Comment

The UK tax system: from trust to transparency

Speed read

How far does information technology implement the will of Parliament, and to what extent does it displace it? In the 'good old days', the tax system was a system of decentralised administration carried on by generalist authorities, while the courts sought to maintain a fair balance between taxpayer and Revenue interests. The introduction of self-assessment was driven by the need and the policy to computerise the tax system, while the administration of taxes became centralised on a largely mechanised and computerised basis. But computer programs are binary; they cannot produce value judgments. The danger is that long-term institutional values may be immolated in the short-sighted causes of greater efficiency and squeezing out tax avoidance.

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The question

The question is: in relation to the tax system, how far does information technology (IT) implement the will of Parliament and to what extent does it displace it? Has IT had a transformational effect on the tax system, or merely altered the characteristic mode in which it is conducted? Are we now assessed to tax by computer program rather than by legislation?

This was the question I sought to raise in a recent seminar of the *Journal of Tax Administration*, organised by Professor Lynne Oates of Exeter University. My problem in seeking to answer the question posed is that, while I know a certain amount about tax, I know precious little about IT. Long experience in court has taught me that the best way of avoiding a question which one cannot answer is to go back in time.

The good old days...

Nostalgia is not what it used to be (in the words of Tennyson):

> 'For now I see the true old times are dead,
> When every morning brought a noble chance,
> And every chance brought out a noble knight.'

When I joined the Inland Revenue in the 1980s, this was still the era of the district inspector of taxes. He was a much respected figure. He was one of the local worthies, together with the mayor, the town clerk, the bank managers, the police superintendent, and the local chairmen of the Rotary Club, the Chamber of Commerce, the Law Society, the Institute of Chartered Accountants and the Institute of Insurers. Tennyson again:

> 'The goodliest fellowship of famous knights
> Whereof this world holds record.'

These figures were a rallying point for everything that needed order and stability in order to live.

The tax system which prevailed was a system of decentralised administration carried on by generalist authorities. There was a broad public service ethos, which meant that public bodies sought to meet their responsibilities by the direct provision of services. This in turn produced a distinct pattern of accountability. The system rested on a set of unwritten rules, which all parties knew and were expected to observe. In short, it rested on trust.

The importance of trust

As far as tax was concerned, the main element of this unspoken code was an acceptance that most people adhered to basic honesty. This was a convenient fiction. It had various useful consequences. Both sides treated each other with respect, be it sometimes through clenched teeth. Taxpayers did not use footling legal arguments to escape liability. For their part, public authorities were expected to observe higher standards than private parties. As Mr Justice Ungoed-Thomas observed in one case:

> 'I conceive it to be the duty of the Inland Revenue to behave like gentlemen.'

A balance had to be struck between alienating taxpayers and tolerating a degree of avoidance and evasion. On the other hand, if avoidance and evasion were allowed to go too far, this structure would be undermined. The courts were there to maintain a fair balance between taxpayer and Revenue interests, without any agenda of their own.

The forces of change

The first force of change consisted in marketed tax avoidance schemes produced by Bradman and the Rossminster group. These were clever but stupid. They sought to make tax liabilities disappear by magic. That is neither possible nor sensible. As Stewart Bates QC observed of the *Ramsay* scheme itself: 'Like the trees – don't like the wood.' The decision of the House of Lords in *WT Ramsay Ltd v IRC* [1981] STC 174 was thought to have killed off artificial avoidance. It did not do so, for a number of reasons. From the mid-1990s, there was an upsurge in second wave marketed tax avoidance schemes.

An important contributing factor was the introduction of self-assessment in 1996/97. The introduction of self-assessment was driven by the need and the policy to computerise the tax system. Self-assessment tax returns would be automatically processed by computer, and from 2003 onwards be submitted online. In this new world, the tax system would run on automatic pilot. It was the victory of mechanism over moralism. The guiding principle was: 'Process now – check later.' The taxpayer would pay the amount of tax his own return showed to be due, without any further intervention.

Under the former system, assessments were made and claims were allowed by the inspector. Under the new system, tax and claims were self-assessed. This had two immediate consequences: (i) the preliminary sifting by the inspector disappeared: the taxpayer became his own tax inspector; and (ii) the financial benefit of claims for tax relief could be obtained upfront and seemingly without question.

The common feature of all the second wave tax avoidance schemes was that they offered immediate cash

Annual allowances charge

Mr L is a member of a defined contribution occupational pension scheme. He makes an annual pensions contribution of 7.35% of his salary. His pension increases by 2.32% a year. His employer is treated as making an annual contribution of (pension increase x 16). His salary is £170,000. The results are:

	£	£
Salary	170,000	
Pension contribution @ 7.35%	(12,496)	
	157,504	
Add back	12,496	
Adjusted net pay	170,000	
Additional pension earned in year @ 2.32%	3,944	
Capital contribution	3,944 x 16	63,104
Tapered annual allowance	40,000 – (20,000/2)	(30,000)
		33.104
Tax on excess	33,104 x 45%	14,896

benefits, combined with the indefinite delay of any day of reckoning.

These features did not derive from the self-assessment system itself. The original scheme had plenty of built-in safeguards, both for the taxpayer and the Revenue. However, they were simply not operated or they were abandoned, because they would have conflicted with the theory of running on automatic pilot or restricted the Revenue in the exercise of its powers.

Self-assessment in turn led to the demise of the district tax office. Likewise, the local general commissioners of income tax lost their *raison d'être*. This had frequently consisted in attempts to cajole reluctant taxpayers into submitting tax returns ('delay hearings'), a common explanation for such oversights being that the dog had eaten the tax return.

The administration of taxes became centralised on a largely mechanised and computerised basis, directed by specialist offices, which would often buy in services rather than provide them directly.

The outcome of change

Tax avoidance without tears ended in tears without tax avoidance.

The Labour government's cautious reaction to the second wave schemes was to introduce the disclosure of tax avoidance schemes (DOTAS) rules in FA 2004. This introduced reporting requirements but did not alter the substance of tax rules. The Coalition government's more rumbustious approach was to use the DOTAS scheme as a springboard from which to launch the accelerated payments notices legislation in FA 2014.

The trend of much modern legislation, such as that introducing accelerated payments notices (APNs), is to confer powers on a public body, and then attach conditions for their exercise which may not in practice be judicially enforceable.

HMRC took a policy decision to issue APNs to all taxpayers who had implemented schemes on all DOTAS lists, save for a few insignificant exceptions. As I have said in court many times, APNs were issued on an industrial scale. Given that the DOTAS scheme was deliberately drafted widely to encourage maximum disclosure, the question was whether the coterminous correlation of DOTAS and APNs corresponded to an authentic expression of the will of Parliament.

In most cases, the APN will supersede the ordinary mechanisms for the assessment and collection of tax. The Revenue is a tax collecting authority, not a tax imposing authority. That is the role of Parliament. The extensive use of these demands renders that distinction otiose.

Two comments may be made. Courts which do not exercise the powers they have will find that they have no powers to exercise. And the legislation decisively marked the gravestone of the old world of the 1980s, and the unspoken understandings which had underpinned it. Some of the tensions of the new system were illustrated in a case which reached the Court of Appeal: *Donaldson v HMRC* [2016] STC 2511. The self-assessment system, consistent with the desire for minimum human intervention and to spare dogs from indigestion, is driven by penalties. Wherever delay in submitting a tax return exceeds three months, HMRC may impose daily penalties. The legislation says such penalties 'should be payable'. 'Should', not 'must' or 'are'. 'Should' implies some further action: 'I should get up earlier/drink less.' In practice, a computer program operates to impose such penalties in every case automatically, without further human intervention. It was courageously argued (by Rebecca Murray) that this could not constitute a decision within the meaning of the Act. The Court of Appeal would have none of this. Such a 'generic decision', as represented by the computer program, came within the scope and intent of the legislative scheme.

Tax avoidance without tears ended in tears without tax avoidance

The problem here is that computer programs are binary. They do not provide for nuances. They cannot produce value judgments.

It is also worth considering the situation set out in the example (see box above right). In a year when an individual earns an additional retirement pension of £3,944 a year, he has an additional income tax charge of £14,896. Assume that the additional pension is payable for ten years and taxed at 40%. The total tax charge on net pensions benefits of £23,664 (£3,944 x 10 x 60%) is £30,672 (£14,896 + £15,776). This seems an odd way of encouraging occupational pensions provision.

The problem here is massively detailed legislation which seems to lose its policy direction.

From trust to transparency

The general direction of these changes is clear. The trend is from the informal to the formal; from trust to prescription; away from opaque practices and towards transparent mechanisms; to provide value for money through the specification of statements of purpose, visions, values, goals, strategic priorities, targets and key performance indicators.

Trust and transparency are quite different. Trust is believing what you have not seen. Transparency is only believing what you have seen.

This has been profoundly subversive of the nature, methods and role of the traditional model of public

service. Parliament confers on the Revenue powers and discretions, which are then turned into rules, which may in turn be programmed into computers. The results are automatic and not the result of any decision about how to operate those powers in the public interest, save in generic terms.

The danger is that the long-term institutional values of autonomous decision making, judicial detachment and administrative fairness may be immolated in the short-sighted causes of greater efficiency and squeezing out tax avoidance. People may then be left with a sense of unfairness, compounded with powerlessness to obtain justice. Those that see the law as an enemy will become enemies to the law.

The resultant system was anticipated by Mr Justice Walton in 1982 in *Innocent v Whaddon Estates Ltd* [1982] STC 115 at 121:

> 'It has been suggested that the whole of the law of taxation could be simplified to a one-clause Act: "The taxpayer shall, after due enquiry and report by the Commissioners of Inland Revenue, be entitled to retain such proportion of his income and assets as the Commissioners shall think fit", which would produce very much the same result as is produced today by the enormous mass of legislation which we have.'

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Ever since the beginnings of the industrial revolution, critics of progress from William Morris to Thomas Carlyle have complained of the mechanisation of processes and that decisions formerly made by human beings are now made by machine. I do not entertain the Luddite dream of a world in which ruddy-faced peasants sit round the village green, quaffing foaming mugs of British beer, watching a game of cricket, all the while conducting a lively discussion of the government's latest proposals for Brexit.

The Lord Mayor of London has organised a tax debate on 'The business of trust'. That would seem an apt forum to take forward some of the issues touched on here. What the tax system needs is not fewer computers but informed override. For the moment, amidst these swirling currents, the British tax system seems destined to play the role of Hamlet – 'adrift of old faiths and not yet anchored in new'. ■

This article is based on paper given at a conference organised by the Journal of Tax Administration on 26 February 2018.

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