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Judicial Control of Tax Negotiation

Sandra Eden*

Abstract

This article considers the supervisory jurisdiction of the UK courts through an examination of their control of the UK tax authorities. It concentrates on the conditions under which the tax authorities have been authorized by the UK courts to enter extra statutory arrangements to afford some taxpayers concessional treatment. The article considers the basis of judicial review and then examines the legislative framework within which the Revenue operates. With this background the article considers the principles of judicial review in tax cases. Starting with the general principles, it then examines the argument that the Revenue makes extra statutory concessions on the basis of its powers of care and management and it considers the limitations of that argument. The cases dealing with legitimate expectation are examined too, as are the limits on the legitimate expectation principle. Finally, the article considers "the slippery principle of equality" within the UK constitution and the equally frustrating (for third parties) problem of establishing locus standi.

The article concludes that there are significant tensions between competing interests when the Courts review the Revenue's granting of extra statutory concessions. They seem to have afforded the taxing authorities considerable autonomy in their fulfilment of their mat24 Tm(t te)T82206.w5.1s1146.2973 474.8l401 Tj5024a 0 Tm,l730023sf474.80023 940ue3 9 4724 T5 518.48016 Tmtti

Parliament via the medium of statutory interpretation. Sir William Wade, one of the leading exponents of administrative law in the UK expresses this as follows,

> Having no written constitution on which he can fall back, the judge must in every case be able to demonstrate that he is carrying out the will of Parliament as expressed in the statute conferring the power. He is on safe ground only where he can show that the offending act is outside the power, The only way in which he can do this, in the absence of an express provision, is by finding an implied term or condition i

derives independently from common law principles.[14] This puts the role of the court onto a rather different footing as the direct link between the exercise of the courts' supervisory jurisdiction and the supremacy of parliament disappears. Under communitarianism, power wielded by parliament is not absolute but is simply one manifestation of the theory of democracy under an unwritten constitution in terms of which power is transferred to parliament to be exercised subject to fundameprem

Section 1 of the *Taxes Management Act* 1970 states

that acts which are *prima facie* within the scope of a body's lawful powers become unlawful if they are tainted by either procedural or substantive defects: an abuse of power as opposed to a simple excess of power. One is struck when reading the judgments in this area by the frequency of the reference to fairness as the overarching principle. Lord Scarman explained the principles of judicial review as follows,

> The Commissioners [of Inland Revenue] have their statutory powers and duties, the exercise of which can be challenged by the process of judicial review only if certain8.88034 638.30017 Tm(7mj10o025 0 bertain8.88034 6322t:91.7e.6G34241 649.8

> greater collection of revenue than if the agreement had not been reached or 'amnesty' granted.[33]

In other words, if you have to dangle the carrot of not collecting past tax in order to persuade taxpayers to comply with their duties to pay future tax, this is within the scope of what is reasonable. Adverse comments can be expressed on this view, such as it is hard to believe that the Inland Revenue would not have the legal powers to ensure that tax was collected in the future and, if they did not, how were they to expect the employers to operate PAYE or the reporting requirements without legal authority? Leaving such criticisms aside, this case provides clear authority for the view that it is within the powers of the tax authorities to agree not to collect tax, and furthermore, makes it clear that the tax authorities are invested with wide discretionary powers, the use of which are only to be disturbed in the clearest possible cases.

Subsequently, the Inland Revenue's power to come to a negotiated settlement was confirmed in *IRC v Nuttall*[34] in which a taxpayer was seeking to escape from an earlier agreement on the basis that it was not within the Inland Revenue's capacity to make it. Drawing on *National Federation*, the Court of Appeal unanimously held that such settlements (or "back tax agreements" as they are frequently described) fell within the powers or care and management awarded under s 1 of the 1890 Act.

Limitations ottlements (

> example is clearly called for), upon what basis have the commissioners taken it upon themselves to provide that income tax is not to be charged upon a miner's free coal and allowances in lieu thereof? That this should be the law is doubtless quite correct: I am not arguing the merits, or even suggesting that some other result, as a matter of equity, should be reached. But this, surely, ought to be a matter for Parliament, and not the commissioners. If this kind of concession can be made, where does it stop; and why are some groups favoured as against others? I am not alone in failing to understand how any such concessions can properly be made.[37]

He added, "One should be taxed by law and not be untaxed by concession."[38]

However, despite the approval of the above sentiments in the House of Lords, this took place prior to the decisions in *Na*

Wilkinson) v IRC[42], careful judicial consideration of the constitutional basis of such concessions is apparent. One of the issues in this case was whether the Inland Revenue should have granted a concession in order to make a statutory relief (available to women only) available to men too so as to achieve compatibility with rights provided for by the ECHR. The Court of Appeal held that the Inland Revenue had no power to grant the concession to override an unequivocal legislative provision except for the purposes of facilitating the overall task of collecting taxes as part of its duty of "care and management".

> No doubt, when interpreting tax legislation, it is open to the commissioners to be as purposive as the m

The Inland Revenue had initially argued that, although in general they had the power to enter into forward tax agreements, this particular one was ultra vires. This was on the basis that it provided that the taxpayers were to be treated as domiciled outside the UK, whatever the true position, but contained no provisions for termination in the event of a change of circumstance and was entered into on the basis of insufficient information. However, in the lower court it had been decided that all forward tax agreements were ultra vires

another factor in the equation: the balance between some tax and no tax. In a narrow sense, the agreement maximises the return to the Treasury. The deal is as follows: a taxpayer, contemplating a transaction (A), says to the Revenue, "If you tax A in full, it is not worthwhile me carrying it out. I will not engage in the transaction and you get no tax. However, if you agree to take a lower sum, we both win." Expressed like this, one can see why such agreements cannot be permitted: they subvert the tax system by attributing different tax consequence from those which are intended by parliament and they give particular taxpayers preferential treatment.

Legitimate expectation – the reliance cases

There are a number of different situations in which a taxpayer may seek to rely on statements by the tax authorities. The statement may be about the authority's interpretation of a particular rule, as to the amount of tax due, or their intention to take no further proceedings. The statement may be made to a specific taxpayer, either at a p 0 0n08 Tm(e)Tj10.98 0 0 10.98rB .98 345.03345 584.4sgTeay(e)T1t 0 1s1t3be

weighed up in the event that the authority was considering whether to change its mind, rather than an independent ground. In other words, his view was that the existence of any expectation created was relevant and must be taken into account in any subsequent consideration of the case, but did not determine the outcome. This relegates a legitimate expectation to a relevant consideration, rather than being an independent constituent of the right to be treated fairly.

However, as it turned out in *Preston*, the taxpayer was not protected from further assessments on the facts, although the judgments oddly never spelt out precisely why. It might be that the case should be viewed as a "cards face-up" situation, although the actual term had not at that stage emerged.[53] There is though a narrower alternative basis, for which there is authority in Lord Scarman's judgment. This does not involve wider issues such as fairness but is based simply on the terms of the agreement with the taxpayer:

> It was the appellant's case that upon the true construction of the correspondence … the Commissioners purported to contract or to represent that they would not thereafter reopen the tax assessments of the appellant for the years 1974–75 and 1975–76 if he withdrew his claims for interest relief and capital loss. Had he made good this case, I do not doubt that he would have been entitled to relief by way of judicial review for unfairness amounting to abuse of the power to initiate action under Pt. XVII of the Act of 1970. But he faild

> legitimate expectation is, prima facie, that he will be taxed according to statute, not concession or a wrong view of the law. …No doubt a statement formally publi

The taxpayers failed on two grounds: one, on the basis that although sufficient information to enable inferences to be drawn was disclosed, this may not amount to full disclosure; two, that the taxpayers knew or should have known that clearances for such schemes should have been sent to the technical division, and that by applying to the local inspector, they were falling short of their obligation of acting fairly.

The success rate of the taxpayers in the reliance cases has been limited and the taxpayers have generally failed either because they could not show that they fell within the terms of the statement[60] or the statement was not in sufficiently clear terms as to create an expectation that it could be relied upon[61]. The courts have held the tax authorities to their statements on the basis of legitimate expectation of the taxpayer in only two cases. The first, *Greenwich Property Ltd*,[62] is a fairly straightforward application of a concession to the facts. A statement had been published which, by concession, treated a particular transaction as zero-rated for the purposes of VAT and the tax authorities were held bound by this even though the particular transaction entered into was not precisely the one contemplated by the concession whilst coming strictly within its terms..

The second case, *R v IRC ex parte Unilever*[63], is more interesting as the expectation derived not from published statement but from previous Inland Revenue practice. This pushes forward the boundaries of the principle as expounded in *MFK Underwriting Agencies*[64], where it was suggested that the rule applied only to clear, unambiguous and unqualified representations. The facts of *Unilever* were rather unusual. The statutory time limit for making loss relief claims is two years from the end of the accounting period of loss.[65] Over a period of twenty years and in the context of at least thirty occasions, the Unilever group had submitted estimated figures which took into account loss relief without specifying the details. Tax was paid on this estimate with the final tax computations submitted at a later date (outwith the two year time limit) whereupon adjustments were made. One year, out of the blue, loss relief was refused by the Revenue on the basis that no relevant claim had been made in time.

In upholding the taxpayer's claim that this was so unfair as to amount to an abuse of power, the judges were careful to stress the "literally exceptional" nature of the case. A strong factor in the decision is the "demonstrable pointlessness" of the strict application of the time limit for both parties.[66] Although there was no statutory discretion to extend the loss relief time limit (this was added later) it was held that the power to do so was implicit in the care and management provision.

The case is also interesting for its observa

Limits to legitimate expectation

Notwithstanding the importance that the courts

principle that no-one can legitimately expect a statutory body to act illegally.[72] So, while the petitioners might have had an expectation, it was not legitimate.

The distinction between *Al Fayed* and *F & I Services* on the one hand and *Unilever*, discussed above, on the other is the legitimacy of the decision relied upon. In *Unilever*, the discretion to extend time limits beyond those provided for in statute was regarded as integral to the care and management function. As such, it was one which was within the Revenue's powers to make and could form the basis of legitimate expectation. One must also though be able to explain why a decision as to the meaning of statute, made bona fide albeit wrong in law, is ultra vires whilst the deliberate decision not to apply time limits was perfectly legal. This must pivot on the reason for the actions in each case. One was made deliberately for reasons of administrative convenience and the other was just a plain mistake. Mistakes are evidently permitted as part of the care and management function

Equality

The slippery principle of equality lurks behind many of the elements of our unwritten constitution. Thus the rule of law, which is

However, despite acknowledgment of the existence of the equality principle in court judgments, it has not yet succeeded in practice. It would only be in the most unusual of circumstances in which differential treatment as between similar taxpayers could be used as an argument by a taxpayer. In *R v C & E Commissioners v British Sky Broadcasting Group*[77], there was no suggestion that mere inconsistency of treatment as between different tax offices would resul305 Tm(itish Sky)T141usu0 [ire3gToin ys

This was not a view shared by any of the five Lords who heard the appeal. Each was of the view that in the circumstances, the Federation had no locus standi. Curiously, most of the judgments regarded the locus standi decision as being intimately connected with the substantive issues. Lord Wilberforce expressed his views as follows:

> There maybe simple cases in which it can be seen at the earliest stage that the person applying for judicial review has no interest at all ...; then it would be quite correct at the threshold to refuse him leave to apply. The right to do so is an important safeguard against the courts being flooded and public bodies harassed by irrespothe per bei

evidently hoped, by requiring Customs to apply the strict letter of the law, to put their competitors out of business. More recently, in a case in which Freeserve, a UK internet service provider, was denied locus standi to challenge the tax treatment of an offshore competitor, Evans Lombe J referred to the "rule" that one taxpayer has no right to bring judicial review proceedings in relation to the tax affairs of another.[88]

The one case where standing was granted to a third party in a tax context was unusual in the extreme.[89] ICI plc had sought review of the Inland Revenue's determination of a transfer price of a gas for the purposes of oil producers. ICI, not being an oil producer, was not eligible for this treatment and was disadvantaged by what it (correctly) regarded as an erroneously fixed price. One critical aspect of the decision was that the complaint did not concern a specific assessment but a valuation, the effects of which would have continued for a period of time. Another aspect mentioned was that the act was complained of by ICI not as taxpayer, but as competitor, an argument which, as already noted, subsequently failed in *Freeserve*.

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references to the expertise present in the Revenue and a general judicial regard is evident for the way in which the tax authorities carry out their functions.[91]

However, where the courts have been required to delve a little more deeply, it appears that to the extent the tax authorities are vested with implied discretion to override the express requirements of statute, it may only be exercised in the course of their care and management of the tax system and in the context of their primary duty which is to collect tax. In particular here we must recall *Wilkinson* where it was held that there was no power to grant an extra-statutory concession in order to give effect to rights under the ECHR and *F & I Services*, where it was held that a decision not to collect tax on the basis of an error of law was ultra vires, in contrast to such decisions made as a result of policy. Even in *Al Fayed* where there is a reasonable argument that the agreement was made to maximise income, it was not made to maximise tax.

Pausing for a moment to make an assessment of the balance achieved between the respective interests of the tax authorities and the taxpayer, one would be likely to conclude that the courts have marshalled the boundary rather effectively. Clearly the tax authorities cannot be expected to collect every last penny due in all circumstances irrespective of whether it is economic or reasonable and some discretion has to be built into the process. On only two occasions have the courts been prepared to say that the tax authorities were acting outside their powers in entering into agreements[92] and one of these was on the basis that they were effectively collecting tax which was not due, which seems a reasonable limitation on the tax authorities' powers.[93]

And while taxpayers have largely found themselves able to rely on statements made by the tax authorities, it must be in the interests of fairness between the parties that they should be able to do so: they must come to the table with clean hands and, even should they fall within the scope of any general statement, they must show that they placed reliance on it. There are perhaps one or two cases where one might have had some sympathy with the losing taxpayer, for example in *Matrix* it appeared that not only is the taxpayer required to lay all his cards face up on the table, but he is also expected to explain the significance of the hand. However, in the round, the courts have given the tax authorities and the taxpayer the chance to do a deal and have imposed reasonable duties on each in the course of holding each side to it.

However, whilst scoring well on the management of the relationship between the two parties intimately concerned, it is argued that wider interests which might legitimately have a claim to be taken into account are faring less well.

The principle of equality between taxpayers has been mentioned on several occasions by the judiciary as a relevant consideration, but an examination of the decisions suggests that this has in practice not been an important factor. The interests of the small businesses in *National Federation* were overridden, as were the arguments of BSkyB[94] that they had to pay VAT when none of their competitors did.

The evidence on locus standi, although limited in quantity, shows a reluctance on the part of the courts to recognise third party interest in the affairs of other taxpayers. Lord

[91] Eg *Unilever* op cit note 21.
[92] *Al Fayed* and *Kay* both op cit note 19.
[93] *Kay* op cit.
[94] Op cit note 77.

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level this may be interesting but is not significant in the normal case of judicial review.

It is suggested that some evidence can be gleaned from the patterns of decision making in the cases considered above and, although the evidence is ambiguous, on balance it provides the majoritarian theory with most support.

The strongest argument in favour of the communitarian view lies in the courts' recognition of extra statutory concessions as it is hard to explain such deliberate departure from the terms of the statute on the basis of implied authority within the statute. Arguments based on managerial discretion and legitimate expectation have prevailed over the narrow statutory approach but it is possible that these arguments themselves reflect an approach to decision making which is evidence of the majoritarianism. The tax authorities have been afforded perhaps a surprisingly wide degree of discretion, but this has largely been given through the application of the private law concepts of certainty, reliance and disclosure. In particular the fact that the taxpayer must be able to establish that they have acted in reliance upon published statements before they can rely on them comes very close to operating the rule of estoppel, in direct contrast to the public law rule that estoppel cannot be used against the Crown. There are several statements in the cases which link the content of the doctrine of legitimate expectation with breach of contract or misrepresentation and *Preston* is a clear example of the contractual approach. It is argued that the quasi-contractual approach, with its emphasis on the immediate interests of the parties involved, is evidence of a rejection of the communitarian view which would be more likely to place emphasis on the public interest and suggest more liberal rules on locus standi.

The quasi-contractual approach is consistent with the stress on manageria1(lic5e/o988 428 01539Tc (r