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The Delicate Balance

Tax, Discretion and the Rule of Law

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HMRC's Management of the U.K. Tax System: The Boundaries of Legitimate Discretion

Judith Freedman and John Vella*

1. The revenue authority's discretion and its limits

Taxation provides a critical point of contact between the individual and the state. It requires a number of delicate balances to be negotiated, ensuring, on the one hand, that the tax imposed by the legislature is collected efficiently and, on the other, that taxpayers' rights and interests are respected.

Whilst it is generally accepted that revenue authorities need to be able to employ some discretion in the exercise of their duties, much difficulty is encountered in agreeing on the breadth of discretion to be allowed. Indeed, the benefits of discretion (including the efficient operation of the tax system) find a counterweight in strong demands from taxpayers for certainty, legitimacy, consistency and equality. The property and business interests involved in taxation lead some to suggest that certainty in tax law is of the utmost importance – perhaps even more so than in other areas of law. This view stems from a deep-seated notion, arising from a history of hard-fought political battles, that taxation of property and labour is a form of legitimated property confiscation requiring powerful justification.¹ Even those who argue the contrary view, that is that all taxpayers can ever be entitled to is what they are left with *after* taxation,² would presumably agree that taxation must be *legitimately* levied and collected, according to the tests of legitimacy applicable in the relevant state.

* Faculty of Law and Oxford University Centre for Business Taxation and Oxford University Centre for Business Taxation respectively. This work has been supported by Oxford University Centre for Business Taxation and particularly the Economic and Social Research Council large grant (RES-060-25-0033), which is gratefully acknowledged. The authors also thank Mark Aronson, Rebecca Williams, Rita de la Feria and the participants at the conference, *The Delicate Balance: Revenue Authority Discretions and the Rule of Law*, Monash Prato Centre, 23-24 September 2010, for their helpful comments on the conference version of this chapter.

1. Monroe, Hubert H., *Intolerable Inquisition? Reflections on the Law of Tax* (London: Stevens & Sons, 1981); Nozick, Robert, *Anarchy, State and Utopia* (Oxford: Blackwell Publishing, 1974), p. 169.

2. Murphy, Liam and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford: Oxford University Press, 2002), p. 9.

1.1. Constitutional principles

Taxpayer protection is guaranteed ultimately by the constitutional principles which underpin each national tax system. Debates on the amount of discretion that can be vested in revenue authorities must thus take place against the background of each country's specific constitutional principles. These principles will define the outer boundary of the discretion that is allowed under that particular legal system. In the U.K., in a revenue law context, these principles include the supremacy of Parliament and the rule of law as embodied in the unwritten constitution and legal system, Article 4 of the Bill of Rights Act 1689 which vests the sole authority to tax in Parliament, the treaties of the European Union and principles deriving from them, to the extent that they are relevant in any given case, and the principles emerging from the Human Rights Act 1998.

These principles determine how much discretion can be vested by statute in Her Majesty's Revenue and Customs (HMRC), the U.K. revenue authority. As a corollary to this, courts also draw upon these principles when performing their crucial role of overseeing HMRC's use of the discretionary powers vested in them.

1.2. Discretionary powers of the U.K. revenue authority

Within the framework described above, powers are granted to HMRC through express legislation. Statutory provisions granting specific discretionary powers to HMRC are found in different parts of the legislation.³ In addition to these specific discretionary powers, section 5 of the Commissioners for Revenue and Customs Act 2005 (CRCA) vests HMRC with a more general discretionary power to undertake acts in relation to their responsibility for the "collection and management" of taxes.⁴ Section 9 of the CRCA then expands on this provision by giving HMRC the power to "do anything which they think (a) necessary or expedient in connection

3. For example, Taxes Management Act 1970, s. 102 - discretion to mitigate penalties: see *Simon's Taxes* (London: LexisNexis Butterworths, 2008) (looseleaf), A4.526.

4. Section 51(3) of the CRCA provides as follows: "A reference in this Act, in an enactment amended by this Act or, subject to express provision to the contrary, in any future enactment, to responsibility for collection and management of revenue has the same meaning as references to responsibility for care and management of revenue in enactments passed before this Act". These words are designed to make clear that there was no intention to change the scope of the responsibility, as set out in the cases discussed in section 4, *infra*, when the legislation was rewritten in 2005.

with the exercise of their functions, or (b) incidental or conducive to the exercise of their functions". For ease of reference, this is referred to in this chapter as HMRC's "general discretion".

This chapter discusses HMRC's general discretion using the following categorization:

- A. Discretion as to non-application of the law where its proper interpretation is agreed.
- B. Discretion as to how to interpret the law.
- C. Discretion in management of legislation and litigation.
- D. Hybrids of the above categories.

These categories, and the discretionary acts which fall within them, including concessions, guidance, waivers, deals and litigation strategies, are discussed in more detail below.

1.3. Secondary legislation

The general discretion of HMRC must be contrasted with express powers bestowed by primary legislation authorizing HMRC⁵ to produce secondary legislation.⁶ HMRC has a type of discretion to produce secondary legislation within the limits imposed by the primary legislation. Whilst somewhat similar to certain actions undertaken by HMRC under its general discretion, the two are fundamentally different in nature. The discretion given under section 5 of the CRCA is limited to care and management and does not give HMRC the authority to issue binding regulations, even if these are purely interpretative. Guidance issued by HMRC under its general discretion, as discussed below, is not binding on the courts in a case on the substantive meaning of the legislation, although it may give rise to legitimate expectations under an action for judicial review, as discussed in section 3 below.

5. Tax legislation may authorize bodies other than HMRC, such as Her Majesty's Treasury (HMT), to produce secondary legislation. See *Simon's Taxes*, supra, n. 3, A1.106.

6. Secondary legislation is also known as "delegated" or "subordinate" legislation. It can take many forms including orders, rules and regulations. For example, see Income Tax Act 2007, s. 1005 – designation of stock exchanges as "recognised stock exchanges" for the purposes of tax legislation.

Secondary legislation, on the other hand, has the force of law.⁷ As a result there are considerable safeguards surrounding such legislation. It is subject to parliamentary control, following one of the procedures laid down in the Statutory Instruments Act 1946.⁸ These procedures range from becoming law on a stated date where the material is not at all contentious, through the negative resolution procedure, where instruments laid before Parliament become law after a specified time period unless there is an objection, and to the less commonly employed affirmative resolution procedure, where instruments cannot become law unless they are approved by Parliament. Whether secondary legislation is subject to a parliamentary procedure and, if so, which procedure, is determined by the empowering Act and failure to follow it leads to the invalidity of the secondary legislation.

Unlike guidance under HMRC's general discretion, secondary legislation produces binding substantive rules. Like guidance issued under the discretion, however, in order to be valid all secondary legislation must be *intra vires* the power given by Parliament to produce this legislation, and it must not conflict with other primary legislation⁹ or constitutional principle.¹⁰ In *R. v. Inland Revenue Commissioners, ex parte Woolwich Equitable Building Society*,¹¹ for example, the Inland Revenue (as the tax authority was then called) was held to have exceeded its powers in regulations¹² and was thus ordered to repay the GBP 57 million received under the *ultra vires* regulations, plus interest. Finally, delegated legislation is subject to the substantive judicial controls applicable to all administrative acts, which are discussed further in section 3 below.

7. On secondary legislation in the U.K., see Craig, Paul, *Administrative Law* (London: Sweet & Maxwell, 6th ed., 2008), ch. 22. See also House of Commons Information Office, *Statutory Instruments*, Factsheet L7 Legislative Series (May 2008), available at: <http://www.parliament.uk/documents/commons-information-office/107.pdf> (accessed on 11 April 2011).

8. HMRC guidance is at times discussed in Parliament – see the discussion in section 4, *infra*.

9. *R. v. Secretary of State for Social Security, ex parte Joint Council for the Welfare of Immigrants* [1997] 1 W.L.R. 275.

10. For an example from the tax sphere see *Attorney-General v. Wilts United Dairies Ltd.* (1921) 39 T.L.R. 781.

11. [1987] S.T.C. 654.

12. Parliament subsequently enacted legislation to the same effect. For further discussion of the principle, see Eden, Sandra, "A Tax on All Blue Eyed Persons. Constitutional Limitations on Tax Raising Powers in the U.K.," in Joseph Edrey and Marco Greggi (eds.), *Bridging a Sea. Constitutional and Supranational Limitations to Taxing Powers of the States Across the Mediterranean Sea* (Rome: Aracne, 2010), p. 175.

The role of secondary legislation in relation to HMRC seems to be considerably more restricted than the powers of the U.S. Treasury to issue regulations, for example.¹³ Indeed, the powers vested in the U.S. Treasury include that to “prescribe all needful rules and regulations for the enforcement” of the tax laws.¹⁴ This allows for broader rule-making powers than those afforded to HMRC. Furthermore, whilst HMRC may issue guidance under its general discretion,¹⁵ U.K. courts will make their own interpretation of secondary legislation and not necessarily uphold that of HMRC, even if this might be an arguable one.

1.4. Control of discretion

1.4.1. Courts

Courts control HMRC’s use of discretion through adjudications in substantive cases in the normal way and through public law action for judicial review of the exercise of administrative authority.

1.4.2. Parliament

It is for Parliament to decide how much discretion it is desirable for a revenue authority to have. Relevant factors include the constitutional principles (as these have been developed over many years to provide essential safeguards), efficiency, equity as between taxpayers, administrative resource constraints, compliance costs of taxpayers, risk of revenue loss and the international competitiveness of the tax system as a whole.

Once discretion is vested in HMRC, Parliament also plays a role in scrutinizing its exercise. A number of mechanisms are in place to facilitate this. In particular, the Comptroller and Auditor General (C&AG),¹⁶ is required to examine the accounts of HMRC to ascertain that adequate regulations

13. On the U.S. Treasury’s power to issue regulations in the U.S., see Hickman, Kristin, “The Promise and the Reality of U.S. Tax Administration” (this volume), text at nn. 51–83.

14. Inland Revenue Code, s. 482.

15. U.K. courts do not share the U.S. *Chevron* doctrine on deference: *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984); *Mayo Foundation for Medical Education and Research v. United States* 131 S.Ct. 704 at 714 (11 January 2011). See Hickman, Kristin, “The Promise and the Reality of U.S. Tax Administration” (this volume), text at nn. 43–46 and 54–55 and the references there cited.

16. An Officer of the House of Commons: National Audit Act 1983, s. 1(2).

and procedure have been framed to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out.¹⁷ The C&AG must examine the correctness of the sums brought to account and report the results to the House of Commons. This is done through reports to the Public Accounts Committee (PAC)¹⁸ by the National Audit Office (NAO), a parliamentary agency, of which the C&AG is the head.¹⁹ The PAC can also commission the NAO to investigate and report to it on matters of concern and has done so in respect of the recent as yet unsubstantiated allegations regarding settlements as between HMRC and large businesses.²⁰

A further parliamentary body that may assess the use of discretion by HMRC is the Treasury Select Committee.²¹ This Committee is appointed by the House of Commons to examine the expenditure, administration and policy of a number of bodies, including HMRC. The Committee chooses its own subjects of inquiry.²² It is given a wide discretion in its conduct of inquiries, often taking written and oral evidence before producing a report.

HMRC's misuse of discretion will only ever be challenged by taxpayers in court (or even before the bodies discussed below) if it is detrimental to their interests. As standing to challenge a discretionary act favouring another

17. Exchequer and Audit Departments Act 1921, s. 2.

18. Available at: <http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/>. See Dunleavy, Patrick, Christopher Gilson, Simon Bastow and Jane Tinkler, *The National Audit Office, the Public Accounts Committee and the Risk Landscape in U.K. Public Policy*, Risk and Regulation Advisory Council (October 2009), available at: <http://eprints.lse.ac.uk/25785/> (accessed on 11 April 2011).

19. See http://www.nao.org.uk/about_us.aspx.

20. House of Commons Committee of Public Accounts, *HM Revenue and Customs' 2009–10 Accounts*, Eighteenth Report of Session 2010–11 (1 February 2011), pp. 6–7.

21. See <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/>.

22. See, for example, the inquiry into the administration and effectiveness of HMRC announced on 27 October 2010, available at: <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news/sub-committee-inquiry-into-hmrc/> (accessed on 11 April 2011).

taxpayer is only granted exceptionally,²³ such discretionary acts would generally go unchallenged. Parliament's role is thus particularly important as it ensures vigilance against the misuse of discretion *in favour* of certain taxpayers.

Recently, parliamentary scrutiny of HMRC appears to have been particularly responsive to concerns that have been aired by the public or interest groups.²⁴ Discussion of tax matters by the public is an important part of democracy and it is undoubtedly positive that Parliament is undertaking its scrutinizing function with vigour. It is important, however, for public and parliamentary debates to be well informed and there is a serious lack of specialist advice for U.K. Members of Parliament in the tax sphere at present.²⁵

23. Standing to bring an action for judicial review is granted if a person is deemed to have a sufficient interest in the matter to which the application relates (Supreme Court Act 1981, s. 31(3)): Endicott, Timothy, *Administrative Law* (Oxford: Oxford University Press, 2009), pp. 393-403. Taxpayers have been deemed to have sufficient interest in HMRC's decisions in relation to third party taxpayers when said decisions affect their competitive position: *R. v. Attorney-General, ex parte I.C.I. plc.* (1986) 60 T.C. 1. When taxpayers are not affected by HMRC's decisions relating to third party taxpayers, it would seem that standing will be granted only exceptionally. See *Inland Revenue Commissioners v. National Federation of Self-Employed and Small Businesses Ltd.* [1982] A.C. 617, discussed at n. 132, *infra*, and accompanying text.

24. See, for example, the Minutes of Evidence taken before the Public Accounts Committee regarding HMRC's accounts on Tuesday 16 November 2010, available at: <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpublic/uc502-ii/uc50201.htm>.

Some of the questioning by the members of the PAC appears to have been instigated by the abovementioned unsubstantiated allegations, dismissed by HMRC, about a settlement reached with Vodafone Ltd. These rumours were picked up by U.K. Uncut protesters who took to the streets and later claimed victory when PAC questioned HMRC on this issue: U.K. Uncut, "Major victory: NAO to investigate HMRC's dodgy deal" (25 January 2011), available at: <http://www.ukuncut.org.uk/blog/major-victory-nao-to-investigate-hmrcs-dodgy-deals> (accessed on 11 April 2011). See also Robinson, Duncan, "Protesters target Vodafone over taxes", *Financial Times* (27 October 2010), available at: <http://www.ft.com/cms/s/0/61f291de-e1d7-11df-b71e-001444feabdc0.html#axzz1J6Gasa00> (accessed on 11 April 2011).

25. See, for example, Working Party on the Institutional Processes for the Parliamentary Scrutiny of Tax Proposals and for the Enactment of Tax Legislation (Sir Alan Budd, chair), *Making Tax Law*, Tax Law Review Committee (TLRC) Discussion Paper No. 3, Institute for Fiscal Studies (March 2003); Working Party chaired by Lord Howe of Aberavon (Lord Howe Working Party), *Making Taxes Simpler*, final report (July 2008); Chittenden, Francis and Hilary Foster, *Is There a Way Out of the Tax Labyrinth?*, Association of Chartered Certified Accountants Discussion Paper (2009); Chartered Institute of Taxation, *The Making of Tax Law* (2010); Bowler, Tracey, *Tax Policymaking in the U.K.*, TLRC Discussion Paper No. 8, Institute for Fiscal Studies (2010). Most recently this has been recognized by the House of Commons Treasury Committee itself: *Principles of tax policy*, H.C. 753 (2011), paras. 15-16.

1.4.3. Internal procedure and other bodies

Internal procedures are in place within HMRC to deal with taxpayers' complaints;²⁶ a taxpayer's first port of call in the event of an alleged misuse of discretion by HMRC. Taxpayers can first approach the person or office they dealt with and, if existing concerns remain unresolved, the taxpayer shall be referred to a complaints handler. If the taxpayer is unhappy with the complaint handler's response, the matter may be referred to another complaint handler. Once the second handler's response is given HMRC's complaints procedure is exhausted.

Having gone through HMRC's internal procedure a taxpayer may then make use of the further protections provided by the Adjudicator and the Parliamentary and Health Service Ombudsman. The Adjudicator²⁷ looks into complaints about the manner in which taxpayers' affairs have been handled by HMRC.²⁸ Complainants must have exhausted HMRC's own complaints procedure and have received a final response from them. The Adjudicator considers complaints on matters including unreasonable delays, mistakes, and, crucially for our purposes, the use of discretion. Disputes about policy or matters of law are beyond the remit of the Adjudicator. Complaints can result in "recommendation letters", through which the Adjudicator sets out what, if anything, HMRC should do to put things right. "Mediation" is also possible where a resolution is found that is acceptable to both the complainant and HMRC. The Adjudicator, amongst other things, may ask HMRC to apologize and to meet any additional costs reasonably incurred as a direct result of their mistakes or delays or to make a small payment in recognition of any worry and distress a complainant suffered.

The Ombudsman²⁹ may also undertake independent investigations into complaints that HMRC have not acted properly or fairly or have provided a poor service. Again, one normally must have exhausted HMRC's internal procedures before filing a complaint with the Ombudsman. Also, complaints must be filed through a Member of Parliament.

26. See <http://www.hmrc.gov.uk/factsheets/complaints-factsheet.pdf>.

27. See <http://www.adjudicatorsoffice.gov.uk/>.

28. The Adjudicator also looks at complaints about the Valuation Office Agency (VOA) and The Insolvency Service.

29. This office was set up by the Parliamentary Commissioner Act 1967: see <http://www.ombudsman.org.uk/>.

There was hope that a Taxpayer's Charter would provide further protection but the HMRC Charter that resulted, which was introduced in the Finance Act 2009, is very weak at present.³⁰

1.5. Chapter outline

The next sections of this chapter investigate the discretion vested in HMRC and the limitations on that discretion in more detail. Section 2 outlines some relevant constitutional law principles which both determine how much discretion may be granted by law to HMRC and also serve to define the scope of that discretion once granted. Section 3 gives some background on the administrative law procedure of judicial review, with particular attention given to the creation of legitimate expectations, which is central to some contentious issues on the use by HMRC of its general discretion. Section 4 turns to the general discretion vested in HMRC. Section 5 concludes.

2. Constitutional limits on HMRC discretion

2.1. The framework dictated by the supremacy of Parliament principle

A number of constitutional principles determine how much discretion may be granted to HMRC by legislation. The traditional starting point is the supremacy of Parliament principle. According to this principle, Parliament enjoys “the right to make or unmake any law whatever: and, further, that no person or body is recognized by the law of England as having a right to override or set aside the legislation of Parliament”.³¹ It follows that, theoretically at least, any law may be enacted by means of a simple majority

30. The HMRC Charter, introduced in section 92 of the Finance Act 2009, can be found at <http://www.hmrc.gov.uk/charter/charter.pdf>. As presently constituted, it does not appear to give taxpayers any additional rights: see Whiting, John, “HMRC Charter – Magna Carta the second?”, [2009] *British Tax Review*, p. 616.

31. Dicey, Albert V., *Introduction to the Study of the Law of the Constitution* (London: Macmillan, 1885). Bradley and Ewing explain that “...in the United Kingdom the legislative supremacy of Parliament appears to be the fundamental rule of constitutional law and this supremacy includes power to legislate on constitutional matters. In so far as constitutional rules are contained in an earlier Act, there seems to be no Act which Parliament could not repeal or amend by passing a new Act. The Bill of Rights of 1689 could in law be repealed or amended by an ordinary Act of Parliament”: Bradley, Anthony and Keith Ewing, *Constitutional and Administrative Law* (Harlow: Longman, 14th ed., 2008), p. 57.

in Parliament, including a law that accords extremely broad discretionary powers to the revenue authorities. Any law or even constitutional principle which stands in the way of conferring such discretion, including the Bill of Rights Act 1689,³² the rule of law, the Human Rights Act 1998 or even, ultimately, in theory at least, any aspect of EU law,³³ may be overcome by express words in an Act of Parliament.³⁴

The above analysis follows the traditional understanding of the doctrine of parliamentary supremacy. Some senior judges have intimated that this doctrine would need to be revisited in extreme situations.³⁵ This suggests that U.K. courts might intervene if, for example, a statute breaches the rule of law in an extreme fashion. Whilst this would be considered a fairly uncontroversial and unremarkable process in many jurisdictions, so deeply entrenched is the doctrine of parliamentary supremacy within the British constitutional system that fellow senior judges and commentators have dismissed this possibility out of hand.³⁶ Thus the supremacy of Parliament principle dominates the constitutional landscape in the U.K. A law which simply stated that “HMRC may determine the tax to be collected from

32. Article 9 of the Bill of Rights Act 1689 was amended by section 13 of the Defamation Act 1996.

33. There is some debate as to the extent to which the U.K. Parliament could intentionally legislate in a manner contrary to EU law. The better view appears to be that if any aspect of EU law were to stand in the way of Parliament, Parliament could ultimately repeal the European Communities Act 1972 and, by means of a simple Act of Parliament, end the U.K.'s membership of the EU, although since this involves international treaties and institutions this would obviously be very complex in practice. See generally on the relationship between U.K. and EU law, House of Commons Library (Vaughne Miller and Oonagh Gay), “European Union Bill”, H.C. Bill 106 of 2010-11 Research Paper 10/79 (2 December 2010), available at: <http://www.parliament.uk/briefingpapers/commons/lib/research/rp2010/RP10-079.pdf> (accessed on 11 April 2011).

34. On the European Communities Act 1972, see *Thoburn v. Sunderland City Council* [2002] E.W.H.C. 195; [2003] Q.B. 151 and *Factortame Ltd. v. Secretary of State for Transport (No. 2)* [1991] 1 A.C. 603; on the Human Rights Act 1998, see *Watkins v. Secretary of State for the Home Department and others* [2006] U.K.H.L. 17; [2006] 2 A.C. 395.

35. See Lord Woolf, “Droit Public – English Style” [1997] *Public Law*, p. 57; *Taylor v. New Zealand Poultry Board* [1984] 1 N.Z.L.R. 394 at 398 per Lord Cooke and *R. (Jackson) v. Attorney-General* [2005] U.K.H.L. 56; [2006] 1 A.C. 262 at [102] per Lord Steyn.

36. Lord Bingham, “The Rule of Law and the Sovereignty of Parliament”, 19 *King's Law Journal* 2 (2008), p. 223. See also Ekins, Richard, “Acts of Parliament and the Parliament Acts”, 123 *Law Quarterly Review* (2007), p. 91 and Goldsworthy, Jeffrey, “Is Parliament Sovereign? Recent Challenges to the Doctrine of Parliamentary Sovereignty”, 3 *New Zealand Journal of Public and International Law* 1 (2005), p. 7.

individuals” would be legal, albeit “unconstitutional” in the sense that it contravened well-established constitutional principles.³⁷

The overpowering strength of this principle might seem to leave the various other constitutional principles, discussed below, with little room to protect taxpayers. Whilst true in theory, this is less so in practice.³⁸

2.2. The principle of legality

The “principle of legality” enjoins courts to interpret statutes in a manner that ensures compatibility with basic constitutional rights and principles, unless these are overridden by express language or clear and necessary implication.³⁹ This is an interpretative presumption which allows courts to depart from the natural meaning of the statute in order to ensure compatibility with such constitutional rights and principles, unless legislation expressly or by clear and necessary implication runs counter to them.⁴⁰ Lord Rodger explained that courts employ this presumption “because the substance of the rule is perceived to be so important that Parliament must squarely confront what it is doing when it interferes with it and must accept the political cost”.⁴¹

37. Bradley and Ewing, *supra*, n. 31, p. 26.

38. It might appear strange to assert parliamentary supremacy in a system where the doctrine of judicial precedent plays such a strong role. These are, however, consistent, since the role of the judges is to ascertain the intention of Parliament. If Parliament dislikes any resulting interpretation it may pass amending legislation. Thus the supremacy is maintained, in theory at least. See Forsyth, Christopher, “Of Fig Leaves and Fairy Tales”, 55 *Cambridge Law Journal* 1 (1996), p. 122; Elliott, Mark, “The Ultra Vires Doctrine in a Constitutional Setting”, 58 *Cambridge Law Journal* 1 (1999), p. 129; Craig, Paul, “Competing Models of Judicial Review” [1999] *Public Law*, p. 428; Craig, Paul, *Administrative Law*, *supra*, n. 7, ch. 1.

39. On the principle of legality see Sales, Philip, “A Comparison of the Principle of Legality and Section 3 of the Human Rights Act 1988”, 125 *Law Quarterly Review* (2009), p. 598.

40. *Regina v. Secretary of State for the Home Department, ex parte Pierson* [1998] A.C. 539. In *R. v. Secretary of State for the Home Department, ex parte Simms* [2000] 2 A.C. 115, Lord Steyn described the principle of legality as a constitutional principle. The principle of legality has been held to apply to both constitutional principles arising from the common law, as well as those arising from statutes, such as the Bill of Rights Act 1689: *Thoburn v. Sunderland City Council* [2002] E.W.H.C. 195; [2003] Q.B. 151.

41. *Watkins v. Secretary of State for the Home Department and others* [2006] U.K.H.L. 17; [2006] 2 A.C. 395. Some administrative lawyers might argue that courts employ the principle of legality because Parliament “must have intended” them to do so: see Forsyth, *supra*, n. 38 and Elliott, *supra*, n. 38.

The principle of legality is important for the purposes of the topic discussed in this chapter because it enjoins courts to interpret any statutory provision which vests discretion upon HMRC in a way that ensures conformity with the remaining constitutional principles, such as the rule of law. If necessary this could also entail narrowing the apparent scope of the discretion. These constitutional principles thus come into play again when courts are determining the scope of discretions granted to HMRC by statute.

Although the remaining constitutional principles described below can be breached by a simple Act of Parliament with no apparent redress being available, serious breaches of these principles would rouse political clamour, meaning that politicians have a vested interest in treading carefully in such areas. Egregious breaches could lead to a political backlash and are thus less likely to arise.⁴² More subtle breaches of these principles do not raise such clamour, however, and thus constitute a real and pernicious possibility. This makes it all the more important to identify the boundary established by these principles in as clear a fashion as possible. If they are to be breached, this should be done knowingly and on the back of reasoned consideration.

2.3. Remaining constitutional principles

As seen, whilst the UK Parliament may enact any law by means of a simple majority, including one that confers untold discretion upon HMRC, in practice political considerations and constitutional principles do provide protection for taxpayers. The two main constitutional principles that are of interest for this purpose are Article 4 of the Bill of Rights Act 1689 (in this chapter, Article 4) and the rule of law. The Human Rights Act 1998 and EU law place further limitations on the conferral of discretionary power on HMRC. Each is examined in turn.

42. A recent example was clause 11 of the Asylum and Immigration (Treatment of Claimants etc.) Bill. For a description of the issues and the strong response from the judiciary and the legal profession, see Pannick, David, "Asylum: an abuse of power that would embarrass even Mugabe", *The Times* (24 February 2004). The authors thank Rebecca Williams for this example.

2.3.1. Article 4 of the Bill of Rights Act 1689⁴³

Article 4 provides:

That levying money for or to the use of the Crown by pretence of prerogative, without grant of Parliament, for longer time, or in other manner than the same is or shall be granted, is illegal.

Article 4 is a potent constitutional principle. It has been used by courts and has had an important effect in a variety of contexts. Article 4 was invoked to show that the courts could not have developed a judicial anti-avoidance rule.⁴⁴ This constitutional principle, the judges argued, would be violated by a judicial anti-avoidance rule, as this would be tantamount to tax being imposed by the courts rather than Parliament. The anti-avoidance rule that had appeared to surface and take shape from *Ramsay*⁴⁵ onwards was thus recast as an instance of statutory interpretation.

Article 4 played an equally decisive role in the creation of a remedy in restitution for tax paid under an ultra vires demand. In *Woolwich Equitable Building Society v. Commissioners of Inland Revenue*,⁴⁶ Lord Goff held that full effect can only be given to the principle enshrined in Article 4 “if the return of taxes exacted under an unlawful demand can be enforced as a matter of right”. Furthermore, this principle has been expanded to cover cases in which a tax or other levy has been wrongly exacted by the public authority not because the demand was ultra vires but also if the authority has misconstrued a relevant statute or regulation.⁴⁷ This potent constitutional principle can thus both curtail and assist the development of a judge-made rule.

43. An Act Declaring the Rights and Liberties of the Subject and Settling the Succession of the Crown 1688, 1 Will. and Mar. Sess. 2, c. 2 (known as The Bill of Rights) emerged from the “Glorious Revolution” of 1688-89: House of Commons Library Note SN/PC/0293 (2009), available at:

<http://www.parliament.uk/documents/commons/lib/research/briefings/snpc-00293.pdf>.

44. *MacNiven v. Westmoreland* [2001] U.K.H.L. 6; [2001] S.T.C. 237 at [29] per Lord Hoffmann and *The Collector of Stamp Revenue v. Arrowtown Assets Ltd.* [2003] H.K.C.F.A. 46 at [105] per Lord Millett.

45. *W.T. Ramsay Ltd. v. Inland Revenue Commissioners* [1981] S.T.C. 174. For a discussion of the status of this rule see Freedman, Judith, “Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament”, 123 *Law Quarterly Review* (2007), p. 53.

46. [1993] A.C. 70.

47. See Lord Goff’s *obiter dictum* in *Woolwich* which seems to have been accepted in *British Steel plc. v. Customs and Excise Commissioners* [1997] 2 All E.R. 366.

Article 4 was also determinative in *Attorney-General v. Wilts United Dairies Ltd.*⁴⁸ and *Commissioners of Customs and Excise v. Cure & Deeley Ltd.*⁴⁹ Article 4, in conjunction with the principle of legality, allowed the court to find that a statutory provision delegating power to an administrative agency could not be deemed to have included the power to raise taxes. If Parliament intended to empower administrative agencies to impose taxes, counter to the constitutional principle embodied in Article 4, it must do so expressly. As this was not done in these two cases the court concluded that the power was not implied and, therefore, the imposition of taxes by the agencies was ultra vires. Article 4 therefore clearly protects against the self-arrogation of taxing power by the executive.

Article 4 thus remains an important principle of British constitutional law. The question then arises as to how it affects the conferment of discretionary powers upon HMRC. Would vesting HMRC with very broad discretion be tantamount to tax being imposed by a body other than Parliament, and hence be in breach of Article 4? The principle of legality would mean that the courts would do all they could to interpret such a power as narrowly as possible although ultimately, the supremacy of Parliament doctrine would mean that such a law, as long as it is expressed in clear and unequivocal language, would be required to be respected by the courts.

Less extreme cases present greater difficulty. Consider how the general discretion conferred by section 5 of the CRCA might be narrowed by the principle of legality to ensure conformity with Article 4. The principle of legality should narrow this provision by excluding discretionary powers which are tantamount to tax being imposed by HMRC rather than Parliament. Whilst it is clear that HMRC should not seek to collect taxes that are not imposed by statute, what tax a statute actually imposes is often less clear. Indeed, it is often the case that two (or more) tenable interpretations exist, according to one of which a transaction is taxed, and according to another it is not.⁵⁰ In that situation, HMRC of course has the discretion to pursue the interpretation that it prefers and to litigate the matter on the basis of its properly formed view. If, however, both alternatives are based on arguable cases, it can be questioned whether a declaration by HMRC that one

48. (1921) 37 T.L.R. 884 confirmed on appeal by the House of Lords (1922) 38 T.L.R. 781.

49. [1962] 1 Q.B. 340.

50. Eminent members of the judiciary have frequently disagreed on the interpretation of a taxing provision and hence the outcome of a tax dispute: e.g. *Craven v. White* [1989] A.C. 398.

of those interpretations is “unacceptable” and not the view of Parliament should then lead to a taxpayer being treated less favourably than another prior to adjudication by the courts. The risk rating techniques adopted by HMRC for classifying taxpayers, for example, as discussed further below, could be argued to involve problematic exercises of discretion of this kind.⁵¹

Likewise, a decision to reach a settlement with a taxpayer is clearly within the powers of HMRC as discussed in section 4 below, but the discretion does not extend to permitting a deal about non-payment of tax in the future⁵² and might be curtailed if it were found to be made on unreasonable grounds, although, as seen in section 1.4.2 above, it would be very difficult for a taxpayer not involved to establish sufficient standing to bring a judicial review case.

Once a court or a tribunal has settled on one of a number of possible interpretations it would seem to be beyond HMRC’s discretionary powers to insist on collecting tax following a different interpretation. A recent statement by HMRC that they would not be following a First Tier Tax Tribunal decision is open to criticism on this ground and, had the decision been taken by a higher-level court, HMRC’s view would certainly have been open to challenge.⁵³

2.3.2. The rule of law

The rule of law is generally viewed as one of the main pillars of the British Constitution.⁵⁴ It has been interpreted in different ways by constitutional experts as well as legal philosophers, and, in keeping with this trend, no

51. See section 4, *infra*.

52. See *Al Fayed v. Advocate General for Scotland* [2004] S.T.C. 1; discussed in more detail in section 3, *infra*.

53. In the case of *John Price* the Tribunal agreed with the appellant that roller blinds were “building materials” for value added tax (VAT) purposes (TC/2010/01287). Following the result, however, HMRC issued Revenue & Customs Brief 02/11 (25 January 2011) which stated that “roller blinds (and other ‘window furniture’) are not ‘building materials’ as defined” and that it will not be changing its policy. HMRC stated that the Tribunal chairman did not hear any evidence on the point but reached his conclusion as a matter of judicial notice, that is, as a common sense fact. Given the small amount at stake in this particular case, it was decided to ignore it rather than appeal: <http://www.hmrc.gov.uk/briefs/vat/brief0211.htm> (accessed on 11 April 2011). See Huber, Nick, “HMRC Picks its Tribunal Battles”, *Accountancy Age* (31 January 2011), available at: <http://www.accountancyage.com/aa/analysis/2012480/hmrc-picks-tribunal-battles>.

54. See Dicey, *supra*, n. 31.

definition was attempted when it made its first appearance in a statute in 2005.⁵⁵

The classic statement of the rule of law in the U.K. is to be found in Dicey in his *Introduction to the Study of the Law of the Constitution*.⁵⁶ His definition of the rule of law is in part contentious but his inclusion of the absence of arbitrariness, in that government should govern by known rules rather than by whim or discretion, is widely accepted.⁵⁷ Tomkins argues that, in English public law, the rule of law has at its core a simple and clear meaning - that the executive may do nothing without clear legal authority first permitting its actions. This can be seen as the basis of the legal principle of judicial review, discussed in section 3 below.⁵⁸

The legal philosopher Raz puts forward a slightly different formalist conception of the rule of law and argues that the basic intuition from which the rule of law doctrine derives is that “the law must be capable of guiding the behaviour of its subjects”.⁵⁹ A number of principles follow from this concept, which Raz, Fuller and others have suggested over the years. The principles that are directly relevant to the issue discussed in this chapter appear fairly uncontroversial.

First, the lives of individuals should be governed by law and not by administrative discretion. This principle overlaps with the public law concept described by Tomkins. Secondly, the law should be clear enough to allow individuals to regulate their affairs in advance. Thirdly, the exercise of governmental authority directly affecting individual interests must rest on legitimate foundations. Fourthly, the final determination of the meaning of law should be made by an independent third party. This last principle requires some elaboration. Legislation interpreted by its drafter might be given a meaning that is in line with the drafter's subjective intention in drafting it, but which cannot be apparent to anyone else upon reading the legislation. Therefore, individuals would not be able to regulate their affairs in advance, as demanded by the rule of law, because they would not have

55. Constitutional Reform Act 2005, s. 1, which states that the Act does not adversely affect (a) the existing constitutional principle of the rule of law, or (b) the Lord Chancellor's existing constitutional role in relation to that principle.

56. Dicey, *supra*, n. 31.

57. Tomkins, Adam, *Public Law* (Oxford: Oxford University Press, 2003), p. 22.

58. *Id.*, p. 78.

59. Raz, Joseph, *The Authority of Law: Essays on Law and Morality* (Oxford: Oxford University Press, 2nd ed., 2009), ch. 11 (“The Rule of Law and its Virtue”).

access to the meaning of the law as it will be eventually interpreted by the drafter.

Whilst fairly uncontroversial, these principles do not easily lead to precise prescription. Whilst the lives of individuals should be governed by law and not by administrative discretion, some degree of discretion is undoubtedly necessary and this principle is of limited help in determining how much this should be.⁶⁰ Similarly, whilst one cannot but agree with the proposition that law should be clear enough to allow individuals to regulate their affairs in advance, yet some vagueness in law is unavoidable,⁶¹ and this principle is of limited help in determining how vague a law ought to be. To this extent it would appear that the rule of law will primarily serve as a general guide on the framework the tax system should follow and aspire to and to protect against serious breaches.

That is not to say that instances where these principles have a more immediate impact may not arise. *Vestey v. Inland Revenue Commissioners*⁶² provides an interesting example. The case concerned assessments to tax made upon beneficiaries under a discretionary trust. The relevant statutory provision was so broadly drawn that, interpreted strictly, it arguably allowed HMRC to assess a single beneficiary on the basis of the total income of the settlement in the year of apportionment of the capital sums, and this regardless of the amount of benefit actually received by him.⁶³ HMRC argued that in such cases it had a discretion which enabled it to assess one or more or all of the individuals in such sums as it thought fit, the only limitation upon this discretion being that the total income may not be assessed more than once.

There are implied references to the rule of law in the judicial response to this. The rule of law requires legislation to be of sufficient certainty to allow individuals to regulate their affairs in advance and it requires law to be laid down through established procedures. The vagueness of the provision, and the need for HMRC to fill in the detail as to how the legislation was to be applied, arguably meant that both rule of law principles were breached. The issue could also be framed in terms of Article 4 of the Bill

60. Pettit, Philip, *Republicanism: A Theory of Freedom and Government* (Oxford: Clarendon Press, 1997), p. 175.

61. Endicott, Timothy, "The Impossibility of the Rule of Law", 19 *Oxford Journal Legal Studies* 1 (1991), p. 1.

62. [1980] A.C. 1148.

63. *Vestey v. Inland Revenue Commissioners* [1980] A.C. 1148 at 1193.

of Rights. Clearly, in this situation and more generally, the rule of law and Article 4 are kindred constitutional principles.

This case raises the question of whether HMRC's general discretion can be allowed to fill in a vague provision. Lord Wilberforce found this idea "a remarkable contention".⁶⁴ He also stated:

Taxes are imposed upon subjects by Parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined. A proposition that whether a subject is to be taxed or not, or, if he is, the amount of his liability, is to be decided (even though within a limit) by an administrative body represents a radical departure from constitutional principle. It may be that the revenue could persuade Parliament to enact such a proposition in such terms that the courts would have to give effect to it: but, unless it has done so, the courts, acting on constitutional principles, not only should not, but cannot, validate it.

The commissioners have, I gladly accept, done their best to devise a system which is workable and reasonably fair. But whatever system they might devise lacks any legal basis. I must regard this case therefore as one in which Parliament has attempted to impose a tax, but in which it has failed, in the case of discretionary beneficiaries, to lay down any basis on which it can be assessed or levied. In the absence of any such basis the tax must fail.⁶⁵

Lord Wilberforce does not mention the rule of law or Article 4 expressly but his sentiments reflect their contents. Lord Wilberforce was unwilling to interpret HMRC's general discretion as including discretion to give effect to this statutory provision or to interpret the relevant statutory provision as implying the necessary discretion to give effect to it. The presumption that Parliament would not want to overturn the rule of law or Article 4 is too strong to allow either. Lord Wilberforce was prepared to simply find that the statutory provision "failed".⁶⁶

This leaves open the task of determining how much discretion a provision requires for its application before it runs into the problems faced by the provision in *Vestey*. Or, viewed from a different perspective, how vague can a taxing provision be? This is clearly a matter which ought to be taken into

64. *Vestey v. Inland Revenue Commissioners* [1980] A.C. 1148 at 1171.

65. Note also that Lord Wilberforce states that if the correct interpretation of the section is that argued for by HMRC he would conclude "that no method for levying the tax in such cases has been prescribed by Parliament, that this gap cannot be filled by administrative decision and the assessments of it fail": [1980] A.C. 1148 at 1179.

66. See also *Customs and Excise Commissioners v. Top Ten Promotions Ltd.* [1969] 1 W.L.R. 1163.

consideration when designing new tax legislation. If a provision requires discretion of the proportions discussed in *Vestey*, it is necessary to ensure that Parliament vests HMRC in a clear and unequivocal manner with the discretion necessary to apply it unless it is to run the risk of being deemed by a court to have “failed”. Of course, it is not altogether apparent from Lord Wilberforce speech how “clear” a conferment of discretion on HMRC needs to be. In any event, the provision at issue in *Vestey* was exceptionally broad. Crucially, it provided no indication on how HMRC ought to narrow its application in practice. It seems, therefore, that a provision would need to bestow a remarkable amount of discretion before it could be deemed to have “failed” on these grounds.

Another example which might raise rule of law as well as Article 4 issues can be seen in the context of the risk rating of taxpayers.⁶⁷ As noted above this seeks to change attitudes towards tax avoidance by persuading taxpayers to follow what HMRC considers to be the correct interpretation of the law even though this may not be the way in which the courts would interpret the legislation in question. This involves treating taxpayers favourably (for example by making fewer interventions) if they accept HMRC interpretations and so raises questions about the rule of law.⁶⁸ Similarly, a non-statutory “Code of Practice on Taxation for Banks”⁶⁹ introduced in 2009, requires banks to follow the “spirit” as well as the letter of the law and encourages banks to moderate their tax planning. It would appear from the

67. On risk rating for large businesses see Freedman, Judith, Geoffrey Loomer and John Vella, “Corporate Tax Risk and Tax Avoidance: New Approaches”, [2009] *British Tax Review*, p. 74. See also Freedman, Judith, “Tax Risk Management and Corporate Taxpayers - International Tax Administration Developments”, in Anuschka Bakker and Sander Kloosterhof (eds.), *Tax Risk Management. From Risk to Opportunity* (Amsterdam: IBFD Publications B.V., 2010), p. 111. It should be noted that the guidance on risk rating of large business has been modified since this research was done. Some dissent is permitted without low risk rated companies losing their rating, but frequent questioning of revenue interpretations will raise doubts about this status. See HMRC, *Tax Compliance Risk Management Process*, available at: www.hmrc.gov.uk/manuals/tcrmanual/index.htm (accessed on 11 April 2011).

68. On the interaction between risk rating, responsive regulation and the rule of law see Freedman, Judith, “Tax Risk Management and Corporate Taxpayers – International Tax Administration Developments”, *supra*, n. 67; Yeung, Karen, *Securing Compliance: A Principled Approach* (Oxford: Hart Publishing, 2004), pp. 170 and 248.

69. HMRC, *A Code of Practice on Taxation for Banks, Consultation Response Document* (December 2009) (amended from earlier version), available at: http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD1_030008

HMRC guidance to this Code⁷⁰ that the spirit of the law is intended to go beyond purposive interpretation and thus might require payment of more tax than would be held by the courts to be due. The prestigious Financial Markets Law Committee (FMLC)⁷¹ suggested that if failure to abide by a Code which required taxpayers to go beyond the law led to greater scrutiny than would otherwise be the case, this could be a potentially coercive framework going beyond mere administrative discretion. This resulted in some minor changes to the Code with HMRC emphasizing that it was open to the taxpayer bank to take matters to court and that therefore transactions would be taxed in accordance with the law, not the Code. Nevertheless it is still the case that failure to follow the Code will be relevant for risk assessment purposes and so impacts on the treatment of the banks by HMRC. Therefore it is open to question whether this change meets the FMLC's rule of law objections; nevertheless it is the case that many banks have signed up to this Code.⁷²

2.3.3. Human Rights Act 1998

A major part of the European Convention on Human Rights (ECHR) was incorporated into U.K. law by the Human Rights Act 1998 (HRA).⁷³ The supremacy of Parliament principle however means that a domestic court may not strike down primary legislation which contravenes the ECHR. Instead protection through the courts is afforded by three other mechanisms. First, domestic courts will try to interpret legislation consistently with the ECHR.⁷⁴ As noted, this is similar to the principle of legality but stronger, in that courts can go even further in interpreting statutes to ensure

70. HMRC, "A Code of Practice on Taxation for Banks, Supplementary Guidance Note" (9 December 2009), para. 3.

71. Financial Markets Law Committee, *Proposed HMRC Code (Issue 146 – October 2009)*, available at: <http://www.fmlc.org/papers/Issue146Oct09.pdf> (accessed on 11 April 2011). At para. 5.10, the Committee commented that this might be an unjustifiable departure from well-established "rule of law" values such as: a) the law must be clear and ascertainable so that citizens can govern their conduct according to its precepts; and b) citizens are entitled to expect that administrative decisions will be applied to them on the same basis.

72. See HMT Budget 2011, para. 1.91: "Two hundred banks have now adopted the Code, including the top 15 banks operating in the U.K.". This appears to have been the result of a certain degree of governmental pressure: see <http://www.bbc.co.uk/news/business-11560409> (accessed on 11 April 2011).

73. For an extensive survey of the case law on taxation until April 2000, see Baker, Philip, "Taxation and the European Convention on Human Rights" [2000] *British Tax Review*, p. 211.

74. Article 3 of the HRA.

conformity with the ECHR.⁷⁵ Secondly, if this is not possible, a superior court may declare legislation to be incompatible with the ECHR, in which case the government may make a remedial order removing the incompatibility from the statute.⁷⁶ Parliament, however, might simply choose not to alter the offending legislation, meaning that “[t]he constraints upon its [i.e. the HRA’s] exercise by Parliament are ultimately political, not legal”.⁷⁷ A third protection is provided by Article 6 of the HRA which requires public authorities to adhere to the ECHR, and which gives courts the power to strike down any act which does not. Thus the rights set out in the ECHR can be employed as grounds for judicial review, their infringement becoming a ground of illegality, unless direct authority for the infringement can be found in primary legislation.

Despite the above, there appear to be limited opportunities for these mechanisms to be invoked in narrowing HMRC’s discretionary powers discussed in this chapter. The main substantive right to which appeal could be made, Article 1 of Protocol 1, protects the right to property. This includes the protection against deprivation of one’s possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. It explicitly does not impair the right of a State to enforce such laws as the State deems necessary to secure the payment of taxes. Article 14 could also come into play in this context. It provides that the enjoyment of the rights set out in the convention shall be secured without discrimination.

Legislation conferring discretionary powers could violate Article 1 of Protocol 1 and Article 14.⁷⁸ A judicial review application could also be brought on the grounds that HMRC has violated these Articles whilst exercising its discretionary powers. Examples might include the use of discretionary powers in a discriminatory manner contrary to Article 14 or demanding tax that is clearly not required at law, thus contrary to Article 1 of Protocol 1. It is not clear that the ECHR could provide a ground for redress in the

75. See *R. v. Inland Revenue Commissioners, ex parte Wilkinson* [2005] U.K.H.L. 30; [2006] S.T.C. 270. Therefore rights protected by means of the ECHR may only be overturned by express language or necessary implication to the contrary, as courts presume that even the most general words were intended to be subject to the basic rights of the individual. See also *Regina v. Secretary of State for the Home Department, ex parte Pierson* [1998] A.C. 539.

76. Articles 4, 5 and 10 of the HRA.

77. *Regina v. Secretary of State for the Home Department, ex parte Pierson* [1998] A.C. 539 per Lord Hoffmann.

78. For example a law which grants HMRC the discretion to decide whether a tax is to be imposed on either men or women.

event that HMRC chose not to apply published practice or to respect an undertaken given.⁷⁹

2.3.4. EU law

EU membership presents a number of challenges to the traditional U.K. constitutional order. First, EU institutions enact rules enjoying direct effect in the U.K. Secondly, EU law is superior to domestic law meaning that U.K. courts must set aside U.K. legislation which is inconsistent with EU law, whether or not the U.K. legislation was enacted before or after the relevant EU law.⁸⁰ The relationship between U.K. and EU law is governed by the European Communities Act 1972 and therefore it is this Act which allows for these breaks from traditional constitutional principles. In theory at least, from the U.K. perspective,⁸¹ it follows that the U.K. Parliament could, at any time, repeal this Act and bring an end to the U.K.'s membership of the EU.

Although a number of directives dealing with direct tax matters have been introduced, direct taxation falls within the competence of Member States. This notwithstanding, EU law can affect HMRC's discretionary powers in an indirect manner in this field. In the course of litigation on the substantive provisions, U.K. direct tax law can be set aside to the extent that it breaches the principles of the EU Treaty. It would follow that legislation purporting to vest HMRC with discretionary powers breaching these principles would be set aside and HMRC's general discretion would be similarly limited.

3. Judicial review and HMRC discretion

To some extent, the constitutional principles examined above also underpin judicial review, a process through which administrative discretion is kept under check. Some of the main features of judicial review under U.K. law are described in this section, as this will provide further necessary background to the discussion in section 4 of HMRC's general discretion.

79. Lee, Natalie, (gen. ed.), *Revenue Law – Principles and Practice* (Haywards Heath: Bloomsbury, 28th ed., 2010), p. 1532.

80. 6/64 *Costa v. E.N.E.L.* [1964] E.C.R. 585, 11/70 *Internationale Handelsgesellschaft* [1970] E.C.R. 1125; 106/77 *Simmmenthal* [1978] E.C.R. 629.

81. EU Member States and the EU institutions have divergent views on the specifics regarding the supremacy of Parliament. See Craig, Paul and Gráinne de Búrca, *EU Law: Text, Cases and Materials* (Oxford: Oxford University Press, 4th ed., 2007), ch. 10. See nn. 33 and 34, *supra*.

It is primarily through the process of judicial review that the U.K. courts have probed, set limits on and thus defined the scope HMRC's general discretion.

Judicial review has been described as:

a central control mechanism of administrative law (public law) by which the judiciary take the historic constitutional responsibility of protecting against abuses of power by public authorities.⁸²

It is a procedure through which courts, on the demand of individuals, assess administrative actions. The case law has classified the grounds on which this can be done under three general heads: illegality, irrationality (or unreasonableness) and procedural impropriety.⁸³ Each of these grounds can be subdivided into further, more specific grounds, such as abuse of power. The categories are not mutually exclusive and the considerations to be borne in mind under them may even clash.

Judicial review can provide control over the use of discretion, in that it allows individuals to challenge actions on the grounds that they were beyond the ambit of the relevant authority's discretionary powers, or, whilst within the authority's discretion they were taken on the basis of irrelevant considerations, for improper purposes or following inadequate procedures and so on. It does not, however, allow an appeal on the merits of a decision, as courts are to be wary of substituting their decisions for those of the public authority, and it is crucial that there remains space for a court to disagree with the public authority and yet uphold its decision. In fact, whilst unreasonableness is a ground for review, it denotes a level of unreasonableness of outrageous proportion, such that no reasonable person would have taken such a decision (known as *Wednesbury* unreasonableness after the case in which the test was established).⁸⁴

The recent development of judicial review, and indeed administrative law, in the U.K. has been remarkable. Over the course of a few decades "the

82. Fordham, Michael, *Judicial Review Handbook* (Oxford: Hart, 5th ed., 2008), para. 2.1.

83. *Council of Civil Service Unions v. Minister for the Civil Service* (the *GCHQ* case) [1985] A.C. 374 per Lord Diplock.

84. See the *GCHQ* case [1985] A.C. 374 and *Associated Provincial Picture Houses Ltd. v. Wednesbury Corporation* [1948] 1 K.B. 223. See also the more recent cases *R. v. Chief Constable of Sussex, ex parte International Trader's Ferry Ltd.* [1999] 2 A.C. 418 and *R. (on the application of Daly) v. Secretary of State for the Home Department* [2001] U.K.H.L. 26; [2001] 2 A.C. 532.

circumstances in which the courts have been prepared to provide relief for unlawful administrative action have expanded in spectacular fashion".⁸⁵

HMRC's general discretionary powers have been examined by court decisions on judicial review applications over the years, and as seen in section 4 below, these cases found that HMRC's general discretionary powers allow them to enter into back duty agreements,⁸⁶ to give guidance and advance clearances⁸⁷ and to make extra-statutory concessions in some circumstances,⁸⁸ but not to enter into forward tax agreements to collect less tax than strictly due with an individual.⁸⁹

In the remainder of this section the focus is on the creation of legitimate expectations to be protected by the judicial review doctrine. This is a central element of the control by the courts over the exercise by HMRC of its general discretionary power.

3.1. Legitimate expectations

The doctrine of legitimate expectations has been developed in the context of judicial review. Both procedural and substantive rights can be protected through the doctrine of legitimate expectations.⁹⁰ The doctrine requires a careful balance to be struck between certainty and fairness for the individual on the one hand, and flexibility and public interest on the other.⁹¹ One consideration to be taken into account is the possible effect of a rigorous enforcement of legitimate expectation, which might include dampening the authorities' appetite for producing policies or other documentation.⁹²

85. Lord Woolf, Jeffrey Jowell and Andrew Le Sueur, *De Smith's Judicial Review* (London: Sweet & Maxwell, 6th ed., 2009), para. 1-001.

86. *Inland Revenue Commissioners v. Nuttall* [1990] S.T.C. 194 (C.A.).

87. *R. v. Inland Revenue Commissioners, ex parte M.F.K. Underwriting Agents Ltd.* [1990] 1 W.L.R. 1545; [1989] S.T.C. 873, *Matrix Securities Ltd. v. Inland Revenue Commissioners* [1994] 1 W.L.R. 334.

88. *R. (on the application of Wilkinson) v. Inland Revenue Commissioners* [2005] U.K.H.L. 30; [2006] S.T.C. 270.

89. *Al Fayed v. Advocate General for Scotland* [2004] S.T.C. 1703.

90. *De Smith's Judicial Review*, supra, n. 85, pp. 609 et seq.

91. See Craig, Paul, *Administrative Law*, supra, n. 7, pp. 650-653.

92. *Id.*

U.K. law on legitimate expectations is still in a state of development, but provides considerable protection.⁹³ Representations or assurances by HMRC can give rise to legitimate expectations.⁹⁴ Since *R. v Inland Revenue Commissioners, ex parte Preston*,⁹⁵ courts have justified this in terms of fairness. In *Preston* the taxpayer sought relief against the use by HMRC of its statutory powers to raise an assessment on the ground that it had given an undertaking so not to do as part of a wider agreement it reached with the taxpayer. Lord Templeman held that HMRC is not allowed to resile from such an undertaking when it would amount to an abuse of power to do so.⁹⁶ This condition would be satisfied if “their conduct would, in the case of an authority other than Crown authority, entitle the taxpayer to an injunction or damages based on breach of contract or estoppel by representation”.⁹⁷

3.1.1. The limits of the legitimate expectation principle

Basis in a lawful promise

The orthodox position is that an ultra vires assurance cannot give rise to a legitimate expectation.⁹⁸ This appears to be unfair on individuals who relied on such assurances. It is not clear why they should bear the loss. On the other hand, allowing legitimate expectations to arise in such cases would have the “dual effect of unlawfully extending the statutory power [of the relevant public body] and destroying the ultra vires doctrine by permitting public bodies arbitrarily to extend their powers”.⁹⁹ There is clearly a very difficult balancing act to be performed here, especially where it is unclear

93. *Oxfam v. Her Majesty's Revenue & Customs* [2009] E.W.H.C. 3078 (Ch.); [2010] S.T.C. 686, para. 47. Other systems, e.g. Germany and France, provide greater protection of legitimate expectations: Australia does not recognize the doctrine at all.

94. A review of these cases can be found in *Simon's Taxes*, supra, n. 3, Binder 2, A5.303.

95. [1985] 1 A.C. 835.

96. *Preston* was cited in the seminal case *R. v North and East Devon Health Authority, ex parte Coughlan* [2001] Q.B. 213 as authority for the proposition that when a substantive legitimate expectation arose, courts would decide whether the frustration of the expectation was so unfair that to take a new and different course of action would amount to an abuse of power. For a discussion of *Coughlan* see Craig, Paul, *Administrative Law*, supra, n. 7, pp. 654–658.

97. Craig, Paul, *Administrative Law*, supra, n. 7, p. 671.

98. *R. (Bibi) v. Newham London Borough Council* [2001] E.W.C.A. Civ 607; [2002] 1 W.L.R. 237, para. 46 per Schiemann L.J.; *R. v Secretary of State for Education and Employment, ex parte Begbie* [2000] 1 W.L.R. 1115 at 1125 per Gibson L.J. See the discussion and cases cited in *De Smith's Judicial Review*, supra, n. 85, p. 636.

99. *R. v Ministry of Agriculture, Fisheries and Food, ex parte Hamble (Offshore) Fisheries Ltd.* [1995] 2 All E.R. 714 at 731 per Sedley L.J.

whether a decision is ultra vires. Although critical of the orthodox position, the courts appear to feel bound by it.¹⁰⁰

In the case of HMRC, as discussed in section 4, case law recognizes a discretion not to collect all tax due in some circumstances, but at some point the failure to apply the law becomes ultra vires and therefore not subject to protection by legitimate expectation. The dividing line is illustrated in the *Al Fayed* case,¹⁰¹ where it was accepted that HMRC had power to forgo the collection of the full amount of tax due, taking into account the difficulties of assessing accurately the total amount, but no power to accept an advance assessment of liability. Thus an agreement in respect of past tax due was valid, but an agreement in respect of forward payments was ultra vires and so could not be the basis of a legitimate expectation claim. HMRC did not, therefore, act unfairly in terminating an agreement early.¹⁰² Lord Cullen stated that “[t]here can be no legitimate expectation that a public body will continue to implement an agreement when it has no power to do so”.¹⁰³

HMRC also has some limited discretion to grant extra-statutory concessions, but the dividing line between lawful and unlawful concession is not clear, as discussed in section 4 below.¹⁰⁴ This again creates uncertainty as to the creation of legitimate expectations.

3.1.2. The limits of guidance

Legitimate expectations can arise from a practice. In *R. v. Inland Revenue Commissioners, ex parte Unilever plc.*¹⁰⁵ it was held that HMRC could not frustrate a legitimate expectation created by its long practice of accepting a claim for a tax refund despite the statutory time limit having expired. HMRC had not made any representation to the taxpayer about the practice,

100. Subject to some property rights under the HRA: *Rowland v. Environment Agency* [2003] E.W.C.A. Civ. 1885; [2005] Ch. 1.

101. *Al Fayed v. Advocate General for Scotland* [2004] S.T.C. 1703.

102. *Al Fayed v. Advocate General for Scotland* [2004] S.T.C. 1703, para. 114. The Court held that it was not even within HMRC's discretion to respect the then current agreement once it was understood to be ultra vires.

103. See also Judge J. in *M.F.K.*: “No legitimate expectation could arise from an ultra vires relaxation of the relevant statute by the body responsible for enforcing it”. *R. v. Inland Revenue Commissioners, ex parte M.F.K. Underwriting Agents Ltd.* [1990] 1 W.L.R. 1545 at 1573.

104. *R. v. Inland Revenue Commissioners, ex parte Wilkinson* [2005] U.K.H.L. 30; [2006] S.T.C. 270.

105. *R. v. Inland Revenue Commissioners, ex parte Unilever plc.* [1996] S.T.C. 681.

which had simply developed over the years: it was not irrelevant to the judges, however that this was a procedural rather than a substantive issue.

Most of the revenue cases dealing with legitimate expectation involve representations to a specific taxpayer or more general guidance. In *M.F.K.* it was held that there is “[n]o doubt [that] a statement formally published by the Revenue to the world might safely be regarded as binding, subject to its terms, in any case falling clearly within them”.¹⁰⁶ Circumstances might arise which justify a change in the guidance; however, HMRC accepts that it will normally remain bound to the guidance unless and until it announces a change, which would apply prospectively.¹⁰⁷

Less formal representations by HMRC may also give rise to legitimate expectations as seen in cases such as *Preston*.¹⁰⁸ In *M.F.K.* it was suggested, however, that representations of this kind would require a more detailed enquiry. In particular they will only give rise to a legitimate expectation if the “taxpayer put all his cards face upwards on the table” and the ruling or statement must be “clear, unambiguous and devoid of qualification”.¹⁰⁹

This condition does not, however, seem very different from that applicable to published concessions and guidance. These more general statements are almost always subject to caveats, which frequently state that they are inoperative in cases of avoidance. How this impacts on the legitimacy of any expectations arising can be a difficult question of fact and this may be very undermining of the protection offered by these statements. Taxpayers must prove that the facts at issue fall foursquare with the descriptions or examples used in the guidance. This is often difficult due to the use of the cautious language and relatively simple examples given in the guidance.

106. *R. v. Inland Revenue Commissioners, ex parte M.F.K. Underwriting Agents Ltd.* [1990] 1 W.L.R. 1545 at 1569. This starting point was recently confirmed in *R. (on the application of Davies and another) v. H.M. Revenue & Customs; R. (on the application of Gaines-Cooper) v. H.M. Revenue & Customs* (hereafter the *Gaines-Cooper* case) [2010] E.W.C.A. Civ. 83; [2010] S.T.C. 860, para. 18, although the actual result in this case seems to somewhat undermine this (paras. 20-21).

107. *Gaines-Cooper* case [2010] E.W.C.A. Civ. 83; [2010] S.T.C. 860, para. 19. HMRC’s acceptance of this point with regard to Statements of Practice can be seen in its Administrative Law Manual ADML5100, available at: <http://www.hmrc.gov.uk/manuals/admlmanual/ADML5100.htm>.

108. *R. v. Inland Revenue Commissioners, ex parte Preston* [1985] 1 A.C. 835.

109. *R. v. Inland Revenue Commissioners, ex parte M.F.K. Underwriting Agents Ltd.* [1990] 1 W.L.R. 1545 at 1569.

In *R. v. Inland Revenue Commissioners, ex parte Fulford-Dobson*¹¹⁰ it was held that HMRC was not bound by an extra-statutory concession because of a caveat stating that concessions would not be given “in any case where an attempt is made to use it for tax avoidance”.¹¹¹ In *R. (on the application of Thompson) v. Fletcher*¹¹² the Court cited a caveat as one of the grounds on which the taxpayers’ challenge, which was based on the wording of HMRC documents, failed. Similarly, in *Hanover Company Services Ltd. v. The Commissioners for Her Majesty’s Revenue & Customs*,¹¹³ a caveat led the Court to the conclusion that a specific representation in a Manual¹¹⁴ did not give rise to a legitimate expectation. The “health warning” in this case was in the Introduction to HMRC’s Guidance Manuals. This caveat, which applies to all HMRC Manuals, provides:

It should not be assumed that the guidance is comprehensive nor that it will provide a definitive answer in every case. HMRC are expected to use their own judgement, based on their training and experience, in applying the guidance to the facts of particular cases...Subject to these qualifications readers may assume that the guidance given will be applied in the normal case; but where HMRC considers that there is, or may have been, avoidance of tax the guidance will not necessarily apply.¹¹⁵

The decision in *Hanover* was made by a first level tribunal and is under appeal, but it has caused concern. If it were correct, HMRC’s Manuals, as a whole, would be incapable of producing legitimate expectations and would be a useless tool or even worse, a trap for the unwary. HMRC would be able to side-step any commitment to the interpretations laid out in its Manuals by the simple expedient of a general caveat. Given the reliance placed by HMRC and some politicians on the use of guidance, as well as the recent efforts by HMRC to encourage taxpayers to comply with the interpretations contained therein, this does not seem to give a fair result. Whilst guidance will not provide the definite answer in every case, and the premises upon which the interpretation is given must surely be met, once that is done, arguably it would generally be unfair to the point of being an

110. [1987] S.T.C. 344. Note that this case predates *R. v. Inland Revenue Commissioners, ex parte Wilkinson* [2005] U.K.H.L. 30; [2006] S.T.C. 270.

111. *R. v. Inland Revenue Commissioners, ex parte Fulford-Dobson* [1987] S.T.C. 344.

112. [2002] E.W.H.C. 1448 (Ch.); [2002] S.T.C. 1149.

113. [2010] U.K.F.T.T. 256 (T.C.).

114. The Supply and Consideration Manual VATSC.

115. Available at: <http://www.hmrc.gov.uk/manuals/advisory.htm>. For more examples see Fraser, Ross, “‘The White Open Spaces’ – Revenue Practice and Penalties for Negligent Conduct” [2006] *British Tax Review*, p. 386.

abuse of power for HMRC to be entitled to disown its interpretation on the basis of a general, exculpatory caveat.

The reference to “avoidance” in the caveat could be a particular source for concern. Avoidance is a vague term meaning different things to different persons. The subjective nature of the term might infuse the caveat with indeterminacy, meaning that taxpayers are left with the message that the Manual will generally be followed unless HMRC decides it should not be.

Lack of reliance is another factor which can hinder the emergence of a legitimate expectation. The taxpayers’ lack of reliance on the relevant Manual¹¹⁶ in *Fletcher* was another reason cited by the Court in rejecting the taxpayers’ challenge. There appears to be some uncertainty about this factor. In *Oxfam v. H.M. Revenue & Customs*¹¹⁷ Sales J. considered the issue of reliance at some length showing how its relevance varies from case to case. In a case where the assurance was only given to one taxpayer, and in the Court’s view the public authority was not acting irrationally by adopting a different approach to that given in the assurance, the lack of detrimental reliance would be fatal.¹¹⁸ In other circumstances it would be irrelevant. One example given by Sales J. is that of a general statement of policy which is not altered by the authority, but is applied differently to one particular individual without good reason. In such a case, even if this person did not rely on the general policy, the individual would have a good claim to be entitled to the benefit of that policy, as ordinary rules of public law prevent a public authority from acting arbitrarily and capriciously.¹¹⁹ Others have argued that “it is surely right that reliance should be a ‘necessary precondition’ of a legitimate expectation ‘where statements are made to the public at large’”.¹²⁰

A finding that a taxpayer did not rely on HMRC’s published representation was determinative in *Hanover*.¹²¹ Disconcertingly, the Court made this finding despite the fact that he relied on his accountant, who in turn had

116. The court also found that the Manual did not support the taxpayers’ case: *R. (on the application of Thompson) v. Fletcher* [2002] E.W.H.C. 1448 (Ch.); [2002] S.T.C. 1149, paras. 48 and 49.

117. [2009] E.W.H.C. 3078 (Ch.); [2010] S.T.C. 686.

118. *Oxfam v. H.M. Revenue & Customs* [2009] E.W.H.C. 3078 (Ch.); [2010] S.T.C. 686, paras. 50 and 55.

119. *Oxfam v. H.M. Revenue & Customs* [2009] E.W.H.C. 3078 (Ch.); [2010] S.T.C. 686, para. 54.

120. *De Smith’s Judicial Review*, supra, n. 85, p. 627.

121. *Hanover Company Services Ltd. v. The Commissioners for Her Majesty’s Revenue & Customs* [2010] U.K.F.T.T. 256 (T.C.).

relied on the guidance. This seems to be incorrect unless there is some reason why the agent should be aware of something which makes the guidance wrong.¹²²

3.1.3. The value of the legitimate expectations doctrine in controlling revenue discretion

The limitations discussed here explain why, despite the availability of protection for legitimate expectations arising out of formal and less formal representations, taxpayers are seldom successful in judicial review procedures on these grounds. That in itself is not determinative of the utility of the doctrine of legitimate expectations in keeping HMRC to its word. Generally HMRC will follow its own written guidance and the doctrine is a valuable reminder of the need to do so, though HMRC will feel free to change its mind in cases it considers outside the guidance for prospective cases.

4. HMRC's general discretion: categories and issues

Having provided the constitutional and administrative law context within which HMRC's discretionary powers are granted, exercised and overseen, this section now categorizes and analyses the specific use made by HMRC of its general discretion.

As noted in section 1.2 above, HMRC's general discretion is provided by section 5 of the CRCA, which vests HMRC with the responsibility for the "collection and management" of taxes.

HMRC may be said to apply its discretion in the following categories of case:

- A. Discretion as to non-application of the law where its proper interpretation is agreed.
- B. Discretion as to how to interpret the law.
- C. Discretion in management of legislation and litigation.
- D. Hybrids of the above categories.

122. This view is supported by another First Tier Tax Tribunal decision: *B&J Shop-fitting Services v. The Commissioners for Her Majesty's Revenue & Customs* [2010] U.K.F.T.T. 78 (T.C.).

4.1. Category A: Discretion as to non-application of the law where its proper interpretation is agreed

HMRC may decide not to enforce the law according to its agreed meaning.

There are various ways in which it has done this in the past and the primary methods are:

- (a) published extra-statutory concessions;
- (b) waivers or deals with individual taxpayers or groups of taxpayers on a one-off basis.

4.1.1. Extra-statutory concessions

Extra-statutory concessions have been controversial since they were first introduced.¹²³ Williams noted that the existence of these concessions was first reported to the Public Accounts Committee¹²⁴ in 1897. The Final Report of the Royal Commission on the Taxation of Income and Profit commented that it was “a little disconcerting to find the statute law being amended by this special and selective process”.¹²⁵ The practice increased during the Second World War, but peacetime did not see the withdrawal of this device. Pressure resulted in an agreement to publish a list of extant concessions annually and this practice continues today.¹²⁶ The judiciary sometimes accepted concessions as facilitating the operation of the tax system in a useful way but some judges were considerably more critical. Lord Reid, for example, rejected a concession on the grounds that “administrative moderation ... is no substitute for legal clarity and precision”.¹²⁷

Williams questioned the practice of granting concessions and suggested that it was contrary to the “rule of law”. He was commenting soon after a decision by Walton J. in the case of *Vestey v. Inland Revenue Commissioners*,¹²⁸ whose words “one should be taxed by law, and not be untaxed by concession” were echoed famously by Lord Wilberforce in the subsequent return

123. See Williams, David, “Extra-Statutory Concessions” [1979] *British Tax Review*, p. 137.

124. This is a Committee of the House of Commons that still exists today.

125. Cmd. 9474, para. 240, cited in Williams, *supra*, n. 123, p. 137.

126. The August 2009 list may be found at <http://www.hmrc.gov.uk/specialist/esc.pdf>.

127. *Bates v. Inland Revenue Commissioners* [1969] A.C. 483 at 500, cited by Williams, *supra*, n. 123, p. 141.

128. [1979] Ch. 177 at 197.

of that case.¹²⁹ In fact, as seen in section 2, that case concerned the use of unpublished administrative discretion to attempt to fill a gap in defective legislation and so did not necessarily outlaw the more established published extra-statutory discretions.

Since then there have been further clarifications regarding the scope of concessions which may be granted, most notably by the House of Lords in *Wilkinson*.¹³⁰ This case has caused HMRC to review all of its concessions and to commence a programme of withdrawing some and legislating others that fall outside the scope of its discretion based on that decision.¹³¹

In *Wilkinson* Lord Hoffmann agreed with the statement of Lord Diplock in *Inland Revenue Commissioners v. National Federation of Self-Employed and Small Businesses Ltd.*¹³² that HMRC was granted “a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge, the highest net return that is practicable having regard to the staff available to them and the cost of collection”.

He then continued:

[t]his discretion enables the commissioners to formulate policy in the interstices of the tax legislation, dealing pragmatically with minor or transitory anomalies, cases of hardship at the margins or cases in which a statutory rule is difficult to formulate or its enactment would take up a disproportionate amount of parliamentary time... [i]t does not justify construing the power so widely as to enable the commissioners to concede, by extra-statutory concession, an allowance which Parliament could have granted but did not grant...¹³³

This suggests an outer limit beyond which concessions are ultra vires. Unfortunately, this outer limit is not clearly demarcated. This presents a

129. *Vestey v. Inland Revenue Commissioners* [1980] A.C. 1148. See the discussion of this case, and in particular Lord Wilberforce's comments, in section 2.3.2, supra.

130. *R. v. Inland Revenue Commissioners, ex parte Wilkinson* [2005] U.K.H.L. 30; [2006] S.T.C. 270 per Lord Hoffmann, paras. 20-23.

131. Treasury orders (secondary legislation) to enact concessions can be introduced under a power in section 160 of Finance Act 2008. Several documents discussing the withdrawal or enactment of concessions are now on the HMRC website. Many concessions are considered to be valid under the *Wilkinson* test and these will be retained. Where concessions are withdrawn and not enacted it is stated on the website that an appropriate period of notice will be given to allow taxpayers to review their affairs and there will be no retrospective effect of any change. It is questionable whether this can be binding in view of the above discussion.

132. [1982] A.C. 617.

133. *R. v. Inland Revenue Commissioners, ex parte Wilkinson* [2006] S.T.C. 270, para. 21.

serious problem when it comes to the extent to which concessions can be binding on HMRC under the doctrine of legitimate expectation discussed in section 3.1.1 above, since, as has been seen, ultra vires representations cannot create legitimate expectations. If the taxpayer has no basis for knowing whether a representation is intra vires, however, this appears manifestly unfair. Another complication is caused by the fact that, as elaborated in section 4.2 below, the line between a legitimate statutory interpretation and a concession can at times be blurred.

HMRC's current list of concessions states that:

An Extra-Statutory Concession is a relaxation which gives taxpayers a reduction in tax liability to which they would not be entitled under the strict letter of the law. Most concessions are made to deal with what are, on the whole, minor or transitory anomalies under the legislation and to meet cases of hardship at the margins of the code where a statutory remedy would be difficult to devise or would run to a length out of proportion to the intrinsic importance of the matter.

The concessions described within are of general application, but it must be borne in mind that in a particular case there may be special circumstances which will need to be taken into account in considering the application of the concession. A concession will not be given in any case where an attempt is made to use it for tax avoidance.¹³⁴

The two points to note here are that it continues to be assumed that a valid concession may go beyond the law in some circumstances and that there is a major let out clause for HMRC in cases of "avoidance".

4.1.2. Waivers and deals

In addition to generalized concessions, HMRC has a settled discretion within its powers of management under section 5 of the CRCA to reach agreements with individual taxpayers or groups of taxpayers. This was firmly established in *Inland Revenue Commissioners v. National Federation of Self-Employed and Small Businesses Ltd.*¹³⁵ and indeed it can easily be seen that without the ability to settle cases and decide whether to pursue particular issues it is not possible to run a tax system in a sensible way. The *National Federation of Self-Employed* case permitted the Inland Revenue, as it then was, to come to an agreement with unions and employers

134. See <http://www.hmrc.gov.uk/specialist/esc.pdf>.

135. [1982] A.C. 617.

concerning a group of workers, wiping out past tax liabilities incurred as a result of evasion on the condition of future co-operation. The tax was probably impossible to collect in any event but this waiver was challenged as unreasonable by a group representing small businesses. The case made clear that there was no rule of equality in tax treatment that prevented such a deal in the U.K.¹³⁶ In *R. v. Inland Revenue Commissioners, ex parte M.F.K. Underwriting Agents Ltd.*,¹³⁷ relying on the earlier case of *Preston*,¹³⁸ the Court confirmed that if the revenue authority agreed to forgo tax which might arguably be payable on a proper construction of the relevant legislation, it could be held to that representation under the doctrine of legitimate expectation provided the taxpayer had made full disclosure. There are limits to this, however, as shown in the case of *Al Fayed*.¹³⁹

4.2. Category B: Discretion as to how to interpret the law

It is clearly ultimately for the courts to decide on the proper meaning and application of legislation, but in practice there is considerable scope for HMRC to opine on the meaning of legislation. Unless and until HMRC's view is challenged in the courts it is likely that many taxpayers will rely on the HMRC interpretation and this is therefore a very powerful tool. HMRC uses various devices to express its views on proper interpretation, which will now be discussed.

4.2.1. Statements of Practice, guidance and manuals

These various statements may be used to give a view on new legislation or areas where uncertainties and difficulties have arisen. They are often used

136. This decision is also important in relation to the question of standing. The House of Lords held that the group representing small businesses did not have standing to challenge the agreement between the Inland Revenue and unions and employers. In this difficult case, however, their Lordships did leave open the possibility of granting standing to challenge revenue authority decisions affecting third party taxpayers in certain exceptional cases, such as those involving "some exceptionally grave or widespread illegality": [1982] A.C. 617 647 per Lord Fraser. See also at 633 per Lord Wilberforce and at 662 per Lord Roskill. Note that Lord Diplock (at 644) was prepared to allow standing in a broader set of circumstances and the case is considered by public lawyers to open up the standing issue.

137. [1990] 1 W.L.R. 1545; [1989] S.T.C. 873.

138. *R. v. Inland Revenue Commissioners, ex parte Preston* [1985] 1 A.C. 835; [1985] S.T.C. 282.

139. *Al Fayed v. Advocate General for Scotland* [2004] S.T.C. 1.

to fill in the gaps where the legislation is drafted in broad terms, especially in the case of anti-avoidance legislation or where a term is used that is not defined in the legislation. There is increasing use of guidance in view of the desire to legislate in a broad fashion to escape the problems of complexity in legislation leading to creative compliance. At present this guidance is completely outside the legislative system as it is not contained in secondary legislation but is simply issued by HMRC.

HMRC also publishes manuals, primarily for the guidance of its own staff. These are now published on the internet and have become a valuable and popular starting place for practitioners researching tax questions. This is encouraged by HMRC and it is beginning to put certain forms of guidance directly into the manuals, where it expects taxpayers and their advisers to consult them. Manuals are frequently amended, and this can give rise to real difficulties in keeping track of changes, since amendments are not marked on the face of the amended manual and the old version is removed from the HMRC website.

These forms of guidance raise a number of questions, at times treading a fine line between interpretation and concession. The possibility then arises that the guidance is *ultra vires* and hence incapable of creating legitimate expectations. In such circumstances categories A and B overlap (sections 4.1 and 4.2), as discussed under category D below (section 4.4).

Issues of this type raise questions as to the ability of taxpayers to rely on guidance. The current uncertainty as to the extent to which this can be done was illustrated in the *Gaines-Cooper* litigation.¹⁴⁰ The case concerned statement IR20, which provided guidance on the definition of residence and ordinary residence. It was widely believed that IR20 provided some safe harbours¹⁴¹ and the taxpayer argued that satisfying the bright line tests found in the guidance sufficed, and he need not satisfy an additional test¹⁴² insisted on by HMRC. He argued that the additional test did not arise on a proper construction of the guidance, and even if it did, this was not a construction applied by the revenue authority until these cases provoked an unannounced change of policy. The Court of Appeal found that the satisfaction of this additional

140. *Gaines-Cooper* case [2010] E.W.C.A. Civ. 83; [2010] S.T.C. 860.

141. See Eden, Sandra, "R. (on the application of Davies) and R. (on the application of Gaines-Cooper) v. HMRC: the limits of legitimate expectation remain uncertain" [2010] *British Tax Review*, p. 322; Higginbottom, Louise and Angela Savin, "Gaines-Cooper: case review", 1019 *Tax Journal* (2010), pp. 7–8; Vaines, Peter and Ben Wilkins, "Gaines-Cooper: expert comment", 1019 *Tax Journal* (2010), p. 9.

142. That the taxpayer severed his social and family ties in the U.K.

test was actually required on a proper interpretation of the guidance, which it considered merely followed the case law. This was a result which surprised many practitioners.¹⁴³ Although it has been taken as giving some comfort to taxpayers that the Court of Appeal considered that giving guidance was within the revenue authority's power, since the Court also considered that the statement was intended to reflect the law the decision gives no indication of how far such a statement would be held to be binding if it was considered to go beyond the law. The Court did not think this issue arose on the facts of the case and considered that IR20 did not contain any binding assurance as to how the revenue authority would treat any particular claim, because this was an issue of fact. The Court found that HMRC had not changed its interpretation and application of the guidance; it merely engaged in closer and more rigorous scrutiny and policing of the growing number of claims.

Such a decision saps taxpayers' confidence in their ability to rely on guidance. It sent a signal to taxpayers that ordering their affairs in line with common understanding of the wording of guidance will not always suffice. A number of hard questions remain unanswered. To what extent may guidance create a legitimate expectation that tax which might otherwise be due will not be payable? What is the significance of past practice in the creation of legitimate expectations? The Court failed to answer all the outstanding questions and the outcome of an appeal is awaited.¹⁴⁴

The extent to which guidance may be relied on is also uncertain, as noted in section 3.1.2 above, due to the use of broadly-worded caveats.

4.2.2. Clearances

There is no general system of clearances or rulings in the U.K., although some legislative provisions contain specific clearance application provisions.¹⁴⁵ Unless such a specific provision is included the taxpayer may apply for clearances only in limited circumstances, at present. These are set out in Code of Practice 10 for general customers.¹⁴⁶

143. See Kessler, James, *Taxation of Foreign Domiciliaries* (Oxford: Key Haven, 9th ed., 2010).

144. The Supreme Court will hear the appeal in Summer 2011. Meanwhile, recognizing the disquiet following this case, the U.K. government has announced it will legislate to introduce a new statutory definition of residence: HMT 2011 Budget statement, available at: http://www.hm-treasury.gov.uk/2011budget_speech.htm.

145. For example, Corporation Tax Act 2010, s. 748 (transactions in securities).

146. <http://www.hmrc.gov.uk/pdfs/cop10.htm>.

For business customers there is a more extensive clearance service.¹⁴⁷ For this group, HMRC aims to provide clearances on areas of material uncertainty arising within four Finance Acts of the introduction of any new legislation and on legislation older than the last four Finance Acts where there is material uncertainty around the tax outcome of a real issue of commercial significance to the business itself, determined by reference to the scale of the business and the impact of the issue upon it. HMRC's website states that:

Clearances do not alter the tax treatment but simply give you HMRC's view of what the correct tax treatment is.

Non-statutory clearances under this practice are therefore not binding on HMRC in a strict sense but would bind HMRC under the doctrine of legitimate expectation provided the taxpayer fell squarely within the clearance given and had made all of the facts and details clear to HMRC under the *M.F.K.* doctrine, discussed in section 3.1.2 above.¹⁴⁸

4.3. Category C: Discretion in management of legislation and litigation

Resource allocation is very clearly recognized to be a central area where HMRC needs to have scope to manage in a cost efficient way.¹⁴⁹ There are various examples of this in action.

HMRC has a litigation and settlements strategy which guides the way in which disputes are dealt with, when cases are settled and when they are pursued¹⁵⁰ and Codes of Practice¹⁵¹ under which they will apply their discretion, for example by not exacting the full penalty available under the law where voluntary disclosure of irregularities is made.

A further example is that HMRC may decide the level of resource to devote to any given taxpayer in scrutinizing tax returns and making enquiries. There is an increasing (and entirely sensible) tendency to base such

147. <http://www.hmrc.gov.uk/cap/links-dec07.htm>.

148. *R. v. Inland Revenue Commissioners, ex parte M.F.K. Underwriting Agents Ltd.* [1990] 1 W.L.R. 1545.

149. *Inland Revenue Commissioners v. National Federation of Self-Employed and Small Businesses Ltd.* [1982] A.C. 617.

150. *HMRC Litigation and Settlements Strategy*. This can be found at: <http://www.hmrc.gov.uk/practitioners/lss-intro.htm>.

151. The Codes of Practice can be found at <http://www.hmrc.gov.uk/leaflets/c11.htm>.

decisions on profiling of taxpayers and risk-rating.¹⁵² The process of assigning the risk rating, however, involves the application of criteria the devising of which can itself be a process involving the application of discretion, since the consequences of categorization can be considerable. Categorization has been used quite explicitly to influence the behaviour of the taxpayer. In this way, risk rating, whilst initially appearing to be a purely administrative device, can become a significant application of discretion, even going so far as to attempt to influence taxpayers to be *over-compliant*.¹⁵³ As discussed above, this raises difficult questions about the boundaries of legitimate discretion.¹⁵⁴

4.4. Category D: Hybrids of the above categories

Where a discretion as to how to manage resources or interpret legislation is interlaced with concessionary treatment, a hybrid of the above categories results. The concession may be an integral part of the treatment applied by HMRC and may be a deliberate relaxation or simply the unintended consequence of a particular interpretation.

For example, as noted above, HMRC guidance at times appears to contain an element of concession. Given the indeterminacy of tax law the distinction between interpretation and the giving of a concession can be hard to discern. This is problematic for a number of reasons. Most immediately, if there is a concessionary element, a question mark arises over whether the guidance is *ultra vires* and hence incapable of founding a legitimate expectation. A taxpayer whose tax affairs have been carefully based on HMRC guidance might thus find that the treatment envisaged by the guidance is not actually applied. This has led professional bodies to complain vociferously about guidance which in their view went beyond a narrowing interpretation and constituted, in fact, a concession.

152. This is a worldwide trend: see, for example, Fiscalis Risk Management Platform Group, *Compliance Risk Management Guide for Tax Administrations* (European Commission, 2010), available at: http://ec.europa.eu/taxation_customs/resources/documents/common/publications/info_docs/taxation/risk_managt_guide_en.pdf (accessed on 11 April 2011).

153. Freedman, Judith, "Tax Risk Management and Corporate Taxpayers – International Tax Administration Developments", *supra*, n. 67, citing Baldwin, Robert and Julia Black, "Really Responsive Regulation", 71 *Modern Law Review* 1 (2008), p. 59.

154. See further the discussion at text to n. 67, *supra*.

One such instance arose with the enactment of a broadly-worded Targeted Anti-Avoidance Rule (TAAR) now found in section 16A of the Taxation of Chargeable Gains Act 1992 (in this chapter, section 16A).¹⁵⁵ The main associations of tax professionals argued that its broad scope caught “objectionable” and “unobjectionable” transactions alike. Excluding “unobjectionable” transactions from its scope through guidance was, it was argued, an unacceptable form of law-making. They rejected the government’s and HMRC’s claim that the guidance merely interpreted section 16A and argued that the unobjectionable transactions deemed safe by the guidance were actually caught by section 16A on a straightforward interpretation of it.¹⁵⁶ The guidance thus appeared concessionary and, consequently, it might be unable to create legitimate expectations.

Despite the strongly-worded protests by the professional bodies during the consultation process, the government and HMRC pressed ahead with the enactment of the TAAR without amendment. If taxpayers do pursue transactions which they consider could fall within the wording of the legislation but which seem to be excluded by the guidance, the concern is that the transaction could be challenged by HMRC at a later stage. In such a case, it might be that the taxpayer would not be able to rely on the guidance if it were deemed by a court to be concessionary.

155. Section 16A provides, in part:

- (1) For the purposes of this Act, “allowable loss” does not include a loss accruing to a person if—
 - (a) it accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements, and
 - (b) the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.

Another example is the Stamp Duty Land Tax TAAR introduced by s. 75A of the Finance Act 2003. See Cannon, Patrick, “New SDLT general anti-avoidance rule”, 874 *Tax Journal* (2007), p. 6. Similar concerns were raised as early as 1995: Rowland, Amanda, “Is the Revenue being Fair? Revenue Statements and Judicial Review” [1995] *British Tax Review*, p. 115.

156. See for example, Chartered Institute of Taxation, “Draft TAAR – Chartered Institute of Taxation Comments” (9 February 2007), available at: http://www.tax.org.uk/Resources/CIOT/Migrated%20Resources/0-9/1_10.pdf, Chartered Institute of Taxation, “Targeted Anti-Avoidance Rule (TAAR) for Capital Losses Comments of the Chartered Institute of Taxation” (1 June 2007), available at: http://www.tax.org.uk/Resources/CIOT/Migrated%20Resources/t/to-santos_37.pdf and The Tax Faculty of the Institute of Chartered Accountants in England and Wales, “Avoidance through the creation and use of capital losses” (8 February 2007) Taxrep 07/07, available at: <http://www.icaew.com/en/technical/tax/tax-faculty/tax-faculty-representations/2007-tax-representations>.

5. Conclusion

To operate efficiently and effectively revenue authorities require discretion, but processes must be in place to keep discretion in check. This delicate balancing act takes place against the background of a more general constitutional framework. This chapter has discussed the constitutional principles which determine how much discretion can be granted to HMRC and how it may be exercised. It then briefly described the administrative law procedure of judicial review through which courts have reviewed HMRC discretion. Section 4 of this chapter reviewed some different uses HMRC has made of this discretion.

It has been shown that whilst the courts have interpreted HMRC's general discretion as allowing a number of acts, they have also held certain acts to be ultra vires, but the demarcation between intra and ultra vires discretion is unclear. A number of problems follow from this. In particular, if discretion is used in an ultra vires fashion, it cannot be the basis for a legitimate expectation that will be protected by the courts. This results in uncertainty as to when guidance may be relied upon. One way forward would be for all concessions and guidance to have a statutory basis. Clearly it is preferable to deal with issues through properly drafted legislation wherever possible,¹⁵⁷ but this counsel of perfection does not allow for the realities of a complex system that needs some administrative discretion if it is not to seize up altogether.

Guidance therefore has a role to play, but if it is to be used taxpayers must know what its effect is to be. Judicial review may not be adequate to provide taxpayers with comfort: some special form of statutory protection for reliance on tax guidance might be worth considering.¹⁵⁸ The use of blanket caveats certainly needs to be reviewed and clarity is needed on the position when interpretation becomes concessionary. It might be that the HMRC

157. It is not argued here that primary legislation should become more detailed in an attempt to reduce discretion. Indeed, one of the authors has called elsewhere for more principles-based legislation, which could give better legislative guidance than is achieved by detail in some circumstances: Freedman, Judith, "Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited" [2010] *British Tax Review*, p. 717. See also Dourado, Ana Paula, "The Delicate Balance: Revenue Authority Discretions and the Rule of Law – Some Thoughts in a Legal Theory and Comparative Perspective" (this volume), text at nn. 57-61.

158. See Rowland, *supra*, n. 155.

Charter¹⁵⁹ could be utilized as a basis for this protection, and this might give this document some of the teeth it currently lacks.

Managing a tax system as complex as that found in the U.K. could hardly be done without discretion. On the other hand, vigilance is required to ensure that the limits of discretion are not transgressed. This delicate balancing act requires constant monitoring.

159. See n. 30, *supra*.