HOW CLEAR, TRANSPARENT, ACCESSIBLE & FORESEEABLE IS TAX LAW & PRACTICE?[1]

by David Goldberg QC

On Sunday 3 March this year, I conducted an experiment: I read out loud, first, a number of pages from the Inland Revenue Ordinance of Hong Kong which contains the whole of what is the most widely admired, efficient and accepted tax system in the world and, then, the same number of pages from our tax legislation here which, ex hypothesi, does not contain the most widely admired, efficient or accepted tax system in the world.

In each case, I found the average time taken to read a page and multiplied it by the length of the relevant code: there are 267 pages in the Hong Kong Ordinance, each with fewer words than are to be found on each page of UK legislation; and I took there to be 13,316 pages in the UK's direct tax legislation (though its length and different conventions about page numbering make it difficult to be entirely accurate even about how many pages the UK rules take up).

The experiment indicates that it would take 9 hours and 19 minutes to read the whole of the Hong Kong Tax Code.

The equivalent exercise with the UK legislation would take 768 hours, just over 19 working weeks or about four and one half months: to put that in perspective, if I started reading now for 8 unbroken hours on every working day I might just about finish in time for my summer holiday in August.

Anyone listening to an entire reading of the Ordinance would have some idea, not only of the principles which underlie the tax law of Hong Kong, but also of the rules which govern

it: perhaps because it needs to be translated from English into Chinese and from Chinese into English, the language is relatively clear and the concepts employed are straightforward.

Here, for example, is the relevant part of the main charging provision in the Hong Kong Ordinance, s.14:

> "... profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong."

That tells the reader virtually everything that you need to know about the tax charge: everything else is minor detail.

And here is an example – TIOPA 2010 s.371BA – from the minor charging provisions of the recently simplified CFC legislation:

> "**s.371BA Introduction to the CFC charge**
>
> (1) The CFC charge is charged in relation to accounting periods of CFCs in accordance with section 371BC.
>
> (2) Section 371BC applies in relation to a CFC's accounting period if (and only if) –
>
> (a) the CFC has chargeable profits for the accounting period, and
>
> (b) none of the exemptions set out in Chapters 10 to 14 applies for the accounting period.
>
> (3) A CFC's chargeable profits for an accounting period are its assumed taxable profits for the accounting period determined on the basis –
>
> (a) that the CFC's assumed total profits for the accounting period are limited to only so much of those profits as pass through the CFC charge gateway, and
>
> (b) that amounts are to be relieved against the assumed total profits at step 2 in section 4(2) of CTA 2010 only so far as it is just and reasonable for them to be so relieved having regard to paragraph (a).

(4)"The CFC charge gateway" is explained in section 371BB.

(5) Subsection (3) is subject to section 371SB(7) and (8) (which relates to settlement income included in a CFC's chargeable profits)."

That is an example of modern and vigorous drafting, but it does not tell you everything you need to know about the CFC charge: no one listening to the whole of the UK Code being read aloud would have any idea what it meant; length makes it hard to grasp; the language and the structure make it difficult to understand.

The different length and complexity of the two codes is NOT attributable to the need to raise more taxes here than in Hong Kong. A 267 page code is capable of bringing in as much revenue – and, perhaps, even more revenue – than our 13,000 or so pages of legislation.

Nor is it attributable to a greater fairness in our code than in that of Hong Kong: tax is imposed in Hong Kong without the benefit of democratic sanction but, even so, I do not know anyone who thinks it unfair.

The correct explanation is that the difference between the two systems is attributable to a wholly unnecessary complexity of concept here, coupled with high rates which are then ameliorated, not only by multiple (but necessary) reliefs hedged about by many non essential limitations, but also by charging sub codes unnecessarily introduced to meet the demands of special interest groups.

It might, of course, be said that nobody needs to read the whole of our legislation to find the answer to any particular tax question; and there would be truth in that if our tax code had unity and coherence.

It did, once: it enshrined a basic principle; it taxed income profits calculated by reference to some well established commercial principles.

That is what the tax law of Hong Kong still does.

But the rococo, unprincipled and unnecessary elaboration of our code, cluttered, as it is, with many TAARs means that it no longer does that: it is capable of springing surprises: unexpected loss of relief can occur; tax charges, which are not easily foreseeable, may arise.

It is, accordingly, necessary to know something of the whole tax code in order, accurately, to identify the appropriate tax treatment for any given situation: it is necessary to know that the legislation, quite full of shocks, will not deliver one in any particular case; and the only way of achieving that degree of knowledge is to study something which takes 4½ working months to read and longer – much much longer – to understand.

Length alone accordingly contributes considerably to a lack of clarity, transparency, accessibility and foreseeability in our system.

Now most of the complexity enshrined at such length will not affect a worker paid under PAYE who is likely to be unaware that he or she is bearing tax.

But much of it will affect any small business person setting up a business – especially in corporate form – and it must surely be wrong to subject *any* business to this length of code.

And, in addition to the burden of length, there are European, domestic, cultural, cross-cultural, administrative, curial and political factors which all contribute to a loss of clarity and foreseeability.

The European factors which increase uncertainty are not unique to the UK and I shall not detail them.

The domestic and cultural features which contribute to a lack of clarity are, first, an unwillingness to be honest about the true effects of our tax system (so that we continue to maintain that the income tax and NICs systems are separate and that we have a basic rate of 20%, when they are really the same thing, and the true low rate is, for most people, 32%) and, secondly, a deliberate tendency in the draftsman – which I shall illustrate shortly – to be less than wholly clear.

One cross-cultural factor which complicates and obscures our tax code is an increasing tendency to legislate by reference to accounting standards.

On one level, this can be seen as no more than the recognition of the basic principle that the word "profits" is to be given a business sense.

However, accounting standards are in a more or less constant state of flux as the methods of estimating (not determining, but estimating or, as it might better be called, guessing) when profits arise become supposedly more sophisticated; and they embody three further aspects which make them machines for the manufacture of uncertainty and instability.

First, they are avowedly not a means of computing profits, but a method of presenting a picture of the overall financial performance of a company.

Secondly, accounting standards operate by reference to something which accountants call "the substance" which means that you need to determine what has happened on some supposedly realistic basis which departs from every legal convention known to the civilised world: for example a debt owed by a company may be regarded as not owed by it even though, in law, it is.

There is, accordingly, a basic statutory code intended to operate in accordance with legal principle, which has, within it, a device designed not only to erode that fundamental requirement but also to impose substance tests, which have the effect that it is not only possible, but right, to invent what has happened.

Thirdly, changes in accounting standards to reflect changing views about substance can, unexpectedly, change tax treatment; they can make things which a legislative draftsman could reasonably expect to be there, disappear, with consequences that have been mandated by legislation which has not considered the possibility of disappearance at all.

And I might add that however difficult the drafting of our domestic statutes might be, the language of accounting

standards, although appearing to be in English, makes our statutes look as if they were written by Enid Blyton.

A particular difficulty in legislating for the use of accounting standards is that accountants and lawyers use the same words but, very often, ascribe different meanings to them: an example is debits and credits, which lawyers use in one sense and accountants use in a reverse sense.

Another cross-cultural factor which causes a loss of clarity is that our taxes are no longer self-contained: that renders it unsafe to rely on instinct to find an answer.

For example, the charge to IHT; a capital tax, is supported by POAT, a charge to tax on deemed income; and the charge to SDLT, another capital tax, but this time an indirect one, is to be supported by the charge to ARPT, a direct annual charge.

Incidentally, the need for residential property owners to consider what to do about ARPT neatly illustrates the complexity of our tax system: what ought to be relatively straightforward requires a consideration of 5 taxes: SDLT; IT; CGT; IHT; POAT.

The administrative issue is that HMRC operate very many practices, not all of which are published, which are sometimes applied in an inconsistent fashion.

The need for consistency in that respect and the problem of ensuring that it exists will both grow with the introduction of the GAAR, of which more shortly.

The curial factor which militates against the desiderata for a good tax system is this.

Over a period of, say, 30 years, Courts have moved from regarding tax as purely a statutory thing, liability to which is to be determined only by reading the statute, to regarding it as something which is as susceptible to the common law method as anything else.

The common law method traditionally involves the raising, by inter partes disputes, of issues to which the Courts provide

solutions, historically by a process of evolutionary adjustment as the needs of society change.

The increasing pace of societal change has, rightly or wrongly, led to an increasing rate of judicial response: what used to take 10 years might now take only one or two; the process is no longer evolutionary but revolutionary.

At present we are in the midst of a process of adjustment in relation to what has been called by slovenly minds the problem of tax avoidance; and it is undoubtedly the case that the Courts have not yet found a response to the issues which is, to them, satisfactory.

Thus the original response here was to hold that circular self cancelling schemes and linear preordained transactions did not work, not because of the facts but because of something, unidentified, in the statute.

By a process of several further adjustments, we have reached the present position, which is that all tax questions are resolved by applying the statute, construed purposively, to the facts, viewed realistically, a formulation which involves two elements of uncertainty.

First, purposive construction inevitably involves attributing a meaning to a statute different from that which an ordinary reading of the words gives: unless that is so, there is no need to construe purposively; it is only necessary to construe.

Moreover, the rule that we can now consult material outside the statute adds further to the difficulty of construing statutes.

Secondly, the ability to view the facts realistically raises an issue as to how far it is possible to reconstruct a transaction or to say that nothing at all happened.

At the Court of Appeal level, there is, on the most recent cases, a disagreement as to whether a realistic view of the facts allows things to be ignored or not.

The disagreement is, of course, not expressed: with rare exceptions, Courts always pretend that they are being consistent,

but every practitioner in the field knows not only that a process of revolution is in train, but also that not every judge will apply a strict approach to the resolution of tax issues: as the universe tends inevitably to entropy, the smaller common law world now tends inexorably to the mantra that every result must be fair which, no matter what merit it may have generally, is peculiarly inapt in relation to tax.

On top of this there is, worst of all, the political factor.

As a matter of politics, not as a matter of necessity or economic good sense or sensible taxation, we are now to have a GAAR.

There are many examples of GAARs in the world, but our proposed draft is the most objectionable I have seen.

The GAAR will apply only if the statute, construed purposively and applied to the facts, viewed realistically, still gives the taxpayer a tax advantage (a term which is, unnecessarily, inadequately defined in the draft legislation, an example of the draftsman's tendency away from clarity).

In that situation, HMRC may, if they reasonably consider the taxpayer's conduct to be an abuse of the system, change the law for him alone to deny the tax advantage provided for by the purposively construed legislation.

In other words, the GAAR will apply to deny a tax advantage where the purpose of the legislation is to give that advantage.

And the basis for the denial of the intended advantage is the disapproval of the administrator.

There are, supposedly, safeguards but, in the end, the power is to change the law by administrative fiat and a power of that kind is inevitably unsatisfactory for at least three reasons.

First, experience teaches that the decision as to whether something is reasonable in the tax context is always emotional, not rational, so that the safeguards are apparent but not real.

Secondly, no matter what criticism may be made of what the legislation presently provides, there is no ideal method of identifying a taxable subject matter; every way of doing that

will be open to some form of objection and any one method is just as good as any other.

Thirdly, the proponents of rules like the GAAR see it as upholding the rule of law.

An approach of that kind is, of course, justifiable if every form of profit belongs to the State and the ability of the citizen or corporation to retain any part of it is a gift from the State.

That is, however, not a situation which accords with a correct analysis of our political or legal philosophy and it is necessary to be clear here: what our GAAR is intended to do is to deny, under the guise of law, the benefit of the words in the statute to some chosen class of alleged miscreants whose only misdemeanour is to ask that the law be applied to them honestly.

Here is a quote from Joseph Schumpeter (*The Economics and Sociology of Capitalism*):

> "The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history ... He who knows how to listen to its message here discerns the thunder of world history more clearly than anywhere else."

Our tax system as it stands sends the message that we are a sophisticated, unnecessarily complex but essentially well-intentioned people. If we add to it the GAAR the message changes: we shall show ourselves to be unbalanced, tending to the totalitarian and essentially mean-spirited; it will not be green and pleasant.

Endnotes

1. This article is derived from a talk given by the author at the seminar "Does Our Tax System Meet Rule of Law Standards?" on 21 March 2013. The Bingham Centre will be holding a one-day conference on the topic of "Tax and the Rule of Law" on 20 November 2013.