WHERE IGNORANT ARMIES CLASH BY NIGHT: HOW REDUCING THE SIZE OF THE STATE HAS INCREASED ITS POWER

by David Goldberg QC

The imposition of taxation involves the State in making demands of the citizen which the citizen is obliged to meet.

There is an inevitable clash here between the Government and the governed: it is more or less certain that each side – certainly as a matter of economics and sometimes as a matter of law – will have different views of how much it is right for any one person to pay; and it is essential, where the dispute is about law, that there is an effective and balanced way of resolving it which does not always require resort to the Courts.

It is, accordingly, important that a system of taxation holds the balance between the State and the citizen in an equilibrium in which neither one side nor the other has too great an advantage.

The difficult and serious question which arises is whether our tax system is doing that: is it properly holding the balance between the State and the citizen?

If that is to be achieved, the State has, as a minimum, the obligation of creating, by legislation, a system of taxation which is reasonably clear and certain, so that, for his part, the citizen can know what obligations are imposed on him and can comply with them without too much difficulty.

Although the question of balance is a large one, I want to start with some apparently small things which I think, reveal something of the true character of the system under which we live.

Let me start with the tax return itself: the form is, of course, prescribed by HMRC.

I do not know how anybody else finds it but, even though it now seems a bit clearer than it used to be, I still find it very complicated and, in places, more or less incomprehensible: I need an accountant to complete it for me.

By contrast, I can fill in my Hong Kong tax return with relative ease.

The tax return form itself tells us quite a lot about the complication inherent in our tax system: if the form is difficult to complete it is because the system is not easy to operate.

However, no matter how complex the tax is, receipt of the tax return form imposes an obligation on the taxpayer which is now governed by the rules of self assessment, which make it necessary for a taxpayer not only to decide what facts are relevant and provide them to HMRC, but also to calculate the tax which is due as a result of these facts.

The move to self-assessment changes the way we think about the tax system in a profound and subtle way: indeed, it does more than just change thoughts; it alters, in a fundamental way, who the primary operator of the tax system is.

The taxpayer is no longer a passive recipient of a demand: he originates the demand and, because that is so, he, rather than HMRC, has an obligation to get things right.

Whether the change was originally intended to have this quite far reaching effect I do not know, but the point that it did was definitely recognised by 2007, when F.A. 2007 Schedule 24 introduced a new system of penalties for errors which clearly puts the burden on taxpayers to get things right in making returns; and, since then, the burden on large corporate taxpayers has been increased by the introduction, in F.A. 2009, of a requirement for there to be a Senior Accounting Officer, who has the duty of ensuring that his company's systems produce a correct tax computation.

And there is more, much more of that kind of thing: there is, for example, expected self policing of the GAAR and of diverted profits too.

This is more than just a change of emphasis: there is here an introduction of a new level of policing. HMRC retain a supervisory jurisdiction and have the penultimate say, but the taxpayer also has a policing function: he must police himself and make a considerable endeavour to get things right.

And here, of course, viewed from the perspective of HMRC, the obligation is not to be right according to the general view of taxpayers, but to be right according to the view of HMRC.

Now that does not sound as if it is too arduous a thing, but, at this stage, it is necessary to think about our tax system in a bit more detail.

In some ways, we have two quite distinct systems of taxation in this country: we have the PAYE system which deals, most often in a relatively straightforward way, with most working people; and we have the rest of the tax system, which deals with companies, large and small, individual traders and partnerships.

Of course, the distinction between the two systems is not rigid or absolute, but, on the whole and, no doubt, subject to certain exceptions (likely to arise with employees paid in kind), the PAYE system works well for a lot of people.

Very broadly, direct tax systems can charge tax by reference to payments made or by reference to receipts.

Our direct system imposes tax by reference to receipts and much of the legislation is concerned with the definition of the taxable subject matter: how much of a receipt is brought into account as taxable?

A payments based tax system is inherently more straightforward than one which is based on receipts, and the PAYE system, although in truth receipts based, gives the impression that tax is a payments based, certain, and simple thing.

That, I rather think, is the impression which most journalists

and politicians have of the tax system: it is how, in general, they experience it.

How different, however, is the lot of the person in charge of the tax affairs of a large group, or of an individual who is not an employee, but who has the responsibility of calculating his own tax liability, or of the person whose receipts come to him gross and who has to provide the cash to pay the eventual tax bill, which will almost certainly be unknown at the time of receipt.

Unlike those who are paid subject to PAYE, these taxpayers are faced with some 18,000 pages – 21,000 pages by some counts - of legislation, much of which, though now largely drafted in the apparently simple style of a Janet and John reading primer, is far from clear, and they are expected to distil from this mass a correct tax computation.

Of course, this person may employ the services of an accountant, but, overall, the taxpayers involved may be quite small and the accounting firms may not be large, and both the taxpayer and the accountant will really want to get on with the real business of making money.

The question which arises is whether the burden imposed on the taxpayer by the immense and complicated tax system and the requirement of self-assessment is commensurate: is it a fair balance between the citizen and the State?

It is one thing for a State to say: “These are the facts I need to know. Tell me those facts, and I shall tell you how much tax you owe”.

It is another thing for the State to say: “You decide what facts are relevant and then tell me what tax you owe”.

The one exercise is relatively straightforward while the other is difficult and less certain.

Of course, a system of self-assessment will be in balance if the complication is recognised and the potential burdens which may be imposed on taxpayers are sufficiently limited.

But I am not sure that our tax system, measured by that test, is now properly balanced, and the lack of balance is not created only by the F.A. 2007 penalty regime, though that is, certainly, a factor.

As is well-known, HMRC have, essentially, a period of one year, following the filing of a self-assessment, in which to open an enquiry into the self-assessment.

If HMRC exercise this right and open an enquiry, the taxpayer's affairs go into what might seem like a period of stasis.

Although the legislation gives the taxpayer the opportunity to seek a closure notice, it seems that, generally, HMRC do not have too difficult a task in resisting an application for a closure notice: the supposed and certainly asserted HMRC need to discover more and more facts is usually accepted as a reason for not ordering closure of an investigation; and the question of whether the need is genuine or not does not seem to be analysed in great detail.

As a result, enquiries opened during the enquiry window can drag on for years and will be supported by the battery of information gathering powers which have, over the years, been given to HMRC.

The use of these powers is not easy to challenge and they can impose very large burdens on the taxpayer which are not always truly necessary.

Moreover, during the period while the taxpayer knows that his affairs are under investigation, he may not know what the supposed problem is, nor may he know what the likely outcome is going to be.

Another feature of this period of enquiry is that, during it, the taxpayer will not actually owe any tax to HMRC other than in accordance with his self-assessment.

Here the current hatred of tax avoidance rears what seems to me to be a rather ugly head.

Although, in the period of enquiry, the taxpayer does not

actually owe any tax to HMRC, if he has claimed the benefit of an arrangement registered under DOTAS, HMRC may serve what is called an Accelerated Payment Notice – an "APN" – on him and, in certain circumstances, a Follower Payment Notice – an "FPN" – as well.

These notices require payment of amounts which, apart from the notices themselves, are, where there is an open enquiry begun during the enquiry window, not due to HMRC.

And this demand for payment of amounts which are not certainly due carries heavy penalties if it is not met in short order, with the penalties being non-refundable in some cases, even if the taxpayer is ultimately successful.

There is no right of appeal against notices of this kind: the only possible remedy is judicial review, but, so far, the Courts appear to be unsympathetic to challenges of that kind.

At any rate, in one case where HMRC's claim may be doubtful, an attempt to obtain a judicial review to quash an APN failed at first instance, the judge certifying it as totally without merit and genuinely hopeless – and that, in a case where HMRC's claim is far from clearly right.

APNs and FRNs are not the only cases in which HMRC can demand accelerated payments: astonishingly, they can do it in relation to diverted profits tax too.

The purpose of APNs and FRNs is, of course, to aid the collection of tax: they are to deal with what has been called "the problem of disputed tax".

The identification of disputed tax as a problem ought to be a cause for considerable concern.

For an authority to designate disputes about tax as a problem at least begins to suggest that the authority thinks that disputes of its demands should not be permitted, an attitude that is more suited to the time of the First rather than the Second Elizabeth.

Some systems of taxation around the world provide that, whenever a taxpayer is told by a revenue authority that he must

pay tax, he must pay the amount demanded before he can appeal against the claim.

Indeed, we adopt that system here for VAT and, in a certain sense, whenever HMRC make an assessment to the direct taxes because, when that happens, tax becomes due and payable unless payment is postponed.

In the usual direct tax case, payment once demanded is postponed by agreement, but it seems that, where DOTAS arrangements are involved, that practice will no longer hold good, because the overwhelming likelihood is that, in cases like that, APNs will be served demanding payment of the tax.

Again, issues of balance arise.

Because many systems of tax require payment of tax before an appeal can be lodged, it does not seem sensible to say that a requirement to satisfy a tax demand before any dispute about it is resolved is, automatically, unfair.

However, it does seem odd for a taxing authority to be able to demand a payment before it has formulated a claim pursuant to which it requires tax to be paid.

And it seems more than just odd, but also unpleasant, to give HMRC power not only to do that but also to obtain a penalty, if the demand is not paid, in cases where an appeal might seem a sensible course.

The penalties attached to FPNs and APNs are intended to discourage appeals; and that is what makes the method of tax collection introduced by these notices different from the more usual requirement of payment before challenge to any revenue demand.

Somehow or other, in the period starting immediately before the beginning of self-assessment and ending more or less now, we have moved, legislatively, *from* a situation in which nobody owed anything to HMRC, unless and until it was demanded, *to* a situation in which, as a matter of our procedural law, taxpayers have an obligation correctly to assess themselves

to tax and carry risks greater than normal, if they have attempted to mitigate tax by using DOTAS arrangements.

No doubt, the payment of tax imposed by law is a matter of obligation, not choice; but is it right for a tax system's procedural law to contain, in many cases, an assumption that amounts are due and payable (so that they have to be paid), without easy recourse to a decision as to whether the substantive law supports the assumption? What thinking leads to the conclusion that that is right?

There seem to be four aspects to the Parliamentary thinking, all of which are probably derived from experience of the PAYE system and the belief it engenders that tax is an uncomplicated certain thing:

(1) the first aspect is a political and journalistic belief that nothing which is called tax avoidance nowadays works or should be allowed to work (especially if it can be described as aggressive tax avoidance);
(2) the second aspect is a widely held assumption that the amounts HMRC demand will actually – and more or less automatically – become due;
(3) the third aspect is the assumption that tax should be collected and appeals should be discouraged in any case where HMRC say tax is due, so that in a very real way HMRC's *ipse dixit* leads not only to the collection, but also to the retention of tax; and
(4) the fourth aspect is the wish to cut down expenditure on administration by the State which, inevitably, moves the cost to the citizen.

There is a tendency in all this towards the concentration of power in the State, and it is coupled with an attempt to disempower the citizen or subject: at any rate, there can be no doubt that the creation of FPNs and APNs and, for that matter, diverted profits tax, increases the power of the State and, inevitably, reduces the rights of man.

However, it does not automatically follow from any of these points that the tax system is going wrong and is moving from the moral to the immoral, from the balanced to the unbalanced.

If the system contains procedural checks on the power of the administrator and if the substantive law is sufficiently clear and certain, even a system which gives the edge to the State so far as initial collection is concerned might be in balance.

In short, the fundamental issue is whether the system provide adequate protections for the taxpayer.

Once the enquiry window has closed, HMRC may only reopen a self-assessment if they make a discovery and satisfy one or other of the conditions set out in TMA 1970 s.29(4) or (5) or FA 1998 Schedule 18 Paras 42 to 45 which, in the jargon of tax, are called deliberate and innocent error.

That is, undoubtedly, at least an apparent protection to taxpayers but, as applied in the decided cases, how real is it?

Now there have been quite a few cases about the effect of s.29(4) and (5), but none of them seem to me yet to have made the essential point about these provisions clear.

The general idea behind self-assessment is that the self-assessment is to stand good unless there is a good reason for challenging it.

It is important, if the tax system is to be reliable and sensible, that the self-assessment should be a solid foundation for the system: a self-assessment needs to have a relatively high degree of accuracy, and that need, no doubt, justifies penalties for error (though whether the penalties we have now are too potentially large or not is another matter).

It is, however, important that *both* sides can rely on a self-assessment: HMRC need to be able to expect it to be right, but the taxpayer also needs to know that a challenge to the self-assessment will be timely and exceptional.

It is, accordingly, not meant to be too easy for HMRC to open a self-assessment outside the enquiry window.

Because that is so, the law is that HMRC must establish that the conditions for making a discovery assessment are satisfied, and on that point HMRC carry the burden.

Now, as I see it, although this is not yet clearly set out in the authorities, the fundamental question in discovery cases is why HMRC did not open an enquiry into the self-assessment within the enquiry window?

If the answer is that HMRC did not, within the enquiry window, have enough information to raise the challenge they wish to raise outside it, then the probability is that they can raise it.

But if, on the other hand, HMRC did have sufficient information within the enquiry window, but missed the point, then they should not be allowed to raise the point.

In other words, the question underlying challenges outside the enquiry window is about fault.

Is it the taxpayer's fault that the point was not raised, because he did not provide relevant information to allow it to be raised?

Or was it HMRC's fault, because they failed to spot a point which was there to spot or because they were too lazy to raise it?

I am not sure that this question of fault has yet been placed as sufficiently at the heart of the debate about discovery assessments, as it should be.

There is another issue about the procedure relating to discovery assessments which is important here, and it goes to the different burdens of proof carried by parties in a tax appeal.

As is well-known, once a substantive tax appeal is on foot, the burden of defeating the substantive claim lies on the taxpayer.

But, as I have mentioned, on the procedural question of whether HMRC are permitted to make the assessment at all, the burden lies on HMRC.

This raises a very important issue as to how a case is to be

conducted where there is both the procedural and the substantive issue.

Should the procedural matter be heard separately from the substantive matter?

There are cases in which this is an exceptionally important issue. For example, if it seems unlikely that, on their own and without help from the taxpayer himself, HMRC will be unable to satisfy their s.29 burden or Schedule 18 Paras 42 to 45 burden, the taxpayer may wish them to open the case and call their evidence, so that he can make a submission of no case to answer at the end of HMRC's evidence.

To put that another way, a taxpayer may not wish to allow HMRC to use his own evidence to help them to bring home a charge of innocent or deliberate error.

In a civil trial, a party is not allowed to make a submission of no case to answer unless he elects not to call any evidence at all.

Accordingly, in a tax case, if a taxpayer wishes *both* to make a submission of no case to answer *and* to defend the substantive issue by calling evidence, he must have the procedural case heard separately from the substantive case.

He needs to do that because, if he cannot have the two parts of the case heard separately, he must either abandon the submission of no case to answer, or abandon his right to defend the substantive issue by calling evidence.

It seems to me obvious that, in a s.29 or Para 43 and 44 case, the taxpayer should be allowed to insist on separate hearings of the procedural and the substantive issues: they raise completely different questions and involve different burdens.

Of course, HMRC resist that: they believe that, if the taxpayer fails to show that the substantive claim is wrong, the tribunal will more or less inevitably decide the procedural point in their favour, the taxpayer's failure on the one issue making HMRC's success on the other more likely.

So far the Tribunals have been taking HMRC's side on this

issue, but I am still optimistic about the eventual outcome: the taxpayer should be given, in the fullest measure, the protection which s.29(4) and (5) and Paras 43 and 44 are supposed to give him, and I view with distaste the easy willingness with which some Tribunals have allowed this protection to be significantly weakened.

If HMRC do manage to overcome the procedural bar, the appeal against the substantive issue goes ahead as normal.

Going ahead as normal means that, no matter what the nature of the claim to tax, whether it is an assertion that a sum is taxable or the denial of a relief, it is up to the taxpayer to prove the case.

In many ways this might seem odd.

After all, stripped of procedural issues, HMRC are asserting a demand and are, on a realistic view of the facts, the claimant.

General principles would, accordingly, indicate that HMRC should carry the burden of proof.

However, because the machinery of appeal involves a claim by the taxpayer that HMRC's demand is wrong, the burden is put on the taxpayer to establish the negative.

Custom – long custom – makes us used to this, and it does not seem odd to us.

But I have recently learnt that, under most tax systems in Continental Europe, the burden is different: the revenue have to establish that a demand for tax is right, while the taxpayer has to establish that a claim for relief is valid.

That seems to me to involve quite a sophisticated attitude towards the burden of proof which may be superior to ours: in each case, it puts the burden on the true claimant, regardless of procedure

So far, then, I have raised some concerns about whether our procedure is fair, and I have found that other tax systems might, at least in some respects, have a better approach than ours.

But the disadvantage to the taxpayer, inherent in the

procedural aspects of our system, will not matter, if our substantive law is sufficiently clear and certain.

In this connection, it is necessary to consider not only the clarity of our legislation, but also the way in which judges apply it.

We often take the *Ramsay* case as marking a departure in the way in which we interpret tax statutes.

However, a proper analysis of the case law shows that the way in which we interpret statutes has not changed markedly over the years: there is not really much to complain about in relation to the purposive construction of tax statutes; it is often necessary and inevitable.

Nonetheless, over the years, something does seem to have changed in the practice of substantive tax, and, if it is not truly the approach of the Courts to the interpretation of statutes, what is it?

I think it is possible to identify five changes in the approach either of politicians or of the Courts which feed off each other.

First, in ways I have demonstrated, there has been a shift in our procedural law; from an emphasis on protecting the rights of the taxpayer to an emphasis on protecting the interests of the State.

Secondly, there has been increasing political disapproval of tax avoidance coupled with times of economic hardship.

The influences, flowing from the economic hardship, include, for example, a restriction on judicial pensions, and that may have fed into the attitude of the judges, who might feel that the restriction on their pensions is, in large measure, attributable to people who have avoided tax.

If that is how judges feel, it is hardly surprising that they do not wish to see tax avoidance succeed.

What makes this aspect of the matter particularly pernicious is that there has not been – largely because there cannot be – any serious attempt to define what is tax avoidance and what not.

There are, no doubt, many people with strong opinions

about what is and what is not avoidance, but rational definition seems impossible.

Thirdly, the way in which the Courts analyse facts has become much more elastic than it was, a tendency compounded by the unwillingness or failure of the Courts to set out any rules as to the degree of factual analysis which is permissible or impermissible.

This factual elasticity is the real legacy of the *Ramsay* approach and is highly important: the statute is always relevant in a tax case, but, equally, identification of the situation to which the statute is to be applied is also a constant.

If a statute applies to, say, Saturday afternoons and the taxpayer believes he has created a Saturday afternoon, to be told by the Court that what he thought of as a Saturday afternoon is a banana, will deprive him of benefits which he expected to get.

Since *Ramsay*, courts have been much more willing than they were to say that the facts, when properly analysed, reveal a banana; and they are willing to use a number of devices to achieve that result.

However, there is no clarity as to which analytical devices are permitted and which not, and this, too, contributes to uncertainty in the law.

And, next, there is a rising belief that tax law has a spirit in accordance with which we must all act or face criticism.

Although none of these factors are fundamentally about the rules of taxation, but, rather, are about approaches to the facts and about our attitudes to taxation, they tend to undermine the validity and importance of rules.

We have now enacted, in our GAAR, a rule that, to a very large extent, rules do not matter, because whether something is permitted or not is largely just a matter of opinion.

The GAAR, of course, does not stand alone: we have a host of TAARs and of other provisions, such as the recently enacted

diverted profits tax, which, to a lesser or greater extent, create an element of discretion.

We have also enacted provisions which define the taxable subject matter by reference to accounting standards, which are changed quite often and which, in any event, operate by a reference to a supposed substance which will, itself, be relatively changeable.

Accordingly, as our procedural law imposes increasing burdens on the citizen, the administrator's burden is decreased both by the enactment of laws which, to an extent, draw their vitality from outside the Statute and by the enactment of laws which give the administrator an area of discretion.

And this decrease in the administrator's burden is the fifth and, perhaps, worst change of approach, again increasing uncertainty for the taxpayer and the burdens on him.

Overall, these legal and political factors combine together to create a belief that tax is a part of the law of nature and a public view that, to some extent, all moneys belong to the State and the citizen is only entitled to them if he or she can show, in the law, a specific right to them.

On top of that wrong philosophy of taxation, it has also become much more difficult to settle disputes with HMRC, so that a sentiment of envy has seeped into our system and has driven out much needed pragmatism.

The thought that money belongs to the State unless it is shown it doesn't is one of the things that has led to a loss of pragmatism and seems to me to underlie the philosophy of FPNs and APNs and to inform our general political and journalistic understanding.

No matter what the public belief is, tax is an inherently unnatural thing: it cannot exist unless the subject matter of taxation is defined by man written words which will, inevitably, not cover everything and, equally inevitably, will be thought to be right by some and wrong by others.

In short, where tax is concerned, not many people seem to believe in the value of rules anymore; and those who do believe in the importance of rules have recently been quite heavily criticised.

I think that rules do matter: to me, at any rate, it should be obvious, even to a moron in a hurry, that the abandonment of respect for rules leads to a dangerous path on which democracy itself is at risk.

Of course, the problems created by our present forms of political and journalistic commentary will not be solved only by recognising the importance of rules, rather than of spirit.

Rules are not, of themselves, good: there can be bad as well as good rules, and the need is for rules which at least attempt to achieve good purposes, even if, at the same time, we recognise the possibility of failure in the attempt.

We need to recognise that, even if we do not like what the rule says, there is a prime need for the existence of the rule to be recognised and for the rule to be applied.

What I have tried to show, partly by an examination of some of our procedural rules and partly by reference to the ways in which our approach to substantive law has been changing, is that there has been a shift in the balance of the tax system, so that it now quite heavily favours the State rather than the taxpayer.

This is partly as a result of rule change, partly as a result of judge made law, partly as a result of the supposed spirit of the legislation and partly because of a loss of pragmatism: I rather doubt if the rules or the spirit are presently right.

I say that because I have the feeling that the overwhelming direction of our procedural and substantive tax law is that every single penny should be taxed, even if at, historically, what are relatively low rates.

This does not seem to me to be a coherent theme for a tax system, which surely needs a clear underlying philosophy by

reference to which the taxable subject matter can be identified and the tax collected in a fair and reasonable way.

Nor do I believe that this is a state of affairs which can or will long continue.

I gave this talk a title which contains the last line of Matthew Arnold's poem "Dover Beach".

In full, the last three lines of the poem are:

"And we are here as on a darkling plain
Swept with confused alarms of struggle and flight
Where ignorant armies clash by night"

As things are, that is quite a good description of how, nowadays, it feels to be a tax practitioner, but, as I say, I do not expect things to stay that way.

I believe that the continuing increase in the apparent power of the State will bring forth a reaction in judges, who will move to restore balance.

Moreover, what I have said relates mainly to cases which involve avoidance.

Avoidance is very hard to describe, but most tax questions are not about avoidance at all: they arise in the context of the efficient structuring of transactions or in the normal course of commercial life.

A large part of the art of tax practice lies in the presentation of a situation so that it cannot be seen as involving avoidance.

Where that happens, everything is much more balanced and the risk of criticism – reputational risk – is almost non-existent.

Indeed, in cases of that kind, I would go so far as to put the matter the other way round.

The person who has a genuine dispute with HMRC and does not fight his corner performs a disservice to the State: fighting for the Right is not a mark of shame but a badge of honour and, as the economy improves, I am confident that Courts will recognise that to be so.