficient certainty.
(3) a general exception for legitimate transactions. This approach represents a compromise between the specific exemptions and a purpose clause; and this is, in fact, the approach that Canada ended up adopting.

Section 245(4) of the Canadian Act provides that a transaction is not subject to the general anti-avoidance rule if it does not result in a misuse of any provisions of the Act or an abuse of the Act as a whole. In the French version only the word *abus* is used. The English text used both words because avoiding a provision so that it did not apply might not, as a matter of construction, amount to a misuse of the provision. On the other hand, structuring a transaction to fit within a provision that was not intended to apply to the transaction could be properly described as a misuse of the provision.

Explanatory notes accompany virtually all tax legislation in Canada. Those relating to the general anti-avoidance provision were lengthy and deliberately designed to influence the way in which Revenue Canada and the courts would apply the provision. The notes went to particular lengths to explain what transactions were not intended to be caught by the provisions. For example, there were detailed comments on the transfer of losses between companies and estate-freezing activities. The notes also explained that subsection 245(4) drew on the civil law concept of *abus de droit.* In my view, this reference is unfortunate because the civil law concept does not fit easily into the Canadian legal system.

The explanatory notes indicate that subsection 245(4) is not an exemption from section 245 but rather that it is a rule of construction. According to the notes, the general anti-avoidance rules do not apply to transactions that are in accordance with the object and spirit of the income tax legislation. If subsection 245(4) is treated as an exemption, it is potentially meaningless. The *Stubart* case decided that all legislation was to be interpreted to reflect its object and spirit. Further, the general anti-avoidance rule is a provision of last resort.

Therefore, if a transaction does not comply with the object and spirit of the provisions of the legislation, other than s245, it is unnecessary to apply the general anti-avoidance rule. On the other hand, if a transaction is within the object and spirit of the other provisions of the legislation, it would appear to be exempt under subsection 245(4) because it would not constitute a misuse or an abuse of the provisions of the Act. It is difficult to predict how the courts will interpret s245 in light of this difficulty.

There have not yet been any cases on the general anti-avoidance provision so that it is too early to see how the Canadian courts will deal with it. The 1988 and 1989 taxation years, which are the first years to which the

general anti-avoidance provision applies, are only now being assessed. Ninety or so cases have been considered by a special committee established by Revenue Canada to deal with cases where the general anti-avoidance provision might be involved. The idea behind the committee is to ensure the uniform and consistent application of the rule. Approximately half of the cases referred to the committee have been found to infringe the general anti-avoidance provision. On the basis of only anecdotal evidence, it seems that the general anti-avoidance rule has had little impact on tax planning in Canada. I know of few cases where transactions have not gone ahead because it was feared that the general anti-avoidance provision would apply. In my opinion, it is unfortunate that the anti-avoidance rule is not accompanied by a penalty so that there is a significant cost if the rule applies. Taxpayers and advisers tend to look at matters on the basis that there is little downside risk to a potentially abusive transaction apart from the transactional costs and interest on unpaid taxes.

Although the general anti-avoidance rule remains untested in the Canadian courts, parts of it (in particular the concepts of misuse and abuse) have been used by Ireland in formulating its general anti-avoidance rule. Also New Zealand has borrowed from the Canadian approach in issuing administrative guidelines to its anti-avoidance rule. So just as Canada borrowed from the Australian experience, now other countries are using our experience.

APPENDIX 1
Draft Legislation to Establish an Advance Rulings Procedure

John Prebble*

Taxes (Advance Rulings) Act 1993 (Draft) with Explanatory Notes

The Act

1. Advance rulings

(1) Subject to the provisions of this Act the Board shall, upon application by or on behalf of any person, issue to that person an advance ruling as to the taxation consequences of a transaction specified by that person in the application.

(2) An advance ruling issued under subsection (1) of this section shall specify the beneficiary or beneficiaries of the ruling, being:

(a) the applicant, or
(b) other persons named or identified in the ruling who are parties to a transaction in respect of which the ruling is issued, or
(c) subject to subsection (3)(b) of this section, other persons named, identified, or described by class.

(3) The Board may decline to issue an advance ruling where the application:

(a) relates to a transaction that:
(i) is completed or substantially completed, and

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(ii) must be taken into account in a return due to be lodged by the beneficiary of the ruling within six months of the date of receipt of the application by the Board, or

(b) relates to a person who could qualify as a beneficiary of the proposed ruling only by virtue of subsection (2) (c) of this section, or

(c) relates to a question that is currently pending before the High Court, the Court of Appeal, or the House of Lords, or

(d) requires the Board to decide a question of fact, or

(e) is frivolous or vexatious, including cases where the application is unduly prolix or replete with irrelevancy.

2. Applications

(1) Every application for an advance ruling under section 1 of this Act shall be made in the form prescribed by the Board, shall contain such particulars as may be specified in the form, shall be accompanied by payment of such fee as may be prescribed, and shall have annexed thereto:

(a) a draft of the ruling for which application is made, containing the matters specified in subsection (1) of section 1 of this Act, and

(b) where the applicant has lodged an anonymity notification, a second, edited, draft of the said ruling, and

(c) at the option of the applicant, a draft of the reasons referred to in subsection (4) of section 2 of this Act, and

(d) Copies of all documents relevant to the application, or, at the option of the applicant, where any document is in large part not relevant to the application and the document is lengthy, copies of relevant extracts from that document, and

(e) written submissions in support of the application.

(2) On receipt of an application that complies with subsection (1) of this section, the Board shall forthwith:

(a) record the application in the register to be kept by it for the purpose, and
(b) give written notice of the date of registration to the person by whom the application was made.

(3) On receipt of an application that does not comply with subsection (1) of this section, the Board may, at its discretion, either:

(a) accept the application and take the steps referred to in subsection (2) of this section in respect of that application, or
(b) return the application to the person by whom it was made, or
(c) decline to register the application until it complies with subsection (1) of this section.

(4) Where the Board declines to register an application under subsection (3)(c) of this section, it shall forthwith notify the person by whom the application was made.

(5) The person making the application under subsection (1) of this section, and any person on whose behalf it was made, and any person to whom the application relates, shall from time to time produce, or, as the case may be, furnish to the Board, such further documents or information in relation to the application as may be required by the Board for the purpose of enabling it to exercise its functions under this Act.

(6) Any person who has made an application under this Act may, at any time, by notice in writing to the Board, withdraw the application.

(7) The applicant may at any time amend the application by written notice to the Board. From the receipt of such notice of amendment by the Board this Part of this Act shall apply to the application as amended.

(8) In addition to the written and oral submissions provided for in this Act in relation to any application, the Board may invite or accept, and may take into consideration, such

further submissions, whether written or oral, as the Board thinks fit.

3. Determination of applications for advance rulings

(1) The Board shall take into account any submissions in relation to the application made to it by or on behalf of the applicant.

(2) The Board shall, in respect of an application under section 1 of this Act, make a determination in writing:
(a) granting such ruling as it considers appropriate, or
(b) refusing the application.

(3) Subject to this Act any ruling granted pursuant to subsection (1) of this section may be granted subject to such conditions and for such period or different periods in respect of different beneficiaries or transactions as the Board thinks fit.

(4) The Board shall state in writing its reasons for a determination made by it.

(5) Before making a determination in respect of an application the Board shall comply with the requirements of section 4 of this Act.

4. Board to prepare draft ruling

(1) Before determining an application for a ruling pursuant to section 3 of this Act, the Board shall prepare a draft ruling in relation to the application.

(2) The Board shall send to the applicant a copy of the draft ruling and of its reasons therefor.

(3) The applicant shall notify the Board within ten working days after a date fixed by the Board whether the applicant or other person wishes the Board to hold a conference in relation to the draft ruling.

(4) The date fixed by the Board pursuant to subsection (3) of this section shall not be earlier than the date of the day when

the Board sends to the applicant the documents mentioned in subsection (2) of this section.

(5) If the applicant:

(a) notifies the Board within the period of ten working days prescribed in subsection (3) of this section that he does not wish the Board to hold a conference in relation to the draft ruling, or

(b) does not notify the Board within that period that he wishes the Board to hold such a conference the Board may issue a ruling in the form of the draft ruling menioned in subsection (1) of this section at any time after the expiration of that period.

(6) If the applicant notifies the Board within the period of ten working days prescribed in subsection (3) of this section that he wishes the Board to hold a conference in relation to the draft ruling, the Board shall appoint a place, time, and date (not being a date later than twenty working days after the expiration of that period) for the holding of the conference and give notice of the place, time, and date so appointed to the applicant.

(7) The Board may, of its own motion, determine to hold a conference in relation to a draft ruling and shall appoint a date (not being a date later than twenty working days after the expiration of the period referred to in subsection (3) of this section), time, and place for the holding of the conference and give notice of the date, time, and place so appointed to the applicant.

(8) Subject to subsection (9) of this section, where the Board is of the opinion that two or more applications for rulings involve the same or substantially similar issues, the Board may treat the applications as if they constitute a single application, and may prepare a single draft ruling in relation to the applications and hold a single conference in relation to that draft ruling.

(9) Subsection (8) of this section does not apply where any of the applications in question contains an anonymity notifi-

cation, unless the applicant consents to the application of subsection (8).

cf. Trade Practices Act 1974 (Aust), S90A (1), (2), (5), (6), (13).

5. Rulings without consultation

Notwithstanding anything in section 4 of this Act the Board may issue a ruling without following the procedures set down in that section where:

(a) that ruling complies in all substantive respects with the draft submitted pursuant to subsection (1)(a) of section 2 of this Act and with the draft submitted pursuant to subsection (1)(b) of section 2 if any, or
(b) the applicant waives the requirements of section 4 by notice in writing to the Board.

6. Procedure at conference

(1) At every conference called under section 4 of this Act there shall be entitled to be present and to participate both personally and through a representative:

(a) the Board
(b) the applicant
(c) anyone nominated by the Board or by the applicant, but no other person is entitled to be present.

(2) At every conference called under section 4 of this Act the Board shall provide for as little formality and technicality as the requirements of this Act and a proper consideration of the application permits.

(3) The Board shall cause such record of the conference to be made as is sufficient to set out the matters raised by the persons participating in the conference.

(4) The Board or its representative attending the conference may terminate the conference when it or he is of the opinion that a reasonable opportunity has been given for the ex-

pression of the views of persons participating in the conference.

(5) The Board shall have regard to all matters raised at the conference, and may at any time after the termination of the conference make a ruling in respect of the application.

cf. Trade Practices Act 1974 (Aust), s90A (7), (8), (9), (11).

7. Form of rulings

(1) An advance ruling shall be in writing in numbered paragraphs, shall describe the transaction in question and its tax consequences, and shall contain the following particulars:

(a) the names or descriptions of the applicant for and the beneficiary of the ruling; and
(b) a description of the transaction in respect of which ruling is issued; and
(c) the legislative provisions the effect or application of which are the subject of the ruling; and
(d) the time for which the ruling is to remain in force; and
(e) such other particulars as are necessary for a ready understanding of the effect of the ruling.

(2) The Board shall append to the ruling a statement of the reasons for the ruling together with such comments or qualifications as to it seem useful.

(3) A statement by the Board pursuant to subsection (2) of this section shall be clearly marked off from the text of the advance ruling in respect of which it is made and shall not form part of that ruling.

(4) Where the Board determines that a ruling in terms of the application in question shall be issued the ruling issued by the Board may take the form of a copy of the draft ruling submitting by the applicant pursuant to section 2 of this Act together with a written statement of the Board's reasons for its decision.

8. Reliance on advance rulings

(1) Subject to this Act an advance ruling has effect for the benefit of its beneficiary in respect of transactions to which the ruling applies that are completed while the ruling remains in force.

(2) Where a beneficiary relies on an advance ruling in computing his tax liability in respect of a return under any of the Taxes Acts he shall give notice to the Board to that effect.

(3) A notice under subsection (2) of this section shall be given to the Board within the time within which the beneficiary is required to furnish such return or within such time as the Board in its discretion may allow and shall:

(a) specify the advance ruling and the transaction to which the notice relates;
(b) verify that the said transaction complies with the advance ruling in question, and
(c) set out particulars of any manner in which the transaction does not so comply.

9. Effect of advance rulings

(1) Notwithstanding any statutory provision that is specified in an advance ruling pursuant to subsection (1)(c) of section 7 of this Act, but subject to subsection (2) of this section, in making any assessment the Board shall observe the terms of such advance ruling if:

(a) the person claiming thereunder is a beneficiary of the ruling; and
(b) the beneficiary has complied with the requirements of section 8 of this Act; and
(c) the transaction specified in the notice pursuant to section 8 of this Act complies with the terms of the ruling or fails to comply in immaterial respects only.

(2) The Board shall not be bound to assess the beneficiary according to the terms of an advance ruling if:

(a) since the date of the ruling the legislation on which the ruling was based or that the ruling interpreted has been so repealed or amended that the law is changed to the detriment of the beneficiary or would be so were it not for the existence of the ruling; or

(b) there was a material misrepresentation or omission in the application for the ruling, whether intentional or not.

10. Anonymity

(1) Where an applicant desires that his identity or the identity of any beneficiary of the ruling should not become publicly known he shall so notify the Board by an appropriate entry on the form of application or by some other form of notice acceptable to the Board and shall submit at the same time a second version of the draft ruling that accompanies the application, edited to remove identifying references from the draft.

(2) Where there has been an anonymity notification the Board shall prepare an anonymous version of the ruling edited to remove the name of the applicant or any beneficiary of the ruling and other particulars which are likely to identify them and which, in the opinion of the Board, can be omitted from published versions of the ruling without affecting their usefulness or value.

(3) An anonymous version of a draft ruling prepared by the Board shall be treated as part of the Board's draft ruling for the purposes of sections 4, 5, and 6 of this Act.

11. Assistance

(1) It is the duty of the Board to give reasonable assistance to a person who:

(a) wishes to make an application for an advance ruling, or

(b) in making an application for an advance ruling has not made that appliccation correctly, to make an application in a manner that is in accordance with this Act.

(2) In addition to the written and oral communications between the Board and the applicant that are provided for in this Act the Board may invite or accept and take into consideration such further communication from or on behalf of the applicant whether written or oral and if oral in conference or by telephone or otherwise as the Board thinks fit.

(3) The Board may extend the time for giving any notice, making any application, delivering any statement, or doing any other act, matter, or thing in respect of or in relation to any provision in this Act.

12. Prescribing fees

(1) The Board shall set the fee mentioned in section 2 of this Act and such other fees as may be necessary for the purposes of the Act.

(2) In addition to the fee mentioned in section 2 of this Act applicants for advance rulings shall pay such fees as shall be prescribed by the Board.

(3) In setting such fees payable by applicants the Board shall ensure as far as is practicable that such fees:

(a) cover the fixed costs of the Board in administering the advance rulings process; and
(b) cover, in respect of each application, the share of the Board's costs that are additional to fixed costs and that relate to that application.

(4) Annually in November or December the Board shall publish a schedule of the fees payable by applicants in respect of applications for advance rulings received by the Board in the next calendar year.

(5) Where work is done on an application in more than one calendar year fees shall be payable according to the schedule applicable when the work is done.

(6) During the year in which this Act comes into force and the next year paragraph (a) of subsection (3) of this section

shall not apply but instead the Board shall set and charge such fees to applicants for advance rulings as to it seem appropriate.

(7) Within two months of the date on which this Act comes into force the Board shall publish a schedule of the fees payable by applicants for advance rulings for work done in the year in which this Act comes into force.

13. Payment of fees

(1) When the Board is ready to issue a ruling it shall tell the applicant and at the same time shall advise the applicant of the fee that is payable.

(2) On payment of the fee the Board shall issue the ruling to the applicant, provided that the Board may issue the ruling to the applicant and may cause the ruling to be published pursuant to section 16 of this Act before the fee for the ruling has been paid.

(3) Where an application is withdrawn the Board shall advise the applicant of the fee payable for the work done before the Board received notification of the withdrawal.

(4) Any fee not paid within forty days of the date when the advice of fee is sent by the Board under this section shall be deemed to be unpaid tax owing by the applicant that was due to be paid ten days after the date of the advice of the fee and may be recovered pursuant to Part VI of the Taxes Management Act 1970.

(5) The Board may in exceptional circumstances, in its discretion, waive any fee payable by an applicant under these regulations in whole or in part.

14. Appeals

(1) Subject to this Act and to subsection (9) of this section an applicant may appeal in respect of an advance ruling or any part thereof to the Special Commissioners.

(2) In the case of such an appeal the appellant shall file with the Board a notice stating his intention to appeal and the relief that he seeks:

(a) where the Board has issued an advance ruling, within two months of the date of issue, and
(b) where an appeal is brought by virtue of section 15 of this Act, at any time when the appellant has a right to appeal under section 15.

(3) The appellant shall within two months of filing the notice of appeal with the Board file a statement of the case on appeal at the registry of the Commissioners and shall immediately file a copy of the statement of the case on appeal with the Board.

(4) The statement of the case on appeal shall contain:

(a) copies of the documents specified in paragraphs (a), (b), and (d) of subsection (1) of section (2) of this Act; and
(b) a copy of the advance ruling issued by the Board, if any; and
(c) a copy of the Board's reasons for its ruling, if any; and
(d) a statement of the relief sought by the appellant.

(5) The appeal shall be by way of a full reconsideration of the application.

(6) Sections 49, 50, 51, 52, 53 and 54 of the Taxes Management Act 1970, so far as they are applicable and with any necessary modifications, shall apply with respect to the hearing and determination of the appeal as if an appeal to the Commissioners under this section was an appeal under section 48 of that Act

(7) On hearing any appeal the Commissioners may:

(a) confirm or cancel or vary any advance ruling issued by the Board; or
(b) make any advance ruling which the Board was empowered to make in respect of the application to which the appeal relates; or

(c) make any advance ruling which the Board would be empowered to make if the appeal were before the Board as an application for an advance ruling at the time of the hearing of the appeal.

(8) For the purposes of section 8 and section 9 of this Act a determination of the Commissioners pursuant to subsection (7) of this section, and any determination of any Court on appeal therefrom, shall have effect as if it were a determination of the Board under this Act.

(9) Except so far as may be expressly provided to the contrary in this Act, this section shall not confer any right of appeal with respect to:

(a) any decision or determination of the Board made in exercise of any power or discretion conferred on it to enlarge or extend the time for giving any notice, making any application, furnishing any return, or doing any act, matter, or thing; or

(b) any matter that is left to the discretion, judgment, opinion, approval, consent, or determination of the Board or any act, matter, or thing done or omitted by the Board under or pursuant to any Act.

(10) A party to an appeal to the Commissioners under this section may appeal from the decision of the Commissioners to the High Court.

(11) Sections 56 and 56A of the Taxes Management Act 1970, so far as they are applicable and with any necessary modifications, shall apply with respect to the hearing and determination of appeals under subsection (10) of this section as if an appeal to the High Court under subsection (10) was an appeal under section 56 of that Act.

15. Failure to determine applications for advance rulings

(1) Should the Board fail for a period of three months from the receipt of an application for an advance ruling to advise the applicant pursuant to subsection (1) of section 13 of this Act that it is ready to issue a ruling in respect of the

application the applicant may at any time thereafter until he is so advised by the Board commence and prosecute an appeal under section 14 of this Act as if the Board had determined the application by refusing to issue a ruling in respect of the application.

(2) An applicant does not waive his rights under subsection (1) of this section by making submissions or additional submissions to the Board or by otherwise prosecuting the application.

(3) Where the applicant lodges an amended application the three month period mentioned in subsection (1) of this section recommences from the receipt by the Board of the amended application.

16. Publication of rulings

(1) Subject to subsection (2) of this section the Board may from time to time compile and publish reports of applications for advance rulings and of its determinations thereof and may authorise any person to publish such reports, in written form or on an electronic data base accessible with or without fee, or otherwise as the Board thinks fit.

(2) Where the Board has received an anonymity notification pursuant to section 10 of this Act no such report shall contain the name of the applicant or of any beneficiary of other particulars that are likely to identify them and that, in the opinion of the Board, can be omitted from the report without affecting its usefulness or value.

(3) With necessary modifications, subsections (1) and (2) of this section apply to the Commissioners in respect of appeals under section 14 of this Act and of their determinations thereof.

(4) In any appeal from a decision of the Commissioners under this Act the Court may order that no report of the proceedings shall contain the name of the appellant or of the respondent as the case may be nor the name of any beneficiary of the ruling in question nor other particulars

that are likely to identify any of them and that, in the opinion of the Court, can be omitted from the report without affecting its usefulness or value.

17. Regulations

(1) The Lord Chancellor may, with the consent of the Lord Advocate, make rules:

(a) as to the procedure to be followed in applying for an advance ruling and making any provision that may be necessary or desirable in relation to the issuing of the publication of advance rulings or to enable the Board to set fees for dealing with applications for advance rulings; and

(b) as to the procedure of the Commissioners in respect of appeals under this Act and the procedure in connection with bringing appeals before them.

(2) Rules made under this section may make such consequential provision (including the amendment of any enactment or instrument made under any enactment) as the Lord Chancellor considers necessary.

(3) Rules under this section shall be made by statutory instrument subject to annulment in pursuance of a resolution of either House of Parliament.

18. Interpretation

For the purposes of this Act unless the context otherwise requires:

"Advance ruling" and "ruling" mean an advance ruling issued under this Part of this Act and include a determination by the Board declining to issue an advance ruling in respect of an application;

"Anonymity notification" means an anonymity notification under section10 of this Act;

"Applicant" means an applicant for an advance ruling under this Act;

"Application" means an application for an advance ruling under this Act;

"Assessment" means an assessment of tax made by the Board under any of the Taxes Acts;

"Beneficiary" and "beneficiary of a ruling" mean a person who in terms of an advance ruling issued under this Act is intended to be able to rely upon that ruling whether or not to the knowledge of the beneficiary and includes a person who succeeds by contract, inheritance, or in any other manner to the rights of a beneficiary in respect of a transaction in respect of which an advance ruling has been issued;

"Board" means the Board of Inland Revenue;

"Commissioners" means the Commissioners for the Special Purposes of the Income Tax Acts appointed under section 4 of the Taxes Management Act 1970;

"Prescribed fee" means a fee that has been set pursuant to section 12 of this Act;

"Return" means any return submitted or to be submitted to the Board under any of the Taxes Acts;

"Tax" means income tax, corporation tax, and tax charged under the Taxation of Chargeable Gains Act 1992;

"Taxes Acts" means this Act and the Taxes Acts as defined in section 118 of the Taxes Management Act 1970;

"Transaction" includes any document and any contract, agreement, plan, or understanding (whether enforceable or unenforceable) including all steps by which it is carried out;

"Working day" means any day other than:

(a) Saturday, Sunday, Christmas Day, New Year's Day, Boxing Day, Good Friday, Easter Monday, the Sovereign's birthday; and

(b) if the applicant resides in the United Kingdom, a bank holiday in the jurisdiction where the applicant resides.

19. Commencement and construction

(1) This Act shall come into force for all purposes on 6th April 1994.

(2) This Act, so far as it relates to income tax or corporation tax, shall be construed as one with the principal Act.

20. Short title

This Act may be cited as the Taxes (Advance Rulings) Act 1993.

Draft legislation: explanatory notes

This draft statute sets out rules for an advance rulings process that might be adopted in the United Kingdom. It provides for applications, determinations, issuance of rulings, appeals, fees, anonymity of applicants, and publication of rulings.

Section 1 requires the Board to issue advance rulings as to the tax consequences of a proposed transaction where an application is made by or on behalf of any person. The Board is given a discretion to decline to issue a ruling in certain circumstances.

Section 1 (3)(a) permits the Board to decline to issue rulings in respect of transactions that are substantially completed. This is a rule that is observed in, for example, Canada. One reason that may lead the United Kingdom to adopt an advance rulings procedure is the introduction of self-assessment via the pay and file regime: taxpayers will want rulings so that they can verify their own assessments of their liability at filing, rather than waiting for an audit. Section 1(3)(1) should be deleted if the institution of a rulings system is a response to that need.

Section 2 sets out the procedure in respect of applications for rulings. Application is to be in the form prescribed by the Board and is to be accompanied by the prescribed fee. Several docu-

ments are required to be annexed to the application, including a draft of the ruling that the applicant wants.

The Board is required to record applications in a register and to give the applicant notice of registration. If an application is defective the Board is empowered to accept and register it, to return it to the applicant or to decline to register it until it fully complies with the section.

Provision is made for the Board to require further information and for an application to be withdrawn or amended.

Section 3 provides that the Board is required to make determinations in respect of applications for rulings, either issuing a ruling or refusing the application. Reasons are required to be given for such determinations. Provision is made for rulings to be granted subject to conditions and for specified periods. Before making a determination the Board is required to take into account any submissions made by the applicant and to comply with section 4.

Section 4 sets out the process of consultation with an applicant before a ruling is granted. The Board is required to prepare and forward to the applicant a draft ruling and reasons for the ruling. Provision is then made for the applicant to request a conference with the Board. If the applicant does not desire a conference the Board is empowered to then issue a ruling.

If the applicant requests a conference, or if the Board decides to hold a conference on its own motion, the Board is required to appoint a date, time, and place for the conference. Provision is made for several applications to be treated as one application in certain circumstances. Section 5 provides for rulings to be issued without a conference if the ruling complies with the draft ruling submitted by the applicant or if the applicant waives the requirement for a conference.

Section 6 sets out the procedure to be followed at a conference called under section 4. Provision is made for the Board and the applicant, and for anyone nominated by the Board or the applicant, to be present at the conference.

The Board is required to ensure that the conference is as informal and non-technical as possible and to cause a record of the conference to be made. In making a ruling the Board is required to have regard to all matters raised at the conference.

Section 7 details the form that an advance ruling shall take. In issuing a ruling the Board is required to append a statement of the reasons for the ruling. Provision is made for a ruling to take the form of a copy of the draft ruling submitted by the applicant pursuant to section 2.

Section 8 sets out the method by which the beneficiary of a ruling may rely upon the ruling. The beneficiary must give the Board notice that he relies on an advance ruling. The notice must be given within the time within which the beneficiary is required to furnish his return of income. The notice is required to specify the advance ruling and transaction to which the notice relates, verifying that the transaction complies with the advance ruling in question, and setting out any matters in respect of which the transaction does not so comply.

Section 9 sets out the effect of an advance ruling. In assessing any beneficiary of a ruling for tax the Board is required to assess in accordance with the advance ruling. Precisely, the Board is bound by an advance ruling in respect of the interpretations of particular provisions of revenue legislation that are considered in the ruling. Thus, section 9 makes it clear that a ruling is effectual in respect of specific legislative provisions that have been the subject of the ruling. A ruling does not purport to determine tax liability in general.

The Board is not bound to assess the beneficiary in accordance with the ruling if relevant legislation has been changed to the beneficiary's detriment or if there was a material misrepresentation or omission in the application for a ruling.

Section 10 entitles an applicant to require that the ruling issued by the Board should not disclose his identity or the identity of any beneficiary of the ruling. The applicant is required to notify the Board that anonymity is required and to supply a draft ruling with identifying material deleted. Where an anonymity notifi-

cation has been made any ruling issued by the Board must have any material identifying the applicant or beneficiary deleted.

Section 11 provides that the Board must give reasonable assistance to any person wishing to apply for a ruling or who has applied for a ruling incorrectly.

It is also provided that, apart from the written and oral communications between the applicant and the Board for which specific provision is made, the Board may take any other considerations into account in making a ruling. It is further provided that the Board may extend the time limits specified in the Act.

Section 12 requires the Board to prescribe fees for rulings on an annual basis. In setting the fees the Board is required to ensure that they cover the costs incurred by the Board in administering the advance rulings process.

Section 12(6) and (7) set out transitional provisions in respect of fees for advance rulings. They provide that during the year in which the Act comes into force and in the following year the fees charged by the Board for advance rulings are not required to cover the costs of the Board in administering the advance rulings process. Instead the Board is required to charge such fees as it considers appropriate. It is also provided that the Board is required to publish a schedule of the fees payable by applicants for work done in the year in which this Act comes into force. This schedule will be necessary because in the first year of operation of the Act there will be no schedule published in the previous year, as will ordinarily be required by section 12(4).

Section 13 makes provision for the payment of fees. Generally fees are required to be paid before a ruling is issued. However, the Board is entitled to issue a ruling and to cause it to be published pursuant to section 16 before the fee has been paid. The general recovery provisions of Part VI of the Taxes Management Act 1970 apply to the recovery of unpaid fees.

Section 14 provides for appeals in respect of advance rulings. An appeal lies to the Special Commissioners.

The appellant is required to file a statement of the case on appeal with the Commissioners within two months of filing the notice of appeal. The appeal is to be a full reconsideration of the application.

The procedures under the Taxes Management Act 1970 in respect of ordinary appeals to the Commissioners apply to appeals under this Act, with necessary changes.

On hearing any appeal the Commissioners are empowered to confirm, cancel or vary any ruling made by the Board or to make any advance ruling that the Board is empowered to make. There is no right of appeal in respect of any decision made by the Board in exercising a power to extend the time for doing anything. A further appeal lies to the Courts.

Section 15 provides that if after three months from the receipt of an application the Board has not advised the applicant that it is ready to issue a ruling the applicant may commence and prosecute an appeal under section 14, as if the Board had refused to issue a ruling.

Section 16 makes provision for the publication of advance rulings. The Board or any person authorised by it may publish reports of advance rulings either in written form or on an electronic data base. Where an anonymity notification has been received pursuant to section 10 any report of an advance ruling is required to have any material identifying the applicant or the beneficiary of the ruling deleted. The provisions relating to publication apply to the Commissioners in respect of appeals made under section 14. It is also provided that where an appeal is made to the High Court or the Court of Appeal the Court may order that any identifying material must be deleted from any report of the proceedings.

Section 17 provides power to make regulations.

Section 18 is the interpretation section. It defines the terms "advance ruling" and "ruling", "anonymity notification" (which is referred to in section 10), "applicant", "application", "assessment", "beneficiary of a ruling", "return" and "transaction". The term "beneficiary of a ruling" is wider in scope than

"applicant". This is because pursuant to section 1 an advance ruling may be issued in respect of persons other than the person applying for the ruling.

The term "transaction" is central to the Act because pursuant to section 1 advance rulings are made as to the tax consequences of "transactions". The definition of "transaction" is very wide and includes any document, contract, agreement, plan or understanding and any steps by which the transaction is carried out.

"Tax" and "Taxes Acts" are defined in terms such that rulings under the draft Act are available in respect of income tax, corporation tax, and tax charged under the Taxation of Chargeable Gains Act, 1922.

The appeal authority in the Act is the Commissioners, defined as the Special Commissioners in section 1.

APPENDIX 2
Tax Compliance Survey – Results

Sue Green*

Brief Summary of Results for Section 1: Details re Respondents

Question	*Response (%)*
1.1 Sex	85.6 male 14.2 female
1.2 Age	60.7 under 45
1.3 Professional qualifications	73 ACA 64.3 FCA 19.7 ATII
1.4 Current job	87.8 in practice 10.4 in industry or commerce
1.5 Level at work	72.2 partner or equivalent 12.8 senior manager 11.3 manager 2.9 below manager
1.6 Number of people in dept.	<10 73.5
1.7 Number in firm throughout UK	<10 63.2 10–19 10
1.8 Experience of tax	10+ years 66.5
1.9 Worked for DSS/IR	2.7

* Sue Green is at the University of Bristol. For a full analysis, see Green, S. (1994), *Compliance Costs and Direct Taxation,* Research Board, The Institute of Chartered Accountants in England and Wales.

1.10 *Reading*	*Always* %	*Usually* %	*Sometimes* %
Taxline	56	13	4
Taxation	42	16	17
Tax Journal	17	8	17
BTR	3	2	12
Fiscal Studies	1	1	4
Accountancy	60	17	11.5
Accountancy Age	49	15	10
Taxation Practitioner	19	8	10
Simons Tax Intell.	22	7	11
Law & Tax Review	1	0.3	4
Law Society Gazette	1	0.4	5
Tolley's Prac. Tax	19	12	14.2
Others	16	3	1

1.11 Areas of work currently involved in (%):

Audit	54
Accounts preparation	64
Insolvency	3
Management consultancy	15
Taxation	97
Other	5

1.12 Attitude to work:	*Over last two weeks*	*Over last year:*
Very much enjoy it	29	30
Enjoy it	56	57
Dislike it	5	5
Very much dislike it	1	1
Indifferent	8	7

1.13 Time spent keeping up-to-date:

Time-consuming	78
Not time-consuming	11
Not able to keep up-to-date	11
Relative to past:	
More time-consuming	70
No significant difference	24
Less time-consuming	1
Not able to keep up-to-date	6

General Survey of Results for Section 2: Questions about General Structure and Administration of the Tax System

Question	*Response (%)*	
2.1 Would complexity of tax system be changed if schedular system were abolished?	Decrease	50
	Increase	7
	No change	28
	No opinion	15

2.2 Effects of other changes:	*Increases compliance costs (%)*	*Little or no effect on costs (%)*	*Don't know/ Not applicable (%)*
Restriction of set-offs between sources of Y	67	26	7
Different calculation for different income	73	23	4
Different due dates for different income	64	29	8
Separate assessments	79	14	5

2.3 If schedular system changes, so only one statement of Y each year, would compliance costs be reduced? (%)	27 agree strongly 53 agree 13 disagree 1 disagree strongly 6 no opinion re reduction in costs/no response	}80
2.4 If taxpayers dealt with only one office,would costs be reduced? (%)	39 agree strongly 50 agree 6 disagree 0.1 disagree strongly 5 no opinion /no response	}89
2.5 Should we retain the current fiscal year? (%)	42 yes 43 no 15 don't know/no response	

2.6 Other day? (%)		
	31 December	59
	31 March	35
	Other day	2
	No day specified	4

2.7 Revenue staff in general (%)	*Yes*	*No*	*No opinion*
Helpful	84	7	9
Efficient	36	39	25
Polite	88	3	9
Knowledgeable about technical issues	38	33	29

2.8 Methods of contact (%)	*Often*	*Sometimes*	*Rarely*	*Never*
Phone	44	49	6	1
Letter	95	3	1	1
At interview	3	32	53	12
Commissioners	0.3	5	37	58
Also by fax				

2.9 Contacted Somerset House in last 12 months re technical points (%)	25	Yes
	64	No
	11	Don't know /no response
2.10 Was response helpful? (%)	64	Yes
	31	No
	5	Don't know /No response
2.11 Would costs fall if you got written replies to queries? (%)	9	Yes agree strongly
	34	Yes
	19	No
	1	Disagree strongly
	34	Don't know
	3	No reponse

2.12 Would you be prepared to pay? (%)	3	Agree strongly
	29	Agree
	34	Disagree
	13	Disagree strongly
	19	No opinion
	2	No response

2.13 Satisfactory communication? (%)	*Between tax districts*	*Between districts and collector*
Agree strongly	1	1
Agree	20	20
Disagree	51	50
Disagree strongly	19	24
No opinion	8	4
No response	1	1

2.14 Effect of geographical location of tax districts	13	Agree strongly that costs increased
	31	Agree
	38	Disagree
	3	Disagree strongly
	15	No opinion

2.15 Has service to the public improved since publication of:

	Taxpayers Charter	*Read it?*	*News Release*	*Read it?*
Yes	24	90	25	76
No	52	8	40	21
Don't know	24	2	35	3

2.16 Will you change work practices due to Disclosure Guidelines?

Yes	23
No	54
No opinion	12

2.17 Would a reduction in number of tax districts reduce average compliance costs?

Yes	16
No	56
No opinion	28

2.18 *Has, in my opinion, been unsatisfactory/satisfactory in respect of the following:*

The overall level of service that I have encountered from these levels of staff:	*Dealings with staff over the telephone*			*Prompt replies to correspondence*			*Consistent Revenue practice by different staff at this level*			*Consistent Revenue practice by staff at this level and their supervisors*			*General level of technical competence demonstrated by staff in your dealings with them*			
	Sat	*Not Sat*	*N/A*	*Sat*	*Not Sat*	*N/A*	*Sat*	*Not Sat*	*N/A*	*Sat*	*Not Sat*	*N/A*	*Sat*	*Not Sat*	*N/A*	
	01	02	03	04	05	06	07	08	09	10	11	12	13	14	15	
Revenue Executives (formerly TOHGs)	51	13	25	35	27	26	33	25	27	35	21	28	37	25	23	01
Inspectors in local offices	86	3	5	63	26	3	54	28	8	55	21	11	74	12	4	02
Inspectors in "Pollard Districts"*	16	1	66	14	4	63	13	4	63	13	3	63	15	2	62	03
District Inspectors	71	2	19	66	9	14	54	12	20	51	9	25	67	4	16	04
Inspectors at Somerset House	14	3	67	16	4	61	14	2	63	13	2	63	18	1	60	05
Staff in Enquiry Branch	15	3	66	14	3	62	13	3	64	13	2	62	15	2	61	06
Staff in Special Office	13	2	68	12	4	64	11	4	66	10	4	65	13	3	63	07
Local Collectors of Taxes	52	23	15	42	29	17	42	24	20	42	21	22	44	23	18	08
Staff in Accounts Offices (Shipley and Cumbernauld)	49	24	18	34	38	17	43	20	23	41	19	25	41	24	21	09

* Dealing with large companies and staffed by senior personnel.

Key: *Sat* = Satisfactory; *Not Sat* = Not satisfactory; *N/A* = not applicable.

2.19 Which of the following recent changes do you think will help to reduce compliance costs directly incurred by:

(a) the general public

(b) tax practitioners?

	Will help the general public			*Will help tax practitioners*			
	Yes	*No*	*NA/ DK*	*Yes*	*No*	*NA/ DK*	
	01	02	03	04	05	06	
Colour coding and simplification of Revenue forms	63	23	14	52	37	11	01
The increased use of mobile tax enquiry centres	61	17	22	6	73	21	02
Local radio broadcasts (phone-ins) by Revenue staff	52	29	19	5	75	20	03
Attempts to bring together the work of tax assessment and collection offfices within the Revenue	81	11	8	88	7	5	04
Retiming the March Budget Statement	29	48	23	54	28	18	05
The increased use of computer systems by the Inland Revenue	52	31	17	63	22	15	06
The increase in pre-legislative consultation	37	42	21	82	8	10	07

2.19 (Contd)

	Will help the general public			*Will help tax practitioners*			
	Yes	*No*	*NA/ DK*	*Yes*	*No*	*NA/ DK*	
	01	02	03	04	05	06	
The creation of customer service managers	55	20	25	25	46	29	08
The introduction of the Executive office structure	19	31	50	23	28	49	09
The 28-day turn-around system for post	75	14	11	83	9	8	10

Brief Summary of Results for Section 3: Personal Tax

Personal Tax: Compliance Cost

3.1	*Relatively high (%)*	*Relatively low (%)*	*Don't know*
Schedule A	30	56	14
Schedule D Cases I and II			
Sole traders	72	20	8
Partnerships	87	6	7
Schedule D III	16	73	11
Schedule D IV and V	18	48	34
Schedule D VI	26	55	19
Schedule E	45	48	7
Taxed income	26	68	6

3.2 Change to independent taxation (%)

Increase in compliance cost	70
No significant alteration	25
Decrease	3
Don't know/Not applicable	2

3.3 Effect of abolition of composite rate tax on compliance costs(%)

Increased	41
No significant alteration	53
Decreased	5
Don't know/Not applicable	1

3.4 Effect of IR's attempts to reduce compliance costs for smaller businesses (%)

Reduced costs	19
Not reduced costs	59
Don't know/not applicable	22

3.5	*Have you had discussions with the Revenue about interpretation of the legislation, or about revenue practice in this area?*		*If Yes, do you feel that the the amount of correspondence could have been reduced if the legislation were to be modified/clarified?*		
	Yes (%)	*No (%)*	*Yes (%)*	*No (%)*	*Don't know*
Capital allowance computation	33		56	36	8
Definition of plant for capital allowance purposes	30		74	20	6
Interpretation of office or employment in determining whether a client is taxable under schedule E or schedule D	47		83	13	4
Deductibility of expenses under schedule E	43		74	22	4
Interpretation of emoluments under schedule E	24		70	23	7
Interpretation of legislation governing the taxation of benefits-in-kind	52		81	15	4
Obtaining dispensations for P11Ds	35		57	36	7
Schedule E investigations and PAYE audits	35		58	35	7
Deductibiltiy of expenses for schedule D purposes	55		62	33	5
Distinction between capital and revenue items	43		66	29	5
Schedule D losses	48		51	43	6
Pensions premiums	40		45	49	6
Taxation of overseas income	22		48	35	17
Taxation of foreign nationals	14		46	32	22
Taxation of income from trusts and of deceased estates	29		54	31	15

(Capital Gains Tax is dealt with in Section 5 of the survey.)

3.7, 3.8	*Effect of compliance costs of:* *Fewer tax districts*	*Single district for collection and assessment*
Reduction ?	%	%
Agree strongly	30	38
Agree	42	47
Disagree	19	10
Disagree strongly	1	0
No opinion	8	5

3.9 57% of those who replied estimated that between 5 and 15% of fees could be saved by dealing with one point of Revenue contact (31% said 10–14%)

21% estimated a saving of 15% or over

16% estimated a saving of <5%

3.10 Aware of pilot experiment? (%)

Yes	64
No	36

3.11, 3.12	*Reduce (CC) if agents signing elections?*	*Different time limits unnecessary?*	*Reduce CC if range of limits reduced?*
Agree strongly	23	42	23
Agree	54	44	46
Disagree	15	11	22
Disagree strongly	5	1	4
No opinion	3	2	5

3.13 In each of the following cases, please estimate the average reduction in compliance costs charged to your clients were the proposed change to be introduced:

	Estimated average reduction in fees charged to your clients						
In the event of this proposed change:	*Less than 1% of current fee* 01	*1–4%* 02	*5–9%* 03	*10–19%* 04	*20%+* 05	*DK/ NA* 06	
1. Agents signing elections	23	44	19	6	2	6	01
2. Reductions in range of time limits	23	32	25	9	2	9	02
3. Abolition of schedular system: – issue of single assessment for all sources of income	9	16	29	30	13	3	03
– unlimited set-offs of losses between different sources of income	11	23	28	24	11	3	04
– a single pay day for all sources of income	15	28	29	16	8	4	05
4. Amalgamation of tax and collection officers within the Revenue	10	27	30	21	7	5	06

Initial Results for Section 4: Corporation Tax

4.1	*Tends to be high relative to the other schedules and cases*	*Tends to be low relative to the other schedules and cases*	*Don't know*	
	01	02	03	
Schedule A	24	58	18	01
Schedule D Cases I and II	74	18	8	02
Schedule Case III	10	79	11	03
Schedule D Cases IV and V	28	44	28	04
Schedule D Case VI	19	55	26	05
ACT	53	38	9	06
Charges on income	40	44	16	07
Management expenses for investment companies	43	29	28	08

4.2

Area of legislation	*Have you corresponded with the Revenue about points of interpretation about Revenue practice in this area?*		*If Yes, do you feel that the amount of correspondence could have been reduced if the legislation were to be modified/clarified*			
	Yes (%) 01	*No (%)* 02	*Yes (%)* 03	*No (%)* 04	*DK (%)* 05	
Deductibility of expenses for Schedule D purposes	88		63	31	6	01
Capital allowances computations	73		63	33	4	02
Definition of plant, industrial buildings and scientific research for capital allowance purposes	63		82	15	3	03
Treatment of reserves and provisions	59		58	38	4	04
Treatment of long periods of account	24		37	58	5	05
Schedule D losses	70		41	51	8	06
Deductibility of pension contributions	38		56	41	3	07
Treatment of foreign income	29		63	31	6	08
ACT set-offs and surplus ACT	68		46	49	5	09
DTR set-offs	28		58	36	6	10
Group relief claims	53		53	43	4	11
Treatment of chargeable gains*	62		54	40	6	12
Treatment of specific unusual items in financial accounts (e.g. extraordinary items)	58		45	46	9	13
Valuation of assets and dealings with Valuation Division of Revenue	71		66	28	6	14
Residence of companies	21		49	43	8	15

*There is a separate section of the survey dealing with capital taxation in more detail.

4.4 Would costs be reduced if dealt with single district involving collection and assessment? (%)

Agree strongly	16
Agree	43
Disagree	20
Disagree strongly	1
No opinion	19

Do you in fact deal with only one tax district?

Yes	76
No	22
Don't know	2

4.5 Were you aware of the Revenue's pilot shceme?

Yes	70
No	30

4.6/4.7 Would compliance costs be reduced:

	If agents were allowed to sign elections (%)	*If range of time limits was reduced (%)*	*If blanket elections allowed (%)*
Agree strongly	20	21	18
Agree	52	49	53
Disagree	16	21	12
Disagree strongly	7	3	1
No opinion	5	6	16

In the event of this proposed change:	*Estimated average reductions in fees charged to your clients*					
	Less than 1% of current fees 01	*1–4%* 02	*5–9%* 03	*10%+* 04	*DK/ NA* 05	
Agents signing elections	27	39	14	4	16	01
Blanket elections permissible	15	34	20	7	24	02
Changes in time limits	15	34	20	9	22	03

Initial Results for Section 5: Capital Taxes

5.1 *For these areas*	*The compliance costs* *Tend to be high relative to other areas* 01	*Tend to be low relative to other areas* 02	*Don't know/ Not applicable* 03	
Indexation	67	30	3	01
Rebasing	73	20	7	02
CGT losses	24	68	8	03
CGT and groups of companies	23	24	53	04
Part disposals	75	13	12	05
Inter-spouse transfers	6	75	19	06
Gifts and bargains not at arm's length	72	14	14	07
Connected persons	69	14	17	08
Disposals of only or main residence	13	69	18	09
Options	33	21	46	10
Leases	56	16	28	11
Disposals of wasting assets	47	23	30	12
CGT on settled property	37	21	42	13
Application to CGT to partnership transactions	52	21	27	14
Retirement relief	50	35	15	15
Holdover and rollover relief	67	25	8	16
Identification of securities	56	23	21	17
General dealings with Valuation Divisions in respect of CGT	79	9	12	18

5.2 *The compliance costs*

For these areas	*Tend to be high relative to other areas* 01	*Tend to be low relative to other areas* 02	*Don't know/ Not applicable* 03	
Grossing up and aggregation calculations	38	18	44	01
Treatment of potentially exempt transfers	20	49	31	02
Obtaining agreement re valuation of assets	65	8	27	03
Identification of exempt gifts	15	48	37	04
IHT and settled property	44	16	41	05
IHT and discretionary trusts	49	9	42	06
Reliefs for transfers between spouses	3	64	33	07
Reliefs for gifts for public purposes	6	31	63	08
Agricultural and business reliefs	37	26	37	09
Quick succession reliefs	18	24	58	10
Treatment of associated operations	32	11	58	11
Treatment of gifts with reservation	41	13	46	12
Agreement of liability to IHT	30	29	41	13
Foreign elements of IHT	18	9	73	14
Payment of tax by instalment	17	37	46	15