The Personal Tax Planning Review

ADVANCE RULINGS

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The debate on advance rulings has gone on for a number of years. The recent Inland Revenue Consultative Document on a proposed post-transaction rulings procedure is an opportune time to look at the advantages and disadvantages of rulings procedures in general. This article builds on and expands the ideas presented in a paper by Professor John Prebble at the Institute for Fiscal Studies conference at Oxford in April 1992.

When a businessman decides to invest in a new project, change the way he carries on his trade, sets up a new company or starts exporting to a new country, he needs to know not only the likely return on his new proposal, but more importantly the after-tax return. In many situations, the effect of taxation will be the key to whether or not he goes ahead. Often the taxation outcomes will be clear cut: there is established legislation and case law which is clear and unambigiuous. Unfortunately this will not always be the case. Whilst he can seek normal professional advice, there would be much greater certainty if the Revenue authorities were obliged to give a ruling on the tax consequences of the proposed transaction.

The systems of advance ruling vary from country to country. In some countries, rulings may only be given when the transaction has actually been carried out, or only in a restricted type of case. In addition rulings, may not be binding nor may they be challenged until the time of the conventional appeal process against the assessment.

The UK Revenue have oscillated over the years as to whether to give binding advance rulings or not. This has mainly been a reflection of the shortage of staff resources, and to a lesser extent there is a feeling that the professional adviser should stand or fall by the quality of advice he is able to offer; also that the role of the Revenue is to collect tax but is not that of the professional adviser. Finally, there is the problem of what is a "fair" charge for their services? Should their services be provided at no cost (as at present), should they merely reflect the hourly rate of the Inspector concerned, should they be comparable to that of a top

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tax barrister, or should they reflect the opportunity cost of the Inspector? Is the value of the guarantee of a particular tax treatment to be taken into account or might there be a different charge between a favourable or unfavourable ruling? Is there an argument for basing the charge on a percentage of the amount of tax at stake?

More recently, the commitment to customer service (through endless Charters), better staffing levels (the recession halted the torrential outflow of Inspectors), unfavourable comparison with other countries, have prodded the UK Revenue into issuing a Consultative Document for a post-transaction Rulings Procedure. Another factor is the need to regularise the implications of the *Matrix Securities* case (1994 BTC 85). One outcome of that case was the disclosure that one group of advisers was being given rulings which were not generally available to the general body of taxpayers. The introduction of pay and file and self-assessment have acted as additional spurs.

However, there are still questions to be answered. For example, to what extent does the proposed procedure fulfil the needs of the professional adviser and/or taxpayer? Will this be a hidden subsidy to the professional adviser or an income generating exercise? Will there be any effect on claims for professional negligence by not having sought an advance ruling?

There is considerable strength in Prebble's argument that an advance ruling procedure will promote respect for and compliance with tax laws. A rulings procedure should encourage uniformity in the application of tax laws and help to reduce the number of disputes and contested cases. This situation will be even stronger where rulings are publicly available. It must be remembered that the larger firms of accountants put all current "rulings" (obtained in correspondence on existing cases but post-transaction and post-return) on their computer databases.

Prebble also suggests that another advantage is that the Revenue will be kept up to date on the latest practices in business and tax planning when requests for advance rulings are made. The tax practitioner may regard this as a disadvantage as the more the Revenue is kept in the dark for a longer period the better. Anti-avoidance legislation will not arise until the Revenue is aware of what is going on. This is rarely backdated, or at the most backdated to when it was announced in Parliament. Furthermore, an advance ruling will ensure that the correct tax is paid at the right time without the need for penalties or interest on late payment or repayment. If the UK were to introduce a general anti-avoidance code, the need for an advance rulings procedure becomes even stronger. Such general anti-avoidance rules are usually so widely drafted that transactions with no tax avoidance or even tax mitigation motive appear to be caught. Businesses need to know whether the Revenue will apply the general avoidance rules to a particular transaction.

The UK Inland Revenue have fewer discretionary powers than, for example, New Zealand. However, the Board of Customs and Excise do have many; those for excise and customs duties were brought together when the right of appeal was introduced in the Finance Act 1994 and are listed in Schedule 5 to that Act. It would be of considerable benefit if advance rulings could be obtained, especially as the right of appeal against such discretionary decisions (called ancillary matters) is severely restricted (The Wednesbury test of unreasonableness is applied by s.16(4) Finance Act 1994.) The dictum of Lord Greene, MR, in *Associated Provincial Picture Houses Ltd. v Wednesbury Corporation* [1947] 2 All ER 680 is frequently quoted. (This case concerned the grant of a licence for a Sunday cinema by a local authority.)

> "... the principle, which seems to me to be that the court is entitled to investigate the action of the local authority with a view to seeing whether it has taken into account matters which it ought not to have taken into account, or conversely, has refused to take into account or neglected to take into account matters which it ought to take into account. Once that question is answered in favour of the local authority, it may still be possible to say that the local authority, nevertheless, has come to a conclusion so unreasonable that no reasonable authority could have ever come to it. In such a case the court can interfere."

There needs to be a balance between the concept of "no estoppel against the Crown" and the need for the ruling to be binding on the Revenue. In many jurisdictions, the tax authority is obliged to charge the taxpayer on the basis of its latest understanding of the tax code, irrespective of a possible earlier ruling. This is illustrated by the case of *Liberty & Co. Ltd v CIR* 12 TC 630, where Rowlatt J held: "The CIR have no power to bind the Crown by a general declaration of what the law is in particular circumstances beforehand." Where the Revenue authorities are allowed to deviate from their previous rulings, the value of the ruling is much diminished. The case of *National Federation of Self-Employed,* HL (1981) 55 TC 133 explored the extent to which the UK Revenue were bound to charge taxpayers to tax. The Revenue had offered a tax amnesty to casual workers in the newspaper industry who had been evading tax for many years by the use of fictitious names. The case concluded that the care and management responsibilities of the Board allowed them to take a "commercial judgment" and that it was lawful for them to offer the amnesty.

Where the taxpayer has mislead the Revenue (or deliberately left out an important fact), the Revenue must be allowed to revoke a binding ruling. A greater problem is posed by retrospective legislation. Subsequent adverse court decisions and re-interpretation by the Revenue authorities could be allowed to overrule a ruling provided appropriate compensation was offered or the ruling had a short shelf-life attached to it. There has been a formal clearance procedure for anti-avoidance legislation for many years. These covered such areas as Transactions in Securities; s.707 TA 1988. They were of more use to the potential tax avoider, who was

concerned whether he had successfully designed a scheme not caught by the anti-avoidance legislation, rather than to the tax complier who was doubtful about the correct tax treatment of a particular item.

To ensure that he is dealing with his tax affairs correctly, especially under Pay-and-File, the taxpayer needs to know how the tax authorities will deal with a particular transaction. It is self-defeating if that knowledge is difficult or costly to obtain. It would be too easy for the Revenue to erect barriers by the use of a complex application procedure to defeat many of the advantages. There are a number of potential drawbacks to a rulings procedure. There might be a temptation to pass legislation which subsequently proves to be unsatisfactory or dubious in the hope that it could be made to work by Revenue rulings. There is inadequate time for debate for new legislation (both as to principle and to mechanics) resulting in proceedings in standing committee frequently being guillotined. There would need to be some form of public scrutiny to ensure that the Revenue were not usurping the powers of Parliament to make law and that there was proper public accountability of rulings that had been made. There is also concern that a rulings procedure might encourage corruption in the hope of obtaining favourable rulings, especially if they could not be overruled by a different Inspector.

A rulings procedure might undermine the authority of the local Inspector affecting the necessary good relationships between local traders and their local tax offices. Whilst decentralised decision making (as occurs in VAT) ensures greater consistency (and possibly fairness depending how you define this term) of treatment of taxpayers, it is much slower as everything has to be referred to Head Office. A potential comparison can be seen in the decline in status and competence of bank managers where local discretion is removed and major lending decisions are centralised.

The Revenue should be obliged to give a ruling on a transaction once it has been carried out, but where a ruling is sought before it has occurred the Revenue should be allowed to reserve their position or not to comment at all. This particularly applies where a general ruling (which applies to a number of taxpayers) is sought.

The Revenue should be bound by both pre- and post-transaction rulings given to an individual taxpayer provided all material information was properly disclosed (the *Matrix* situation). The decision to withdraw a ruling should be the subject of a de novo appeal to the Special Commissioners, not judicial review in the High Court. It is open to debate whether the Revenue should be allowed to change their rulings provided the taxpayer had not gone ahead with the transaction. Where a ruling relates to a continuing situation, the ruling should be binding on the Revenue for the time period specified in the agreement.

There is a conflict of interest between the confidentiality needs of individual taxpayers and the general public need to know how the Revenue treat particular

transactions. It is desirable that general rulings are published in the interests of fairness and consistency, or are available in some form of database. It might be possible to publish individual rulings on the basis that the taxpayer could not be identified (the taxpayer would be required to submit the draft), but this would require some form of centralised control. The Revenue already have enough problems where Inspectors' letters are circulated through large firms of accountants as if they were of universal application and binding throughout the Revenue. This undermines the discretion of the local Inspector, especially where some form of "commercial judgment" is desirable. A "commercial judgment" takes into account the legal costs and opportunity costs when making a decision usually in favour of the taxpayer. Tax advisers would rue the day where every point of minor dispute had to be fought to the Commissioners (and beyond) in order to avoid establishing precedent.

It is appropriate to make some comments on the Inland Revenue Consultative Document on Post-Transaction Rulings issued in May 1994. The Revenue's proposals are non-statutory (and therefore could be withdrawn). Whilst they apply to Income Tax, Capital Gains Tax and Corporation Tax, they do not apply to Inheritance Tax, Stamp Duty nor Oil Taxation. This is a particular drawback for those transactions which involve both CGT and IHT, for example a gift of a farm. It is a pity that the opportunity has not been grasped to extend the rulings procedure to the other major business taxes of NIC and VAT. No doubt this would be resisted as the first tentative stage of bringing the three tax collecting departments into one.

There is no right of appeal against the Revenue's decision, nor is there any obligation to give reasons for an unfavourable ruling. Whilst this right of silence might be attractive to the Revenue in some cases, it is hoped that they would point out minor defects in the application which could, if corrected, result in a favourable ruling.

Why are the Revenue so keen for a non-statutory scheme? The reasons are not clearly stated, but there are considerable advantages to the Revenue. First, they keep control of the game; they will be able to change the rules when it suits them; they will retain discretion and flexibility. There cannot be a right of appeal, nor will there be an external overview of how they carry out the procedure. Any complaints will, it is assumed, be dealt with by their own ombudsman, the Revenue Adjudicator. Although the Revenue would like to see the scheme restricted to complex transactions, it is difficult to see how they will be able to justify a refusal for a simple transaction (who decides what is complex, the degree of competence of the professional adviser will influence his perception of the dividing line between simple and complex). Will risk adverse advisers (or their professional indemnity insurers) make greater use of the rulings procedure?

Whilst an independent body for making the rulings has a number of attractions, it appears to be overlooked that the Special Commissioners would need to be

considerably expanded (and may require further training), the Inland Revenue would have to present their case which would at least double their workload. On cost grounds alone, an independent body would be out.

The Revenue say they would normally expect to issue a substantive response within 28 days. Another objection to a statutory scheme is that it would require a response within a given time period or an automatic refusal if no response within 30 days. Under s.15(2)(b) Finance Act 1994 a request for a Customs review is deemed to be refused if no response is provided within 45 days.

As is, unfortunately, usual with tax consultative documents, the Revenue do not appear to have provided any costings for their proposals nor undertaken any research to establish the likely workload. Will the Revenue have sufficient extra staff at the right level to make the proposed system work? Those with long memories will remember the withdrawal of head office advice in April 1986 on the grounds of the continuing loss of experienced Inspectors. The Revenue were also near to collapse: the unanswered post over 2 months had risen from 38,000 in October 1981 to 667,000 in 1986. At a time when government departments are meant to be controlling their expenditure, it is strange that a proposal with far reaching consequences in terms of cost and staff numbers should not attempt to give this information. In terms of public debate, it should be possible to decide whether this might be a costly subsidy to firms carrying out complex transactions and might be of little benefit to the small firm.

Although the Revenue have tried very hard to avoid setting up a precedence system, the large professional firms will no doubt put all decisions on a national database. Under open government proposals, to what extent will decisions be published (by whom, how often and at what cost)?

Will later events be allowed to over-turn earlier rulings? The purveyor of driving schools in *Leach v Pogson* 40 TC 585 might well have been told he was "not trading" if he had applied for a ruling after the sale of 5 or even 10 driving schools. It is very unusual for the sale of a capital asset or one which does not lend itself readily to trading to occur sufficiently frequently to change its nature to trading stock. Yet the Chancery Division held that the Commissioners were entitled to take subsequent transactions into account in throwing light on earlier transactions.

The Inland Revenue have announced in their Press Release of 17th November 1994 that they are going to run a pilot exercise for post-transaction advance rulings for taxpayers whose affairs are dealt with by Bristol and Swindon tax offices. The outcome of this test run which finishes on 31st August 1995 is eagerly awaited. Will companies change their registered offices to Bristol to take advantage of this? (this does not work for groups whose tax affairs are normally dealt with at the tax office of the parent company).