

1-1-1995

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### Recommended Citation

James, Simon and Wallschutzky, Ian (1995) "The Design of an Appropriate Sytem of Tax Rulings," *Revenue Law Journal*: Vol. 5 : Iss. 2 , Article 2.

Available at: <http://epublications.bond.edu.au/rlj/vol5/iss2/2>

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# The Design of an Appropriate System of Tax Rulings

## **Abstract**

This article examines criteria for assessing the respective merits of different systems of tax rulings. Both the Australian and UK arrangements fit what might be described as a "Revenue Service Model of Tax Rulings". The analysis presented suggests that a system of rulings should at least be partly "consumer driven" and that tax rulings should be issued by an independent body and not by the tax authorities.

## **Keywords**

Tax rulings, Australia, law

## THE DESIGN OF AN APPROPRIATE SYSTEM OF TAX RULINGS



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This article examines criteria for assessing the respective merits of different systems of tax rulings. Both the Australian and UK arrangements fit what might be described as a "Revenue Service Model of Tax Rulings". The analysis presented suggests that a system of rulings should at least be partly "consumer driven" and that tax rulings should be issued by an independent body and not by the tax authorities.

"Let all the laws be clear, uniform and precise: to interpret laws is almost always to corrupt them." **Voltaire** (*Philosophical Dictionary*)

### 1 The questions

Tax rulings are official interpretations of legislative provisions. It might be argued that such rulings would be unnecessary in an ideal world; tax legislation should be sufficiently clear and precise as to leave no doubts as to what is intended in each and every circumstance. In particular, it should be possible to ascertain each taxpayer's liability with certainty. This, of course, is not always the case. The existence of thousands of tax cases and a range of

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formal and informal methods of interpreting the law is an indication of the magnitude of the problem.

Tax rulings are one way of interpreting the laws and increasing certainty but there are many possible systems of rulings. The present Australian arrangements have come in for some weighty criticism in terms of quality and content<sup>1</sup> and it might be worth reflecting on the alternatives. Different arrangements for providing rulings are to be found in different countries<sup>2</sup> and some of the relevant issues to be considered in the design of a tax rulings system are shown in Table 1. These include the extent to which a rulings system has a statutory basis, who should issue the rulings and on what, the extent to which they are binding, the actual procedures for obtaining rulings and whether those requesting rulings should be charged and, if so, how much. There is also the more general question of the relationship between tax legislation and tax rulings.

This article considers such questions and, in particular, offers criteria for judging the respective merits of different rulings systems. To do this systematically it is insufficient simply to take a specific rulings system and discuss a series of advantages and disadvantages relating to specific aspects. Although it may be more difficult, a better starting place might be an examination of the environment in which a tax rulings system is to operate and precisely what, within that environment, the rulings are expected to achieve.

The first important consideration is the nature of tax legislation itself and this is raised in Section 2. Methods of interpretation are unlikely to produce the most satisfactory results if they fail to take account of the difficulties in producing legislation which is clear, precise and comprehensive in the first place. Part of the answer lies in the second area of consideration here - the nature of the economic and related activity to which the tax system is applied (Section 3). Elsewhere the present authors have examined many of the relevant economic, financial and social trends<sup>3</sup> and it is clear that such factors are becoming increasingly complex and diverse. Furthermore, there are some current and likely future developments

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<sup>1</sup> "Institute Submission: Public Rulings and Determinations" 29 *Taxation in Australia* 439

<sup>2</sup> For instance, see OECD, *Taxpayers' Rights and Obligations: A Survey of the Legal Situation in OECD Countries* (1990).

<sup>3</sup> For example, James SR and Wallschutzky IG, "The Shape of Future Tax Administration" (1995) 49 *International Bureau of Fiscal Documentation Bulletin* 210.

in information technology as applied to tax administration<sup>4</sup> which should be taken into account.

**Table 1**  
**Different Features of Systems of Tax Rulings**

- Constitutional validity and the degree to which the system is a statutory or non-statutory system.
- The status of rulings vis-a-vis tax legislation and judicial interpretation.
- Responsibility for issuing rulings - the tax authority or some other body.
- The subject matter of rulings.
- The effects of rulings and the extent to which they are binding on the revenue authority and on taxpayers.
- Whether rulings can have effect retrospectively or apply only from the date of issue or announcement.
- Timing issues, for example, a time limit for issuing rulings and a time limit for the validity of rulings.
- The revocation of rulings.
- Public rulings and private rulings and the question of publication.
- The resolution of any conflict between rulings, for example between an earlier or later ruling or between a public and private one.
- Applicability of rulings, for example:
  - Public rulings
    - the extent to which they apply to non-residents
  - Private rulings
    - whether they apply to individuals other than the applicant
    - whether they apply generally or just to the year of income or the circumstances specified in the application or both.
- Appeals.
- Taxpayers' exposure to penalties for failure to follow rulings.
- How the rulings system should be financed.
- More specific procedures.

<sup>4</sup> For instance, see James and Wallschutzky, (1993) *British Tax Review*, and James and Wallschutzky, (1995) *Journal of Financial Crime*.

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Section 4 is concerned with general issues of simplicity and complexity. Section 5 turns to the introduction of self-assessment, which raises yet more considerations and has, at least in part, increased the demand for a more expeditious resolution of doubt about the meaning of particular legislative provisions. Section 6 looks at the desirable characteristics of rulings from the taxpayer's perspective. A successful system of tax rulings must be able to accommodate all these factors. Section 7 summarises different forms of rulings in Australia and the UK and Section 8 sketches out some steps towards the design of a tax rulings system which is responsive to taxpayers' needs. Finally, Section 9 draws together some conclusions and recommendations.

## 2 The nature and complexity of revenue law

While most people might sympathise with Voltaire's views on the ideal characteristics of law, the aims of clarity and precision in tax legislation might not always be compatible. As Sir Ernest Gowers, a former chairman of the Board of Inland Revenue in the UK, once wrote with respect to an example of legal language:

[The] sentence is constructed with that mathematical arrangement of words which lawyers adopt to make their meaning unambiguous. Worked out as one would work out an equation, the sentence serves its purpose; as literature, it is balderdash.<sup>5</sup>

There also seem to have been particular difficulties with income tax legislation from its beginnings in the UK. The original Act of 1799 was a complex document of some 152 pages and it was perhaps an indication of how things would develop that an amending Act was passed only three months later. Such was the complexity that it was felt necessary to produce a guide entitled "A Plain, Short and Easy Description of the Different Clauses of the Income Tax so as to Render it Familiar to the Meanest Capacity".<sup>6</sup>

In more recent years the shortcomings of tax legislation in the UK have attracted increasing attention, for example, by Beighton,<sup>7</sup>

<sup>5</sup> Sir Ernest Gowers, *The Complete Plain Words* (1954 HMSO) ch 7.

<sup>6</sup> Farnsworth A, Addington, *Author of the Modern Income Tax* (1951 Stevens) 15.

<sup>7</sup> Beighton LJH, "The Finance Bill: Scope for Reform?" (1995) 1 *British Tax Review*.

Pagan,<sup>8</sup> Prebble,<sup>9</sup> Sabine<sup>10</sup> and Williams.<sup>11</sup> One area of concern has been the whole process of drafting tax legislation. It has been suggested that this has not always been done in the most appropriate way, because of factors such as insufficient pre-legislative consultation.

More fundamentally there appears to be a general lack of consistent tax policy at governmental level. As Sabine<sup>12</sup> describes the British situation: "What policies? One comment on all the Budgets covered is the ad hoc nature of the majority of measures: expediency, it would seem has been elevated to the status of a fiscal programme".

Similar criticisms have been made in Australia. In 1991 the Taxation Institute of Australia featured an article which said that there was:

increasing acceptance that the entire tax system, not only the law, was so complicated that it was difficult for many tax accountants and lawyers - let alone most taxpayers - to understand it.<sup>13</sup>

One area of criticism has been the poor structure of legislation, which has been further obscured when important additions to the tax law have just been "tacked on". Another criticism is that the language of the law has progressively adopted a style of such formality and precision that its true meaning is hard to establish.<sup>14</sup> The Australian Government has established a Task Force to simplify the tax law. Curiously the group has been split between two centres - Brisbane and Canberra. It has been given three years, Aus\$10 million<sup>15</sup> and over 40 full time staff to simplify the tax law. There is also wide consultation with the community and professional bodies. Early indications are that it might not be

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<sup>8</sup> Pagan JC, "Increasing Length and Complexity of Tax Legislation - Avoidable or Inevitable?" (1993) 14 *Fiscal Studies*.

<sup>9</sup> Prebble J, "Why is Tax Law Incomprehensible?" (1994) 4 *British Tax Review*.

<sup>10</sup> Sabine B, "Further Thinking on Revenue Law" (1991) 5 and 6 *British Tax Review* and Sabine B, "Life and Taxes 1932-1992. Part III 1965-1992: Reform, Rossminster and Reductions" (1993) 6 *British Tax Review*.

<sup>11</sup> Williams D, "The Finance Act 1993: Incredible Drafting, Extraordinary Prose" (1993) 6 *British Tax Review*.

<sup>12</sup> Sabine B, "Life and Taxes 1932-1992. Part III 1965-1992: Reform, Rossminster and Reductions" (1993) 6 *British Tax Review* 515.

<sup>13</sup> "Simplification: Enough to Give You a Complex" (1991) *Taxation in Australia* 244.

<sup>14</sup> *Tax Law Improvement, The Broad Framework* (AGPS 1994).

<sup>15</sup> Senate, Estimates Committee D, *Hansard* 26 May 1994.

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entirely successful. According to the Australian Society of Certified Practising Accountants (CPAs):

[The] Government has shown itself to be tired of major reforms and has instead played the political distraction game by concentrating on non-policy areas such as tax law improvement, FBT compliance, cost reductions and so forth, rather than adopting a broadly based and integrated reform program.<sup>16</sup>

This view could well prove to be correct because the team was asked to improve tax law within the existing tax policy framework but not comment on the tax policy process itself. It is difficult to see how the complexity of the law can be addressed without first reforming the process by which tax policy is generated and implemented. Confused, inconsistent and frequently changed directions in tax policy will inevitably lead to confused, inconsistent and frequently amended tax legislation.

### 3 Applying the law to a complex and changing economic system

The problem of producing appropriate revenue law is much wider than just poor performance on the part of those involved in the legislative process; that is those who formulate and draft tax legislation. One of the recurring problems seems to be the difficulty of applying detailed law to what Prebble<sup>17</sup> refers to as the "natural facts of economic life". Economic activity is complex and changing. Tax legislation cannot be like the law of the Medes and Persians "which altereth not".<sup>18</sup> New forms of financial instruments are continually evolving, for example, deferred annuities, deep discounted securities, interest rate swaps, lease finance and zero-coupon bonds. It is not always easy to see how such new developments fit into the existing framework of tax legislation and definitions and the scope for disagreement can be considerable.

Such uncertainty is inconsistent with one of the main economic criteria for a good tax system - economic efficiency.<sup>19</sup> This suggests that economic transactions should not be distorted by unintended

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<sup>16</sup> Australian Society of CPAs, *Taxation Update* (April 1995).

<sup>17</sup> Prebble, above n 9.

<sup>18</sup> "Now, O King, establish the decree and sign the writing, that it be not changed, according to the law of the Medes and Persians, which altereth not", *Bible, Authorised Version*, Daniel 6:8.

<sup>19</sup> James and Nobes, *The Economics of Taxation* (4th ed 1992 Prentice Hall International).



effects of taxation. If primary legislation cannot achieve the certainty required for sound economic decision-making, then the role of an appropriate system of rulings is likely to take on a more important role in the tax system.

While there are sound underlying economic reasons for many financial developments, some are prompted by motives of tax avoidance. As the late Sir Hermann Black rather charmingly put it, "Oh what a tangled web we weave, when we practice to relieve".<sup>20</sup> Tax avoidance is neither a productive economic activity so far as the wider community is concerned, nor good for the tax morale more generally. The additional difficulty here is not only to decide how particular economic facts should be treated by the tax system but the motivation behind transactions as well - a sure recipe for frequent dispute. In any case, such is the complexity of human and economic motivation that disentangling its various component parts may sometimes not be easy, even for the individual concerned.

The difficulty in fitting the law to such activity is increased if a literal approach to tax legislation is taken by the courts. The literal approach might appear to be a simple solution to the problem of interpretation. As stated by Rowlatt J:

In a taxing statute one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.<sup>21</sup>

While such an approach might look simple, the implications can generate considerable complexity. To begin with, the literal approach can be both harsh and inflexible:

If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.<sup>22</sup>

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<sup>20</sup> Sir Hermann Black, "Sayings of the Week" *Sydney Morning Herald*, 6 July 1985.

<sup>21</sup> *Cape Brandy Syndicate v IRC* [1921] KB 64 at 71. This view was approved by Viscount Simon in *Canadian Eagle Oil Co Ltd v R* [1946] AC 119.

<sup>22</sup> *Patridge v A-G* [1869] 4 HL 106.

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This principle has been clearly endorsed in the Australian context by Barwick CJ:

It is for the parliament to specify, and to do so, in my opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax. The function of the court is to interpret and apply the language in which the parliament has specified those circumstances. The court is to do so by determining the meaning of the words employed by the parliament according to the intention of the parliament which is discoverable from the language used by parliament. It is not for the court to mould or attempt to mould the language of the statute so as to produce some result which it might be thought the parliament may have intended to achieve, though not expressed in the actual language employed.<sup>23</sup>

The implication is that the letter of the law should be comprehensive. The result is that the complexity and length of legislation have increased to cover as many eventualities as the legislators can anticipate. In Australia the first CD-ROM to be released concerning tax legislation, tax rulings and commentary, contains the equivalent of 30,000 pages of printed material.<sup>24</sup> In the UK there have been over 1,300 pages of primary legislation alone added in the last five years.<sup>25</sup> One cannot help feeling, however, that such legislative donkeys will never fully capture the economic carrots.

In Australia in recent years, there has been some movement of judicial opinion away from the strictly literal approach in cases such as *Ure v FCT*<sup>26</sup> and *Cooper Brookes (Wollongong) Pty Ltd v FCT*.<sup>27</sup> It could be argued that, while there has been a shift away from literalism and form towards the substance of transactions, the general approach has not changed radically and still falls short of the substance approach followed by US courts in their tax decisions.<sup>28</sup>

However, the ever changing nature of economic and financial activity means that new circumstances, which could not have been anticipated by legislators, might arise at any time. Therefore, a

<sup>23</sup> *FCT v Westraders Pty Ltd* (1980) 11 ATR 24 at 26.

<sup>24</sup> McIntosh T, *The Australian*, 21 March 1995, 30. The product is priced from Aus\$2,200.

<sup>25</sup> Beighton, above n 7.

<sup>26</sup> (1981) 11 ATR 484.

<sup>27</sup> (1981) 11 ATR 949.

<sup>28</sup> For further discussion see, eg, Lehmann and Coleman, *Taxation Law in Australia* (3rd ed 1994 Butterworths) 21-22.

more fruitful line of approach might be a broad statement of policy rather than ever more refined definitions. Indeed, on the central issue of the definition of income itself, the 1955 Royal Commission on the Taxation of Profits and Income<sup>29</sup> stated that “no real advantage could possibly result from the introduction of a general definition that had to cover so multifarious a subject as taxable income”. The continental European approach has tended to look at the intention rather than simply the letter of the law in interpreting meaning. So, for example, in countries such as the Netherlands, the courts developed the concept of “*fraus legis*” which enabled them to outlaw transactions which were outside the spirit of tax legislation.

This might suggest that a suitable legal framework for rulings might be a clear and careful statement of the policy intentions of the legislature. Apart from adding clarity in its own right as to the purpose of particular aspects of the law, it should provide unambiguous guidance both to those responsible for providing tax rulings and to those who might have to anticipate what those rulings will be. This would also be consistent with the economic criterion of efficiency.

#### 4 Simplicity and complexity

More generally this might suggest different approaches to tax legislation and its administration. One issue is whether every possibility can be incorporated literally, or whether there can be a sufficiently clear statement of intent that can be administered satisfactorily. This relates to the extent to which the rules have a legislative or an administrative basis. Furthermore, at least conceptually, either or both could be simple or complex. This gives four types of possibility - simple or complex tax legislation with simple or complex tax administration. There are no easy choices here. A system which is sufficiently comprehensive to take account of all eventualities is not likely to be comprehensible to the laity, or even some tax professionals, and a system which is simple enough to be comprehensible is unlikely to be comprehensive.

The first possibility is simple tax legislation enforced through a set of simple rules. This is unlikely to be workable in a complex society. A spectacular recent example was the UK community charge or poll tax. This was a very simple local tax; liability was determined en

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<sup>29</sup> *Final Report* (1955) ch 1, para 28.

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masse and taxpayers were normally required to pay the standard charge, whatever their personal circumstances.

It is clear that a major cause of the failure of the poll tax was its perceived inequality,<sup>30</sup> which led to serious civil disobedience<sup>31</sup> and was undoubtedly an important contributory factor in the events leading to the resignation of Mrs Margaret Thatcher as Prime Minister.<sup>32</sup>

The second possibility is simple tax legislation operated through a complex set of administrative regulations. This would seem generally undesirable, as inflexibility has simply been transferred from the legislative to the administrative sphere. Moving too much legislative responsibility away from the primary legislative body and its associated safeguards might be widely regarded as undesirable.

The third possibility of a complex system of tax legislation administered through simple rules reflects to some extent Australian experience. The difficulty then is to fit the simple rules to the everyday complexity of economic and social life. One Australian solution, which appeared to emanate from reforms commencing with those of 1964, was to confer discretionary powers onto the revenue authority. As can be seen from the examples shown in Table 2, these powers are substantial. They have also been the subject of some unhappiness on the part of the taxpaying population.

This leaves the fourth possibility of complex tax legislation and a complex set of tax rules. This seems to be the modern tendency and will cover more eventualities than the previous three possibilities. The authors have to question whether this is the most appropriate way forward. It is likely that whatever the amount of detailed tax legislation, it will still be unable to keep abreast of the changing circumstances of modern times.

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<sup>30</sup> Cullis J, Jones P and Morrissey O, "Evaluating the Poll Tax as a Tax Reform" (1993) 19 *Local Government Studies* and King D, "Local Taxation - Lessons from Britain" in Sandford C (ed), *Key Issues in Tax Reform* (1993 Fiscal Publications).

<sup>31</sup> Mair D and Damania R, "Fiscal Crisis and UK Local Tax Reform" (1992) 18 *Local Government Studies*.

<sup>32</sup> Gibson J, *The Politics and Economics of the Poll Tax: Mrs Thatcher's Downfall* (1990 EMAS).

**Table 2**  
**Examples of the Commissioner's Discretion**  
**in the Income Tax Assessment Act 1936, as amended**

| Section | Discretion   |
|---------|--|
| s 46(3) | To allow a further (ie extra 50%) rebate to private companies in respect of private company dividends received.  |
| s 65    | Power to limit the deductibility of payments, made to associated persons, which otherwise would be allowable deductions.   |
| s 99A   | To tax certain trust income at ordinary rates of tax or at the maximum marginal rate of tax.   |
| s 108   | To treat certain loans made by private companies to its shareholders as (taxable) dividends.   |
| s 109   | To treat certain payments made by private companies to associated persons for services rendered as dividends (these remain assessable for the associated person but cease to be tax deductible for the company). |

One of the essential difficulties with all these approaches is that the legislature or the tax administration are having to anticipate future economic, financial and social circumstances which are unpredictable. There is a need for a consumer-driven element of the process.

An illustrative example from another context is the Director of Grounds of a UK university who decided not to lay out the footpaths on the new campus until it was clear where the well-trodden routes were going to be. The result was quite different from what most people might have anticipated. In a changing economic and social environment it is far more important to provide the appropriate infrastructure and to avoid the spectacle of many aggrieved taxpayers trampling over the fiscal flower beds.

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As long ago as 1965, a former Commissioner of Taxation, DL Canavan stated that the Government was:

no doubt mindful of the fact that any attempt to spell out in detail in the legislation the way which it is to apply in every conceivable set of circumstances could well make the law administratively impracticable, and would certainly further complicate already complex provisions.<sup>33</sup>

In the same year, the then Commissioner of Taxation, ET Cain, also indicated the nature of the problem:

There is just not the opportunity in the complexities of modern society for the legislature in its legislation to deal specifically with the thousand and one intricacies of social and economic situations which must be provided for if the law as written is to achieve its purpose and, at the same time, not hit unfairly in areas where it is not intended to strike.<sup>34</sup>

He went on to identify some of the constraints on the legislative process. One was the amount of time the legislature has available, another was on the limited availability of specialised knowledge required in new and ever multiplying areas and "a limit on the definitive statutory expression of the law in areas where detailed rules or detailed policies must necessarily grow by experience and cannot be formulated beforehand".<sup>35</sup> It is arguable that very little has changed in this respect and that these constraints are still very relevant today.

The implication, therefore, is that part of the system needs to be immediately responsive to the needs of the taxpayers. At present it appears that tax legislation cannot encompass all likely possibilities, or keep abreast of changing circumstances. It seems to be that reform has to wait until the existing application of the law finally becomes intolerable and Parliament is convinced that reform is necessary. It would be more appropriate to have a mechanism for adapting primary legislation to particular requirements as they arise. This should be a major role of a system of tax rulings.

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<sup>33</sup> Canavan DL, "Income Tax: The Commissioner's Discretion" (1965) *Taxation Institute of Australia Victoria Taxation Convention Papers* 10.

<sup>34</sup> Cain ET, "The Discretionary Powers of the Commissioner of Taxation" (July 1965) *The Australian Accountant* 348.

<sup>35</sup> Ibid.

## 5 Self-assessment

An additional consideration is self-assessment. It is interesting to note that in Australia since the introduction of self-assessment in 1986 there has been a trend away from discretions. Initially, it was thought that official rulings on how the Federal Commissioner of Taxation (FCT) would exercise his discretion would be sufficient. However, now the Tax Law Improvement Team is looking at how discretions can be replaced within the legislation.

As already indicated, certainty in the law is important for efficient economic decision-making, but self-assessment introduces the possibility that uncertainty can also lead to tax penalties. Previously, an assessment would be made by the tax office on the basis of information disclosed in a return. If the taxpayer had doubts regarding the legislation or administration of the tax system, the matter could be raised in the return and the tax office was required to consider the matters raised and make an assessment. Failure to address issues raised by taxpayers would stop the FCT from penalising taxpayers in those circumstance where a full and true disclosure had been made. With self-assessment, the responsibility for achieving accurate tax assessments has now been shifted onto taxpayers. To avoid penalties for incorrect tax returns the taxpayers need more information and greater certainty about the application of the law.

In Australia a new system of public and private rulings was included as part of the change to self-assessment in order to help taxpayers interpret and apply the law. Similarly in the UK the introduction of self-assessment from 1996/97 onwards has provoked the development of a formal national system for giving rulings in order to supplement the informal existing arrangements. In outlining such a scheme, the Inland Revenue<sup>36</sup> acknowledged the need for taxpayers to have certainty regarding their liability and that the imminence of self-assessment gave the arguments for greater certainty added force. Under the proposed British system of self-assessment, the Inland Revenue will have one year from the lodgement date to check returns and it is only after the end of that period that taxpayers can be relatively certain that their liability has been agreed or established.

The economic need for such a provision was acknowledged by Finance Secretary to the Treasury, Stephen Dorrell, in a speech at

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<sup>36</sup> Inland Revenue, *Post Transaction Rulings: A Consultative Document* (1994 HMSO).

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the annual dinner of the Association of Her Majesty's Inspectors of Taxes:

Rulings are a logical part of customer service. It is helpful when the Revenue can provide guidance for taxpayers about prospective transactions where the application of the law is uncertain. Advance rulings would benefit industry and the ordinary taxpayer. They would provide a clearer, more certain system, consistent with the principles of self-assessment.<sup>37</sup>

## 6 The desirable characteristics of a rulings system

One of the features of both the Australian and UK systems of rulings is that each emerged without any apparent regard to any criteria for judging the suitability of such systems. The authors consider that such criteria are essential and must be developed before any informed choice about rulings systems can be made. The different aspects of the environment within which a rulings system has to operate give some guidelines as to the features a successful system is likely to include. Beginning with the tax legislation itself, it seems that this is unable in isolation to cater for all possibilities, but it is the supreme authority on such matters. It would therefore seem desirable that it should always include a clear statement of its intentions in order to provide a framework within which rulings can be given. This would remove the need for legislators to attempt to include detailed provisions for every eventuality in the legislation itself.

This is reinforced by the economic criteria on which a tax system might be judged - which suggest a need for certainty in a changing world. A rulings system can then add the flexibility needed to apply primary legislation in a variety of circumstances. It was also suggested that to achieve such an aim it should be at least partly "consumer driven". Taxpayers cannot make the laws directly themselves but they should be able to indicate how and where they need a more precise statement of meaning of the law to be given.

There is some evidence relating to taxpayer needs. A 1994 survey of a random sample of 500 individuals in four electorates in New South Wales<sup>38</sup> included the question, "What was the main reason for using a tax agent?" A summary of the answers is shown in Table 3.

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<sup>37</sup> Inland Revenue Press Release, 14 May 1994.

<sup>38</sup> Wallschutzky and Lewis, "Tax Perceptions and Tax Reform" in Sandford CT (ed) *More Key Issues in Tax Reform* (1995 Fiscal Publications).



**Table 3**  
**Reasons Why Taxpayers use Tax Agents**

|                                 |      |
|---------------------------------|------|
| Tax system complexities         | 37.1 |
| To minimise tax                 | 9.7  |
| To "get it right"               | 32.3 |
| Habit                           | 6.5  |
| Too busy/it was easier/I'm lazy | 7.3  |
| Other                           | 7.3  |

Note: Total does not sum exactly to 100% because of rounding

Perhaps surprisingly, only 9.7% said that it was to minimise their tax liability and a further 7.3% because it was easier or they were too busy. Nearly 70% said that it was either because of the complexity of the tax system or to enable them to get their tax affairs right. One of the implications would seem to be the need for a system which was more "taxpayer friendly". As far as the ruling system is concerned, taxpayers should be able to access the appropriate parts readily and easily, understand the content of the ruling(s) and be able to apply them to their own circumstances with certainty.

There is further evidence from small businesses. In a qualitative study of small businesses<sup>39</sup> a number of relevant points emerged. One was the need for instant advice and some record of that advice in case there is a later audit. It also appears that small business would like to be able to request information without revealing their identity in case this should provoke a tax office audit. In fact one of the main findings of the study was the lack of trust in which the Australian Taxation Office (ATO) was held. Small businesses seem not to perceive the ATO as an organisation which can help them but rather as one which exists only to catch them out if they do something wrong. This is exactly the opposite image the ATO is attempting to portray and it may be an impression that is unjustifiably held by small businesses. Nevertheless, so long as it exists, it has several unfortunate consequences and in the present

<sup>39</sup> Wallschutzky and Gibson, *Small Business Cost of Compliance Project, Final Report* (1993 University of Newcastle) and Wallschutzky and Gibson, "Small Business Cost of Tax Compliance" (1993) 10 *Australian Tax Forum*.

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context adds weight to the suggestion that the body responsible for issuing rulings should be independent of the revenue authority.

The study also led to the suggestion that external accountants employed to assist small businesses were forced to be overly cautious in their advice because of the complexity of legislation. Small practices, particularly those in rural areas, often lack the specialised advice available to larger practices in major cities. It was also suggested that some accounting firms appeared to have the ability to obtain clear ATO guidance by return fax and it was suggested that small businesses should also have such a service. Again, the implication is a need for a system aimed specifically at the consumers.

From the accountants themselves there were complaints that tax rulings were issued frequently but with little apparent co-ordination. Accountants thought that it would be better if rulings were issued together, say quarterly, and had a common starting date.

## 7 Existing forms of rulings in Australia and the UK.

According to one Senate Standing Committee, the "origins of income tax rulings issued by the Australian Taxation Office can be traced to the 1930s, when the Taxation Office first published Income Taxation Orders".<sup>40</sup> The Standing Committee reports an intermittent history for rulings and name changes from "Income Tax Orders" to "public information bulletins". A system of formally published income tax rulings was implemented on 1 December 1982 in order to satisfy the obligations imposed by the Freedom of Information Act 1982. Under this arrangement, Taxation Ruling No 1, issued on 6 December 1982, explained the Taxation Ruling System simply "as a method of publishing and disseminating decisions on interpretation of the laws administered by the Commissioner of Taxation".

The present Australian system dates from 1 July 1992 and consists of both public and private rulings. According to the Joint Committee of Public Accounts, there is no statutory definition of what constitutes a Ruling. However, under the Taxation Administration Act, a Public Ruling is considered to be:

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<sup>40</sup> Senate Standing Committee on Legal and Constitutional Affairs, *Income Tax Rulings Report* (1987 AGPS) 1.

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A determination by the Commissioner of the way in which a tax law or tax laws would apply to any person in relation to a class of arrangements, a class of persons in relation to an arrangement or a class of persons in relation to a class of arrangements.<sup>41</sup>

Similarly, a private Ruling is presently considered to be:

A written response from the Commissioner to a request for a Ruling about the way in which a tax law or tax laws would apply to a specific arrangement or arrangements entered into, or proposed to be entered into, by a specific taxpayer.<sup>42</sup>

The UK approach to the matter has traditionally been less formal. The Inland Revenue may give a ruling on a proposed transaction and the circumstances in which this would be binding on the Revenue are discussed in *Regina v CIR ex parte MFK Underwriting Agents Ltd*,<sup>43</sup> but such rulings are not widely available. The Inland Revenue has suggested that, in many cases, where taxpayers or their agents “seek advice from the Revenue on the tax treatment of completed transactions, the inquiries can be speedily and efficiently resolved by informal contact with Revenue staff”.<sup>44</sup> This may not always be the case, but the Inland Revenue has a variety of other methods for clarifying the tax treatment of particular cases, including a published list of extra-statutory concessions, Statements of Practice, Inland Revenue Press Releases, the Inland Revenue Tax Bulletin and a range of explanatory booklets and leaflets.

As already indicated above, the Inland Revenue is to introduce a formal system of rulings. The proposals regarding post-transaction rulings have already been published<sup>45</sup> and their aims are to assist taxpayers to comply with their obligations, to encourage voluntary compliance with the tax laws and to enhance the UK’s attractiveness as a location for international business.<sup>46</sup> Proposals for a more comprehensive system of rulings are to follow.

These “definitions” and systems of rulings are only two of the many possibilities. In fact they might not be the most appropriate ones.

<sup>41</sup> Joint Committee of Public Accounts, Report No 326, *An Assessment of Tax: A Report on an Inquiry into the Australian Taxation Office* (1993 AGPS) 96.

<sup>42</sup> *Ibid* at 97.

<sup>43</sup> [1990] 1 WLR 1545.

<sup>44</sup> Inland Revenue, *Post Transaction Rulings: A Consultative Document* (1994 HMSO) para 5.

<sup>45</sup> *Ibid*.

<sup>46</sup> Inland Revenue Press Release, 12 May 1994.

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The most suitable system of rulings might be apparent only after careful consideration of the issues raised above.

## **8 Towards a responsive system of tax rulings**

Given the environment within which rulings systems have to operate, it is now possible to examine the possible features of a rulings system shown in Table 1, although there is not the space to discuss them all in detail here.

The Australian system is statutory and both the existing and proposed systems in the UK are non-statutory. Nevertheless, the systems are similar in both countries in the sense that they are considered to represent the particular revenue service's view of the application of the law in particular cases. They both fit what might be described as a "Revenue Service Model of Tax Rulings". Given the discussion above, it is not at all clear that this is precisely the most appropriate form for a system of tax rulings.

The first question is the constitutional status of rulings and how they relate to existing legislation. It could be argued that at least some tax rulings have, or ought to have, the status of a form of "quasi-legislation". The discussion above suggested that in modern societies primary tax legislation alone was insufficient to cover all important present and future circumstances and required supplementation. Such additional rules would not have the status of primary legislation, but would form part of the tax system in a similar way. It seems generally agreed that, in any conflict between primary legislation and any supplementary rules, the former would prevail. Even so, such supplementary rules would seem to have a legal status. For instance, in Australia taxpayers can be exposed to penalties for failure to follow rulings, so that those rulings become, in practice, *de facto* law.

This leads on to a second question which is where the responsibility should lie for issuing rulings.

In Australia, Tax Rulings are issued by the FCT and in the UK the Inland Revenue has proposed itself as the body that should issue rulings under the new arrangements. The Inland Revenue arguments were that anything else would "represent a fundamental change to the UK tax system", that it would lead to a "complex and cumbersome system of rulings", that it would be binding on both the

Revenue and taxpayers and detailed legislation would be required.<sup>47</sup> These would not seem to be totally convincing arguments.

Although rulings systems are operated in many countries by the revenue service, this is not an inevitable arrangement and, it might be argued, not even a desirable one. In Sweden, tax rulings are issued by the Independent Council for Advance Tax Rulings. Its members are appointed by the Government on the basis of their judicial or administrative experience and they are drawn from both the public and private sectors.<sup>48</sup> This would seem to be a superior model since it is both independent of the revenue authority and utilises a wider range of expertise than might be available to a revenue authority acting alone. It might also be thought to be more responsive to a wider range of interests in the community.

In addition, if rulings are “quasi-legislation”, their construction does not appear to be a natural role of a revenue service charged with the assessment and collection of taxation. Indeed, clear conflicts could arise. In the UK it has been suggested that the “Inland Revenue is not slow - and quite rightly - to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer’s pocket”.<sup>49</sup> A clear conflict might arise, for example, in the Inland Revenue’s proposal that no ruling would normally be given “in respect of transactions which, in the Revenue’s view, may have been taken wholly or mainly with the purpose of avoiding tax”.<sup>50</sup> Similarly the Inland Revenue proposes that it should not have to give a ruling where, in its own view, “it would not be possible, without unreasonable diversion of resources, to resolve the issue within an appropriate time”.<sup>51</sup> It would seem to be much more satisfactory if such decisions were the responsibility of an independent authority. This view is reinforced, as discussed above, by the distrust of the revenue authority on the part of Australian small business taxpayers - a distrust that may well be found in other taxpayers and in other jurisdictions.

This leads onto the next area, which is the responsiveness of tax rulings to consumer, that is taxpayer, needs. Table 1 gave a list of possible features of a rulings system, but there is not the space in this article to go through each of them from the perspective of

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<sup>47</sup> Inland Revenue, above n 44 at para 22.

<sup>48</sup> Sandler D, *A Request for Rulings* (1994 The Institute of Taxation) 73.

<sup>49</sup> Lord Clyde, *Ayrshire Pullman Motor Services and DM Ritchie v The Commissioners of Inland Revenue* (1929) 14 Tax Cas 754 at 764.

<sup>50</sup> Inland Revenue, above n 44 at para 19.

<sup>51</sup> Ibid.

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taxpayers. Instead, it is proposed simply to sketch out some of the relevant considerations.

One relates to timeliness. Commercial decisions may be adversely affected by delays in ruling on important taxation aspects. In the survey of small businesses presented above, there appeared to be a demand for instant advice. This might not always be possible - it might be that in some cases it would take a significant length of time to produce a satisfactory ruling on the relevant circumstances. However, it would be important to explore the available possibilities for satisfying the demand for a rapid response. This might involve provisional private rulings on which urgent commercial decisions can be taken in specific cases, provided there were safeguards against abuse. Alternatively, there may be a faster service for urgent cases, which may be available in specified circumstances, or for a charge.

Another area relates to access to rulings. As suggested by the survey of individual taxpayers reported in Section 6, there may be scope for making this aspect of the tax system "taxpayer friendly" in different ways. It might also be made as "tax agent friendly" as possible. With modern information technology there is considerable scope for improving the access to collections of information such as rulings. There is also much that can be done in terms of comprehensibility and so on.<sup>52</sup>

Other aspects of rulings systems can be viewed in a similar way. As the UK Financial Secretary to the Treasury was quoted above, "Rulings are a logical part of customer service"<sup>53</sup> and included in the term customer are industry and the ordinary taxpayer. It follows that rulings should be issued and available in ways which fit the needs of such customers.

It is easily possible to develop other features of a "taxpayer friendly" model of rulings. One way of doing this might be to include a more comprehensive survey of taxpayer needs in terms of tax legislation and its interpretation. This is not to argue, of course, that the features of a taxpayer model of rulings are always the most desirable. The needs of the revenue service are also important, as are other interests in society, and the design of a successful rulings system will have to take account of a wide range of factors.

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<sup>52</sup> See, for example, James SR, Lewis A and Allison F, *The Comprehensibility of Taxation: A Study of Taxation and Communications* (1987 Gower).

<sup>53</sup> Inland Revenue Press Release, 14 May 1994.

The purpose of this article has been to raise the question of what criteria might be employed to judge the advantages and disadvantages of different possible systems of tax rulings. Existing systems often seem somehow to have emerged, rather than to have been designed on the basis of a full analysis of all the relevant considerations. They also seem to have been based largely along the lines required by revenue services - hence the term Revenue Services Model of rulings. However, such an approach has its limitations. There may well be fundamental disadvantages in having a form of quasi-legislation produced by the very organisation which has the responsibility for implementing the law. There might be a temptation for a revenue service to put its requirements above those of the society it serves. Even if it did not, it might still be suspected of putting its own interests before those of others. There might well, therefore, be a strong case, as in Sweden, for tax rulings to be issued by an independent body.

Such a body, and a successful system of rulings generally, would also benefit from clear statements of policy associated with primary legislation. This might increase the general level of certainty. It might also decrease the temptation to produce a mass of detailed legislation in an attempt to provide for every possibility in a changing economic environment. An alternative to a Revenue Services Model of rulings might be the Taxpayer Model of rulings, taking account of such factors as timeliness and access. Such a model would provide a balance to some existing systems but it should not necessarily prevail in all areas. It would, however, add many important criteria which should be taken into account in the design of a modern system of tax rulings.

## 9 Conclusions and recommendations

Primary legislation on its own is insufficient to provide a workable tax system. One of the difficulties is that such legislation is often open to different interpretations. Another is that such legislation cannot cover all possible circumstances - and this is particularly so in a modern and continuously changing economic and social environment. A system of rulings can help promote certainty in tax administration. The question then is how best to devise a system of rulings and this involves taking account of all the relevant aspects - the needs of taxpayers, the role of the tax authority and the difficulties of producing sound tax legislation.

A system of rulings could be operated more consistently if legislation carried a clear statement of intent. In terms of the system of rulings

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itself, it should be a "consumer driven" system. It would therefore be helpful if a comprehensive survey of taxpayers was undertaken to establish their needs. This should be a permanent feature of the system, since change applies to taxpayers' needs as much as to other parts of the tax environment. A "consumer driven" system should include such features as timeliness in the issue of rulings and the use of the most effective technology for taxpayers and tax agents to access rulings.

To increase certainty, the rulings should have statutory backing. It is also recommended that tax rulings are issued by an independent body, as in Sweden, and not by the tax authority. If rulings are "quasi-legislation", the body which issues them should not also be the body which is responsible for tax assessment and collection. However, of all considerations, the most important is to design a system of rulings primarily with the taxpayer in mind. With self-assessment, the onus is now firmly on the taxpayer to get it right rather than to assist the revenue authority. The onus has changed, but the focus of ruling systems has not.