

## ***Tax Law: Rules or Principles?***

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This is the year of simplification of tax legislation and I should like to add my thoughts to the debate. There is nothing new in complaining about the complexity of tax legislation. Every generation does it. To give two examples, the Codification Committee in 1936 looked back longingly to the early days of income tax: ‘... the Statutes of 1842 and 1853 were relatively simple. The growth of legislation since 1907 and its increasing complexity have been in large measure due to the high rates of tax in operation ... The space occupied by the provisions relating to such reliefs and exemptions is now prodigious, and contrasts with the comparative brevity of the earlier code....’<sup>2</sup> Unhappily the actual language in which many of the statutory provisions are framed is so intricate and obscure as to be frankly unintelligible.’<sup>3</sup> In 1955, the Royal Commission said much the same: ‘... the law on the subject of income tax remains voluminous, complicated and obscure....’<sup>4</sup> The history of earlier attempts

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<sup>2</sup> *Report of the Income Tax Codification Committee*, Cmd 5131, para. 18

<sup>3</sup> Para. 20.

<sup>4</sup> Royal Commission on the Taxation of Profits and Income, Cmd 9474, para. 1080.

[to simplify it], however, suggests that the problem may be in fact an intractable one, beyond the reach of recommendations'.<sup>5</sup> Looking back at the legislation as it was in either of those years, we may wonder what they were worrying about, but it is continued inaction that has brought us to the really serious position we are in now. We have the Report from the Revenue<sup>6</sup> and the Interim,<sup>7</sup> and now last week's Final,<sup>8</sup> Reports of IFS's Tax Law Review Committee (TLRC) to prove it. I am sure that we can all agree that tax legislation is complex.

I want in this lecture to build upon the proposals of Leonard Beighton in his Philip Hardman Memorial Lecture, 'The Finance Bill process: scope for reform',<sup>9</sup> in which he put forward, as a solution to the increasing complexity of tax legislation, the case for a more purposive interpretation by the courts, thus enabling the legislation to be simpler, clearer and more direct. One of the points he made was that '... with the principles of European Law becoming increasingly important, and with the role of the European Court of Justice becoming ever more significant, we may find that the United Kingdom courts have in any case to move in that direction'. I intend to examine this influence of European Community tax law in the light of the European Court's and our courts' interpretation of it. I shall put forward the suggestion that, by following this route, we can have legislation that is both simpler and more certain.

## I. THE CAUSES OF COMPLEXITY

There is even quite a lot of agreement about the causes of the problem. The TLRC devotes a chapter of its Interim Report to it. First, it refers to the tax base. It would be natural for an IFS lecture to concentrate on this, but I shall not do so today. If policymakers listened harder to IFS, something might be done, but I am sceptical. I used to think that if all gains and losses on gilts and bonds were taxed as income, the system would be simpler, but after this year's Finance Act, I have my doubts. The TLRC refers also to the legacy of Addington's tax of 1803, the common-law approach, the increasing sophistication of commerce, the desire for certainty, the need for legislation to prevent avoidance, the courts, political tinkering, the parliamentary process, parliamentary counsel, the lack of time — in other words, our whole legal culture. The Revenue's Report concentrates on four of them: tax reform (for example, independent taxation, self-assessment), the increasingly global and sophisticated business environment (for example, foreign exchange gains, manufactured dividends), changes in general legal framework (for example, open-ended investment companies, demergers) and 'the

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<sup>5</sup> Para. 1081.

<sup>6</sup> *The Path to Tax Simplification*, December 1995 and Background Paper.

<sup>7</sup> *Interim Report on Tax Legislation*, Institute for Fiscal Studies, November 1995.

<sup>8</sup> *Final Report on Tax Legislation*, Institute for Fiscal Studies, June 1996.

<sup>9</sup> [1995] BTR 33. See also his comment on the TLRC's Interim Report and the Revenue's Report at [1996] BTR 1.

increasing desire for tax law to be detailed and precise so that it is certain in its application'.<sup>10</sup> My impression is that the first (tax reform) and third (legal framework) are not too important (self-assessment does seem to cover a lot of pages but it has been beneficial in doing away with some of the complexity<sup>11</sup> as well), and that the second (sophisticated environment) and fourth (detail) are connected: while the business environment is more sophisticated, it is not four times more so than in 1970 (swaps may be new but foreign exchange gains existed in 1970). That leaves the pursuit of certainty through more and more detail, which I suggest is now amply proved not to work. Detail and certainty do not necessarily go together. We all agree with Adam Smith about certainty. The desire for it results in more and more detail hoping to answer every question. As the TLRC rightly says, 'The possible permutations of facts are virtually infinite so that legislation cannot realistically aspire to answer every question. In this sense, complete immediate certainty is unattainable'.<sup>12</sup> The result is that tax legislation is more than four times as long as it was 25 years ago but I do not believe that we have achieved any more certainty, rather the reverse. The time has come to do something about it.

## **II. REWRITING TAX LEGISLATION: WILL IT CURE THE COMPLEXITY?**

The Reports by the Revenue and the TLRC have suggested rewriting the legislation in plain English as the, or at least part of<sup>13</sup> the, solution. I have nothing against the draftsman writing in easier-to-understand English; indeed, it will make my life easier. But, if that is possible, why is he not already doing so?<sup>14</sup> To be fair to the much-maligned draftsman, the answer is that he operates under incredible time pressure, usually drafting while the policy is being refined, whereas others take the draftsman's finished product and rewrite it in intelligible English at their leisure. It will take a great deal of resources to rewrite the whole of tax legislation while it is increasing at the current rate, and when it has been done, I do not think we shall really be satisfied that the problem has been solved. Indeed, if the legislation is rewritten, it might in some ways make matters worse

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<sup>10</sup> *The Path to Tax Simplification*, Report, para. 3.

<sup>11</sup> It has also caused some extra complexity, such as different Schedule A rules for companies and individuals. More could be done to simplify the system for self-assessment. Do we, for example, need sections 348 and 349 any more?

<sup>12</sup> Interim Report, para. 3.21. The reference to immediate certainty is to the Renton Committee Report, *The Preparation of Legislation*, Cmnd 6053, meaning having a clear and accurate legal effect without reference to the courts.

<sup>13</sup> See the end of Section V and Section VIII for comments on the other major recommendation of the TLRC.

<sup>14</sup> A simple point that might be considered is whether it is necessary for a subsection to consist of only one sentence; breaking it up into shorter sentences in itself would make it easier to read.

because I would expect the courts to look at the old and the new legislation in order to see the extent to which former decisions can be relied upon. The Australian draft legislation provides that if the rewritten Act appears to have expressed the same idea in a different form of words in order to use a clearer or simpler style, the ideas are not to be taken to be different just because different forms of words are used.<sup>15</sup> This seems to be not just an invitation to, but a requirement on, the courts to look at both the old and the new legislation, so that they might as well just continue to look at the old, which does not appear to be a simplification.

My real objection to rewriting is that I do not find much of a connection between the causes of the problem and the proposed solution. The solution seems to me to be an implied acceptance that nothing can be done to remove the real causes of complexity which are deeply rooted in our whole legal culture. If you start with 6,000 pages<sup>16</sup> of gobbledegook, you will end up with a number of pages (which may be greater or less than 6,000,<sup>17</sup> but will certainly be a large number of pages) of easier-to-read legislation, but will we all say that this is the end of complexity? Suppose we were all gathered here again in five years' time, appropriately in the year 2001 (assuming, contrary to Stanley Kubrick's vision, that judges have not been replaced by computers) when all the then-current tax legislation has been rewritten in an intelligible form in accordance with the wishes of the TLRC and the Revenue; do you think we shall all be saying of our tax legislation that everything is for the best in this best of all possible worlds? I do not believe so, and I think that a more drastic solution is needed. As an Australian, Professor Graeme Cooper, has rightly said, 'a complex system may be clearly expressed and yet will remain a complex system. The complex rule remains'.<sup>18</sup>

### III. PARLIAMENT AND THE COURTS

Perhaps because I am a lawyer, I see the problem in terms of Parliament and the courts. The stages through which tax law passes in the making starts with a Minister with an imaginary cartoon box above his head saying 'Idea' (such as 'let us have a 20 per cent rate of tax on savings income').<sup>19</sup> This is refined by the

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<sup>15</sup> New section 1-3.

<sup>16</sup> See text at note 23 for this figure.

<sup>17</sup> The Revenue says that there is no compelling evidence from existing attempts to rewrite legislation that it will result in an overall increase or decrease in length (Background Paper, Annex 5, para. 84). An Australian writer has estimated that the rewrite will reduce the length of their legislation from about 6,000 pages to about 4,500 pages: see R. Vann, 'Improving tax law improvement: an international perspective', *Australian Tax Forum*, 1995, 193, 225.

<sup>18</sup> 'A rose is a flower is a plant: tax simplification south of the Equator', 1995 Conference Report, *Report of Proceedings of the 47<sup>th</sup> Conference*, Canadian Tax Foundation (in course of press).

<sup>19</sup> These stages are described in *The Path to Tax Simplification*, Background Paper, para. 1.8.

Revenue, subject to the Minister's approval, dealing with such matters as whether savings income includes income from land, annuities or payments from discretionary trusts. It is at this stage that all the detail is introduced, including such matters as the effect of the change on references to exemption from surtax in pre-1971 double taxation agreements (I assure you I am being quite serious).<sup>20</sup> The parliamentary draftsman puts the developed idea into legislative form, containing every conceivable detail identified by the Revenue in its instructions. The parliamentary draftsman is unfairly blamed for all our problems but I do not believe that he is the person insisting on the detail being contained in his instructions. Indeed, I expect the reverse is true: that he persuades the departments that some of it is unnecessary. Parliament debates it, at least in theory, and passes it. Taxpayers, aided by their advisers, act on it by, for example, deducting tax at 20 per cent instead of 24 per cent, and taxpayers, again aided by their advisers, fill in tax returns and are assessed. Finally, if matters are not agreed, they come before tribunals and courts. What matters in the last resort is whether the whole process results in the most efficient way for the court to give effect to the wishes of Parliament (more accurately meaning the wishes of the Minister aided by the Revenue Departments). Put this way, the important issue is the interaction between Parliament (which, from my description above, really means what the Revenue Departments feed into Parliament) and the courts. Parliament is addressing the judges.<sup>21</sup> What really matters is that the courts should come up with the right answers, not whether the rest of us have an easy time reading the statutes, though it would be nice if we could achieve both.

#### **IV. TAX LEGISLATION TODAY**

If we confine our attention to income tax, corporation tax and capital gains tax (so that we eliminate the distortions of the introduction of petroleum revenue tax and the changes from estate duty to capital transfer tax to inheritance tax, and the increasing number<sup>22</sup> of double taxation agreements), since 1970 the legislation has grown from 1,297 to 4,580 pages<sup>23</sup> of primary legislation (a 253 per cent increase) and 171 to 1,444 pages of secondary legislation (a 744 per cent increase), making a total increase of 310 per cent resulting in 6,024 pages. This is a compound growth rate of nearly 6 per cent per annum since 1970, over 8 per cent since 1988 and over 12 per cent since 1992. In five years' time, we shall have 8,000 (33 per cent more), 9,000 (50 per cent more) or 10,700 (77.5 per cent

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<sup>20</sup> FA 1996, Sch. 6, para. 21.

<sup>21</sup> This is another objection to simplified drafting which is aimed at the man in the street or the ordinary adviser, most of whom never read it anyway. The target audience for tax legislation is commented on in the TLRC's Final Report, para. 4.5 onwards.

<sup>22</sup> Which is a good thing.

<sup>23</sup> Taken from Table B in *The Path to Tax Simplification*, the Report itself. A page for this purpose is a royal octavo page as in the HMSO edition of the Taxes Acts.

more) pages at the same respective rates of growth, assuming that the rewritten legislation is the same length (which, of course, makes it doubtful that all the legislation will in fact have been rewritten in simplified form in five years' time). Although we shall have come to the end of the amendments necessitated by self-assessment, my prediction about the rate of increase if there is a new government is at the upper end of the range. There is no reason to suppose that the legislation will not continue to grow. In 10 years from now, we could be looking at 10,600, 13,500 or 19,000 pages at these rates of growth.

We should bear in mind that legislation is not the only measure of the volume of relevant materials. There are numerous statements of practice, extra-statutory concessions, published Revenue guidance, Tax Bulletins etc., and now Hansard, to say nothing of cases in the courts (the decisions of the Special Commissioners are now also being reported) to be considered before answering any problem. Another factor to bear in mind is that most businesses do not deal only with the Inland Revenue, but also with Customs and Excise, where the VAT legislation now runs to 570 pages of primary and secondary legislation plus another 250 pages of European legislation, and there is also some tertiary legislation contained in its booklets. We must not forget National Insurance as well. Tax law is nasty, brutish ... and long.<sup>24</sup>

By comparison, I read recently,<sup>25</sup> but I have not counted it myself, that France has about 450 pages of tax codes plus 400 pages of Annexes, and Germany has about 450 pages of tax legislation (200 on personal income tax, less than 50 on corporate income tax and 200 of supplementary laws). The TLRC mentions that the German constitution requires that its tax legislation should be written in clear and detailed terms, and German practitioners complain that it is becoming more detailed.<sup>26</sup> All things are relative. However misleading such comparisons may be, there must be some fundamental difference between these countries and ourselves which is surely worth exploring. I shall suggest that the main difference is that they are interested in principles while we think of tax law as rules. As an Australian, Professor Richard Vann, has pointed out, 'We suffer from tax rule madness, a disease that affects the advanced Anglo-Saxon countries generally with Australia having a particularly virulent form'.<sup>27</sup> It is no consolation to know that others are worse off, but tax rule madness is a good description of the problem here.

The Revenue's paper says '... it may well be thought that length alone is not an important measure, and the real measure should be how long it takes to find a particular legislative text and understand its meaning'.<sup>28</sup> The TLRC says much

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<sup>24</sup> I wish I had thought of that variation on *Leviathan*. I think it was said of capital gains tax computations but I have been unable to trace the source.

<sup>25</sup> Vann (see note 17), 222.

<sup>26</sup> Interim Report, para. 3.11.

<sup>27</sup> (See note 17) 222.

<sup>28</sup> Background Paper, Annex 5, para. 85.

the same: 'So the reality is not that users of tax legislation want that legislation to be as short as possible but that they need to be able to comprehend it in the shortest time possible'.<sup>29</sup> It does, however, make the point that length presents a serious difficulty for new practitioners becoming familiar with the whole tax field.<sup>30</sup> More importantly, the TLRC rightly draws attention to the spiral effect: 'Once a tax system has become complex, even a conceptually simple change may only be achievable by means of a complex provision — because the new legislation has to fit into the conceptual framework and language of the existing body of law.... In this way, this spiral may become self-perpetuating unless something is done to arrest it'.<sup>31</sup> While length in itself is clearly not the only measure of complexity, when we are dealing with direct tax legislation of over 6,000 pages, I think the time has come to stop the spiral and think at least of slowing down the increase. If you want to cure tax rule madness, you have to do more than treat the symptoms.

## V. THE COURTS

So much for Parliament. I turn now to the courts. Sadly, as the Renton Committee concluded, the real reason the mass of words has increased is that the judges could not be trusted to give effect to the ideas behind them, and so less and less leeway is given to them: 'The real problem is one of confidence. Would Parliament be prepared to trust the courts?'.<sup>32</sup> The Renton Committee's conclusion was 'that interpretation of Acts drafted in a simpler, less detailed and less elaborate style than at present would present no great problems provided that the underlying purpose and the general principles of the legislation were adequately and concisely formulated'. Interestingly, the last words of the report were a quotation to the effect that Parliament's suspicions, that the judges could not be trusted, were wholly unfounded, taken from evidence by two Scots judges, whose tradition in pre-Union statutes was much closer to the present European tradition.<sup>33</sup> It is clear from the increase in size of tax legislation since

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<sup>29</sup> Interim Report, para. 1.18.

<sup>30</sup> Interim Report, para. 1.17.

<sup>31</sup> Interim Report, para. 3.15. A good example is the recent consultative document on employee travel and subsistence which proposes substituting three pages of legislation for the five lines we have had since 1853, which were admittedly in some need of change, but does it really need all this detail?

<sup>32</sup> (See note 12) para. 19.41.

<sup>33</sup> of the interpretation of old statutes of the Scots Parliament, Lord Dunedin (the Lord President) has said 'Such statutes were passed under a totally different state of affairs, with language that does not always fit modern life. The function of the Court in interpreting them is not that of modification. It is truly interpretation, but necessarily, in such a case, of the spirit and not of the letter' (*Heriot's Trust v. Paton's Trs* XLIX Scottish Law Reporter 858). This passage was cited in *Whatmough's Trustees v. The British Linen Bank* 1934 SC(HL) 51 in which Lord Thankerton stated at p. 57 'The Act of 1696, like other old Scots Acts, has necessarily been the subject of much judicial construction and interpretation, and, as pointed out by Lord Dunedin (then Lord President), such interpretation is necessarily of the spirit and not of the letter....'. He also mentions that the

the Committee reported in 1975 that the answer to Renton's question 'Would Parliament be prepared to trust the courts?' (which I suggest really means 'Would the Revenue Departments be prepared to trust the courts?') is no. We are therefore witnessing this ever-increasing spiral of legislation which, judged by my criterion of whether the judges are more likely to give the right answers, is completely and obviously doomed to failure.

One major reason for the mess that we are in is that it was caused by the habit of the courts construing tax legislation as a matter of words. One of the earliest statements about how to construe tax legislation is that of Lord Cairns in *Partington v. Attorney-General* in 1869.<sup>34</sup>

As I understand the principle of all fiscal legislation, it is this: 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. In other words, if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.<sup>35</sup>

These words are usually quoted out of context. Lord Cairns started the paragraph from which this quotation is taken by saying that he found for the Revenue on the basis of both form and substance, which he considers separately in his speech. Hubert Monroe in his Hamlyn Lectures<sup>36</sup> discusses how Lord Cairns, who had himself been Solicitor-General and Attorney-General, came to deliver his guidance on the interpretation of fiscal legislation when in the same volume of the law reports he applies a purposive construction to the Land Clauses Consolidation Act. But whatever the reason, this approach was a fact for the next hundred years. The next quotation comes from another House of Lords case in 1980: 'A subject is only to be taxed upon clear words, not upon "intendment" or upon the "equity" of an Act. Any taxing Act of Parliament is to be construed in accordance with this principle'.<sup>37</sup> But even so there has been a change. Lord Wilberforce continued 'What are "clear words" is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded'. I am not sure that it is

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English courts adopted the same approach to older statutes, such as the Statute of Frauds. I am grateful to Martyn Jones for his assistance over Scots law. Perhaps the Scots have had the advantage over the English that more of their law is found in older statutes and so their tradition has been able to survive better.

<sup>34</sup> A case on probate duty. This was before the courts started hearing cases about income tax in 1874.

<sup>35</sup> (1869) LR 4 E. & I. App. HL 100, 122.

<sup>36</sup> *Intolerable Inquisition? Reflections of the Law of Tax*, Stevens, 1981.

<sup>37</sup> Lord Wilberforce in *Ramsay v. IRC* 54 TC 101, 184E.

right to lump all courts together because the former minute scrutiny of words is primarily a Chancery Division habit, perhaps deriving from its role in construing documents. When the Queen's Bench Division first started on VAT, its reaction was quite the reverse: in the very first case, it refreshingly asked 'what as a matter of substance and reality is the right answer?'.<sup>38</sup>

Change is slow but it has been happening. Lord Justice Diplock, as he then was, said this in a lecture in 1965,<sup>39</sup> long before most of us thought there was a problem: 'Anyone who has decided tax appeals knows that most of them concern transactions which Members of Parliament and the draftsman of the Act had not anticipated, about which they had never thought at all. Some of the transactions are of a kind which had never taken place before the Act was passed: they were devised as a result of it'. And later:

When an Act attempts, as this one [the Income Tax Act 1952, which most of us today would regard as part of the golden age of tax legislation when compared with the present] does, to deal specifically with every class of transaction which the draftsman can foresee, it becomes difficult indeed to extract from the mass of detail any principle which the Courts can say with confidence Parliament intended to be applicable to any class of transaction which the draftsman did not foresee. This is what drives the Court to adopt the narrow semantic approach. We cease to ask ourselves: 'What did the users of these words intend?' and ask ourselves: 'What, as a matter of semantics, do the words they used mean?' These are different questions and may result in different answers.

Ten years' later, he was to say in the course of a judgement 'If one looks back to the actual decisions of this House on questions of statutory construction over the past 30 years one cannot fail to be struck by the evidence of a trend away from the purely literal towards the purposive construction of statutory provisions'.<sup>40</sup> I am not sure that the effects of the change were being felt much in the tax field at the time. I think the turning-point in tax cases was caused by the realisation by the judges that the narrow semantic approach led inevitably to tax avoidance. The courts were faced with lots of cases about tax avoidance schemes, which they alone had caused. Doctors have a word for it: iatrogenic, or doctor-induced, disease; my Greek is not up to it, but there should be a word for the judge-induced disease of tax avoidance, for that is what it was. The only way out of hearing an eternal diet of artificial tax avoidance cases was for the judiciary to invent a principle, a principle so strong that it could overrule a previous House of Lords decision on the same facts.<sup>41</sup> *Ramsay* and then *Furniss v. Dawson*, by

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<sup>38</sup> *Customs and Excise Comrs. v. Automobile Association* [1994] STC 192, 198.

<sup>39</sup> Presidential Address to the Holdsworth Club, University of Birmingham, 1965.

<sup>40</sup> *Carter v. Bradbeer* [1975] 1 WLR 1204, 1206-7.

<sup>41</sup> *Moodie v. IRC* [1993] STC 188 as it affects *Plummer v. IRC* [1979] STC 793.

applying an extraneous principle to the interpretation of tax legislation, came as something of a shock.

Change has continued to the present. In a recent case, the first question Lord Nolan posed in the House of Lords after setting out the legislation and the taxpayer's contention was 'Was this the purpose that Parliament intended to achieve by the words used?'.<sup>42</sup> Whether or not they are saying it, this is much more the approach being adopted by judges today. Unfortunately, just as the courts have become much more interested in the idea behind the words, the words have increased in number, and it is more and more difficult to see any ideas behind the words. As recently as 1990, a judge in an oil taxation case said, and certainly could not have been criticised for saying, 'In reaching these conclusions I have not attempted to achieve any purposive construction of the detailed provisions of the Act, since I am not sure what their purpose is'.<sup>43</sup>

The problem of the courts' new purposive approach is that there is little help available to the judges to answer what is clearly the right question: 'what was the purpose that Parliament intended to achieve by the words used?'. Consequently, as the Privy Council said in a recent appeal, 'Quite often the benefits of a "purposive" approach are illusory, since the purpose which is used as a point of reference merely reflects the contention of one or other of the parties about what the words ought to mean'.<sup>44</sup> The lack of any external materials from which the courts might find the purpose of legislation has changed, although only slightly, with *Pepper v. Hart*,<sup>45</sup> according to which the courts may refer to ministerial statements in Hansard in cases of ambiguity or obscurity, and even now that is a rule that is confined as far as possible. I was disappointed by the House of Lords' refusal in *Melluish v. BMI (No.3) Limited*<sup>46</sup> to use ministerial statements relating to other provisions of the same Act which might have given guidance on the construction of the provision in question, even when it agreed that it was ambiguous and obscure. On the other hand, the courts have been willing to relax the rule further when it comes to construing a statute based on European legislation in order to ascertain its purpose.<sup>47</sup> What advantage is it to require a judge to construe legislation — in other words, decide what Parliament meant — with one hand tied behind his back? No wonder foreigners think we are mad. I recently asked a Dutch tax lawyer what the first source was that he turned to in interpreting tax legislation. His answer was their equivalent of Hansard. The reason was that he, like the Dutch courts, wants to know the answer to Lord Nolan's question: 'Was this the purpose that Parliament intended to achieve by the words used?'.  

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<sup>42</sup> *ICI v. Colmer* [1996] STC 352, 358b.

<sup>43</sup> *BP Oil Developments Ltd. v. IRC* 64 TC 498, 532B.

<sup>44</sup> *Chan Chi-hung v. R* [1996] 1 All ER 914, 922b.

<sup>45</sup> [1992] STC 898.

<sup>46</sup> [1995] STC 964, 978. See [1996] BTR 195, 200.

<sup>47</sup> *Three Rivers District Council v. Bank of England* [1996] 2 All ER 363.

The TLRC's recommendation favouring the use of explanatory memoranda<sup>48</sup> seems to me to be a logical extension of *Pepper v. Hart*, and I support it as being a far more important recommendation than rewriting the legislation. What is in written form prepared in advance (which obviously must exist today) is surely more reliable than what the Minister says while on his feet when he may depart from his notes. We also have the odd situation today that, if the Opposition does not ask for any explanation of a clause, in order to get through the day's business more quickly, the Minister will not even read out his prepared speech, so we are all deprived for ever of this potential guidance. Publishing the memoranda and allowing their use by courts, and therefore by the rest of us, is a minor extension to *Pepper v. Hart* and is another way in which we can discover the statutory purpose. The Revenue's Report seemed much less favourable to explanatory statements but the government has now come round to favouring them.<sup>49</sup>

## VI. OUT OF SYNCHRONISATION?

So both the courts and Parliament have changed, but in opposite directions. Are we not today in the strange situation that Parliament (and, as I keep on saying, this really means what the Revenue Departments are feeding into Parliament) is still legislating for 1960s' judges, who were adopting a narrow semantic approach, for whom the only answer was to put in more detail because they could not be relied upon to supply the detail that was not there? At the same time, the courts are struggling to pay more attention to the purpose behind the words. We are giving the courts the material that they need in order to find the intention of Parliament, and we are talking about making further material available. But Parliament has not adapted to the change in the courts and has continued with its traditional method which was designed not to be used for purposive construction. To quote P. Atiyah and R. Summers,

England has a long tradition of narrow, detailed drafting: the English draftsman has always (or at any rate for at least two centuries) tried to produce language which is capable of neutral, non-purposive interpretation. An English statute has traditionally been drafted in such detail that it can be said to be a catalogue of rules. It is not really a set of *principles* which the judges can be left to apply to a variety of situations, not expressly governed by the wording, or which they can be encouraged to build on, as though they were common law principles. By contrast America has a tradition (which goes back to Jefferson) of

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<sup>48</sup> interim Report, ch. 6, and Final Report, ch. 5.

<sup>49</sup> See the comments in the debate in the House of Lords on 27 March 1996 quoted in the TLRC's Final Report, para. 2.8.

drafting in broader language, using legislation to state wide general principles, such as in the federal Constitution itself.<sup>50</sup>

The question facing us today is whether we can move the Revenue Departments, and thus Parliament, and the judges in the same direction at the same time. As with so much in tax, Malcolm Gammie has been here first. Discussing whether Parliament or the courts should make the first move, he said

This chicken-and-egg situation may yet be resolved by the European cuckoo: as the influence of the European Union on our legislation grows, the different traditions of European law may force us to change our ways, to accept a greater use of statements of principle and to adopt a different interpretative approach. I do not underestimate the task involved in resolving the clash of English and European legal cultures — certainty versus the logical formulation of an idea. The latter may tell us the principle involved — or where the negotiation stopped — but may give us little idea of the answer to a particular problem. Attempts by the English draftsman to provide the answer in detailed legislation may merely perpetuate the cultural differences or be doomed to founder in the European Court.<sup>51</sup>

My answer to the chicken-and-egg situation is that the European influence has already solved the problem. Our courts have already changed: perhaps less in their interpretation of internal law, but considerably in their approach to the interpretation of European Community law. The method of interpretation necessarily varies according to the nature of the material being interpreted. I want to consider what would happen if Parliament started to write tax legislation not merely in plain English, but in a manner that enabled judges to give effect to the intention behind the words, and at the same time gave them some material from which to find that intention. In almost any other situation, we would carry out an experiment, but tax is too serious for that. I suggest that the application of European tax legislation, particularly in the field of indirect tax, has already carried out the experiment for us, and our judges are now coping very well with it. All that remains is for the Revenue Departments to follow the example of European legislation when they are instructing the parliamentary draftsman, rather than insisting that every detail is included, leaving it to the courts to apply principles to its interpretation.

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<sup>50</sup> *Form and Substance in Anglo-American Law*, Oxford University Press, 1987, 323. They give some examples of the differences in approach generally, such as the one-section Sherman Antitrust Act compared with the detailed UK provisions on restrictive practices, or the one section in the Uniform Commercial Code dealing with unconscionable contracts, compared with the UK Unfair Contract Terms Act 1977 (323-9).

<sup>51</sup> 'Legislation for business: is it fit for public consumption?', *Fiscal Studies*, 1994, no. 3, 129, 138.

## VII. PRINCIPLES

Could our tax legislation be rewritten so that it would be construed in accordance with principles rather than containing nothing but rules trying unsuccessfully to cover every eventuality?<sup>52</sup> Ronald Dworkin makes the distinction, which I think we are searching for here, between rules and principles.<sup>53</sup> The distinction is that rules are applicable in an all-or-nothing fashion, whereas principles are not. Principles can have exceptions; can conflict with one another; can, for example, apply only when conduct is reasonable; and they can give one guidance about how to deal with the points not expressly covered by the law. Rules do not conflict with each other (if they do, one of them must give and become a subsidiary rule). Principles do not conflict with rules. If a rule is clear, the rule applies and that is the end of it, even though it is an exception to the principle and therefore in conflict with it. But the real use for the principle is to determine what the rule means in the first place (and hopefully to reduce the amount of detail required in stating the rule), in which case there is no conflict. The difficulty about rules is that, if something is not expressly covered by them, there is no guidance about how to solve the problem, when you are told that only plain words will do. Being brought up on rules, we do not like principles. The TLRC quotes *Bennion on Statute Law*:<sup>54</sup> ‘the pragmatic British are chary of statements of principle. They distrust them because they almost invariably have to be qualified by exceptions and conditions to fit them for real life. What is the use of a principle that cannot stand on its own?’<sup>55</sup> Atiyah and Summers say the same: ‘Indeed, we believe that one reason why English judges seldom regard principles (as distinct from rules) as forms of law is that they tend to think that only rules (preferably hard and fast rules) can be *real law*’.<sup>56</sup> This is at first sight odd, bearing in mind that the common law consists of nothing but principles and it does not bother judges that principles conflict and that the most suitable one is applied.

One might have expected, from the comparison of our method of legislating with that of the United States which I quoted above,<sup>57</sup> that shorter tax legislation would also be found in the US where courts are more used to dealing with principles,<sup>58</sup> in relation to both the Constitution and broadly-worded statutes, even in regulatory fields.<sup>59</sup> This is superficially true of primary tax legislation in

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<sup>52</sup> Or are there no principles in tax law, as suggested by John Prebble in ‘Why is tax law incomprehensible?’ [1994] BTR 380?

<sup>53</sup> *Taking Rights Seriously*, Duckworth, 1977, 22.

<sup>54</sup> interim Report, para. 4.18.

<sup>55</sup> *Bennion on Statute Law*, third edition, 25.

<sup>56</sup> (See note 50) 88-9.

<sup>57</sup> See note 50.

<sup>58</sup> Atiyah and Summers (see note 50), ch. 3.

<sup>59</sup> Atiyah and Summers (see note 50), 76. And see ‘Judicial anti-tax avoidance doctrine in England: a United States perspective’ by W. Popkin [1991] BTR 283, 285.

the US but it is not the whole story because all the detail is in Regulations. I do not know the reason for this unusual amount of detail in US tax law compared with other law but, as I shall comment later, we seem to be moving more in the European direction of placing greater reliance on accounting treatment and less in the US direction of having a self-contained tax system. In any case, Europe is bound to exert a greater influence on our tax system.

John Tiley has summarised the difference in approach between the traditional English way and the European way as one in which the European Court states the principle then works down to the facts whereas our courts do the reverse.<sup>60</sup> The European Court tends not to argue by considering what the position would be if the facts were different.<sup>61</sup> The real difference is that, in the European sense, principles are at a higher level of abstraction than our courts use when making arguments based on the facts. Bennion is right in saying that we are not yet happy to deal with a principle such as discrimination, but a few years ago one might have said the same about legitimate expectation and unjust enrichment.

In this sense, the principle is something external to the rules which helps one to construe the rules and, in consequence, enables the rules to be less detailed. As we have seen, *Furniss v. Dawson* expresses a principle of statutory construction which helps one to construe the rules in the statute in a way that prevents certain types of avoidance, which means that the statute does not itself have to contain so many, or possibly any, anti-avoidance rules. This principle is perhaps not the best example from my point of view to demonstrate that principles lead to more certainty, mainly because the nature of the principle was left to develop as an emerging principle. But now that it seems to have stopped emerging, although it is still developing,<sup>62</sup> we have learned to live with it. The problem, particularly with tax, is that we do not have many such principles.

### *General Principles Drafting*

There seems to me to be some confusion in the discussion about principles in tax legislation. Both the TLRC<sup>63</sup> and the Revenue<sup>64</sup> use the expression 'general principles drafting' when they really mean 'less detailed drafting', such as the statute saying that profits of a trade are taxed, without defining either profit or trade. Describing such legislation as consisting of general principles suggests that it is different in nature from other legislation. The Revenue, however, sees all tax law as rules containing more or less detail: 'Like all legislation, whether in common law or civil law countries, and whether set out in general principles,

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<sup>60</sup> 'The law of taxation in a European environment', *Cambridge Law Journal*, 51(3), 1992, 451, 469.

<sup>61</sup> an unusual example is the consideration by the Advocate-General of the effect of a sublease instead of a surrender in *Lubbock Fine v. Customs and Excise Comrs* [1994] STC 101, considered below.

<sup>62</sup> *Whittles v. Unitholdings Limited (No.3)* [1996] STI 879.

<sup>63</sup> Interim Report, para. 4.5.

<sup>64</sup> Background Paper, Annex 5, para. 5.

or in extreme detail, tax legislation consists of rules that have to be applied to particular facts'.<sup>65</sup> It sees no difference, except of degree, between the scope given by general principles drafting (concepts such as income, trade etc.) and detailed drafting which, however detailed, still cannot cover every set of circumstances. It concludes 'All legislation must consist of a mixture of relatively general and relatively detailed terms that are selected from the limited resources of language to fit the underlying policy as closely as possible to the potentially unlimited facts with which it must deal'.<sup>66</sup> Naturally, it says, it follows from this approach to general principles drafting that, if there is less detail, there is more uncertainty, and so this is not a recommended approach.

When the TLRC and the Revenue speak of general principles drafting, they are not really talking about principles; rather, it is a matter of Parliament leaving it to the courts to invent the principles without much, if any, assistance from the legislation. To say that we tax profits of a trade without explaining either profits or trade does not seem to me to be a statement of principle; it is just a vague rule. It is the courts, not the legislature, that employ principles in explaining what is meant by profit or trade. Other examples of principles invented by the courts are the doctrine of source, the capital / income distinction and 'receivability without receipt is nothing'. In inventing those principles, the courts operated in their traditional fashion, working from case to case refining the principles. A good example can be seen in relation to retirement relief from capital gains tax over the question of whether a farmer has disposed of part of a business or just an asset such as a field or milk quota.<sup>67</sup>

The TLRC quotes the Renton Committee:<sup>68</sup> '... the traditional approach in Europe has been to express the law in general principles.... Here on the other hand the traditional approach has been to spell out in the statutes themselves the precise way in which the law is to apply in differing circumstances'. The expression 'general principles drafting' was originally used by the Renton Committee in connection with European legislation 'which relies upon the courts and the Executive to fill in the details necessary to the application of the statutory propositions to particular cases, in the light of the general intention of the legislature expressed in preambles, recitals and other documents'.<sup>69</sup> The importance of the reliance on these further sources to point the way to the correct interpretation seems to have been ignored by the TLRC and the Revenue in drawing the conclusion that more detailed drafting is necessarily more certain.

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<sup>65</sup> Annex 5, para. 7.

<sup>66</sup> Background Paper, Annex 5, para. 10.

<sup>67</sup> *Atkinson v. Dancer* [1988] STC 758, *Jarmin v. Rawlings* [1994] STC 1005, *Wase v. Bourke* [1996] STC 18.

<sup>68</sup> Interim Report, para. 3.8, quoting from the Renton Committee Report (see note 12), para. 9.14.

<sup>69</sup> (See note 12) para. 9.14.

### **VIII. THE TLRC'S PROPOSAL IN ITS FINAL REPORT**

The TLRC's Final Report, influenced by Leonard Beighton's criticism of the Interim Report,<sup>70</sup> puts forward the interesting suggestion of a two-tier system consisting of primary legislation expressed in general principles supplemented by secondary legislation setting out the details.<sup>71</sup> This proposal is coupled with proposed changes in parliamentary procedure enabling amendments to be made to statutory instruments during debate, and having a standing consultative committee of tax practitioners to comment on the drafts. Unfortunately, this proposal is not put forward for the rewriting of the existing legislation because of the need for these new parliamentary procedures. The following benefits are claimed:

Firstly, the primary legislation would be much shorter and more comprehensible and, consequently, it would be easier to see the right answers to cases at the margins where the application of the detailed rules is unclear — frequently a problem at present. Secondly and leading on from this, we believe that less elaboration would frequently be required than at present so that the total package of primary and secondary legislation would be smaller than the primary legislation typically is at present. Thirdly, Parliament would be able to concentrate on the policy merits of the primary legislation without the detail obscuring these. Fourthly, the legislation would be less cost in stone; the secondary legislation could more easily be amended if this became necessary.<sup>72</sup>

I fully agree with the first (more comprehensible primary legislation), third (Parliament concentrating on the policy) and fourth (ease of change)<sup>73</sup> of these, particularly the first, as it must help the court to see the wood from the trees, and therefore see great merit in the proposal. But I am concerned about whether the proposal really would achieve the second benefit and result in shorter overall legislation. With more time for consultation, there could be more demand for detail in the secondary legislation and a continuation of the current tax rule madness. This proposal is essentially the US solution and, as we have seen, the experience there does not instil confidence that simplification will be achieved.

### **IX. A MODIFIED PROPOSAL**

I should like to put forward a modification of the TLRC proposal, which looks in the direction of Europe rather than the US. This is also a two-level solution, but the levels are different. At the top are more abstract principles corresponding to

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<sup>70</sup> 'The right path to tax simplification' [1996] BTR 1.

<sup>71</sup> Final Report, para. 3.12.

<sup>72</sup> Final Report, para. 3.6.

<sup>73</sup> Although too much change would make it difficult to find the law.

those found in the EC Treaty applying generally, and the more specific principles found in the preamble to Community legislation. The second level is the legislation itself, which is interpreted with the aid of the higher-level principles as well as the explanatory memoranda. There is no third level of detailed legislation, but, of course, below the legislation is Revenue practice which is now published. The reason I put this proposal forward is that one can demonstrate from Community legislation that this does reduce the amount of detail while at the same time still giving certainty.

The real choice, I believe, is not between detailed rules that we have today and less detailed legislation, when detailed legislation wins on the ground of certainty; but between detailed rules and less detailed legislation interpreted in accordance with principles, where less detailed legislation wins on the ground of certainty because the use of principles provides predictability. The Royal Commission said the same thing in 1955 but nothing came of it: it expressed '... a preference for clear statements of principle in a brief enactment over detailed attempts to cover by anticipation all imaginable evasions of it'.<sup>74</sup> The Revenue agrees that countries that use less detailed tax legislation do achieve a reasonable state of certainty.<sup>75</sup> Among the reasons given are that civil law countries rely more heavily on accounting profits, that courts take a more purposive approach to statutory interpretation and that practices such as rulings are more highly developed. As to the first (following accounting profits), we are seeing a shift towards more reliance on accounting treatment and a move away from the capital and income distinction for companies, as in the loan relationship provisions. The logical end result would be that we had two systems of taxation, one for individuals and the other for companies, in accordance with the European tradition; this, in itself, would be a simplification for many taxpayers.<sup>76</sup> The second reason (purposive approach by the courts) is interesting, because it again suggests that certainty is achieved by the courts being purposive, which leads to the question 'how do the courts know what the purpose is?'. The answer presumably is that they have regard both to principles expressed in the legislation and to external materials, such as parliamentary reports.

The reference to rulings is also interesting, because we are in the course of discussing pre-transaction rulings in this country,<sup>77</sup> although personally I do not see much wrong with an expansion of the present system of informal rulings. But, if a more formalised system of rulings could be looked at, not in isolation, but together with a proposal for less detailed drafting, I am all in favour of it. The criticism is sometimes made that rulings place too much power in the hands

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<sup>74</sup> Royal Commission on the Taxation of Profits and Income, Cmd 9474, para. 1089(5).

<sup>75</sup> Background Paper, Annex 5, paras 23-6.

<sup>76</sup> See 'The Finance Bill 1996: keep it short, keep it simple' by D. Williams [1996] BTR 101, 103-4. As he points out, companies now have a different Schedule A, have a different scope to Schedule D Cases I, III and VI, and Case IV does not apply to them at all.

<sup>77</sup> *Pre-Transaction Rulings*, Inland Revenue, November 1995.

of the Revenue. I am not sure that this is a serious objection; the power is already in the hands of the Revenue whenever it says how it will interpret legislation because most people do not want to take it on in the courts. With less detailed legislation, there appears to be more scope for Revenue interpretation, but such interpretation still has to be in accordance with the stated principles. The detailed form of our legislation may have been influenced in the past by the lack of any remedy for the taxpayer against Revenue discretions, with Parliament trying to reduce the discretion exercised by officials.<sup>78</sup> But there is now no lack of safeguards available to the taxpayer, from the Revenue Adjudicator to judicial review,<sup>79</sup> although the latter suffers from the problem of the taxpayer having to start separate proceedings in the High Court. One change that is, however, needed in this area is to give the Special Commissioners power to review exercises of discretions so as to prevent the need for the taxpayer to pursue two separate lines of appeal, often in relation to the same dispute.<sup>80</sup> The VAT and Duties Tribunal has powers to do this but only in some circumstances, which could usefully be extended for the same reason.<sup>81</sup> In many cases, it is the existence of these remedies, not the need to use them, that provides the safeguard.<sup>82</sup> If there is a shift of power, it is to the courts (including, for this purpose, the appeal tribunals).

## **X. THE APPLICATION OF PRINCIPLES TO TAX LAW IN EUROPEAN COMMUNITY TAX LEGISLATION**

One might think that, however beneficial it would be if we had less detailed legislation which we interpreted in accordance with principles, this could not happen without a revolution affecting the legislature, the courts, the Revenue Departments and tax advisers — that is to say, our entire legal culture. Indeed, most of the Australian commentators despair of any change really happening, for this reason. I believe that such an attitude is wrong in the UK where, in relation to Community tax legislation, we are already doing what I am proposing. In Europe, and, more importantly, in the practice of the European Court when interpreting European Community legislation, which is just as much part of our legislation,<sup>83</sup> there is far more attention to principle, with, I suggest, the twin

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<sup>78</sup> See D. Goldberg's Philip Hardman Memorial Lecture, 'Between the taxpayer and the executive; law's inadequacy; democracy's failure?' [1996] BTR 9.

<sup>79</sup> See Beighton (see note 70), 45.

<sup>80</sup> See the author's Philip Hardman Memorial Lecture, 'Tax appeals: the case for reform' [1994] BTR 3.

<sup>81</sup> See FA 1994, Sch. 5 in relation to Customs and Excise matters and some examples in relation to VAT such as the provision of security.

<sup>82</sup> See the Report of the Keith Committee on Enforcement Powers of the Revenue Departments, Cmnd 8822, particularly para. 1.5.1(d) and ch. 25.

<sup>83</sup> In round figures, the Inland Revenue collects £100 billion in taxes, while the European-based VAT and customs duties account for £50 billion, so the part with a European base is not insignificant.

advantages that the rules can be less detailed and that the result is nevertheless still certain. The principles that the Court uses are found in the preamble to European legislation, and there are some general principles that underlie all European Community law.<sup>84</sup> The Court is an interesting institution which seems to combine successfully the methods of civil and common law. We may still regard it as predominantly based on civil law, but elsewhere in Europe the way it follows its previous case law means that it is regarded as based on common law.

One objection to less detailed tax legislation made by the Revenue is that there is no clearly identifiable less detailed drafting style that the UK could take as a model.<sup>85</sup> The Revenue has had little to do with European legislation<sup>86</sup> and so it has probably not paid much attention to it, although its paper did make a passing reference to the civil law drafting of the Sixth VAT Directive.<sup>87</sup> I suggest that European Community tax, and in particular VAT, legislation provides just such a model, although I would not put most of it forward as a model of good drafting. Although the amount of direct tax covered by European legislation is still small, there is a considerable volume in the VAT and customs fields. The TLRC recognises the impact of European legislation drafted predominantly for civil law jurisdictions<sup>88</sup> but it includes this as one of the causes of complexity. This seems odd, particularly when considering directly applicable regulations which are much less detailed than our legislation; it may have some truth in the absurd situation of directives where the taxpayer can argue his case either on internal law or on European law, whichever suits him best, while the tax authority is restricted to arguing on the basis of internal law on the ground that it is the state's fault if this does not correspond to the directive. Although directives require internal legislation, it is not true to say that this is why there is less detail in them. A provision of a directive having direct effect is interpreted without regard to internal law. Have we nothing to learn from how they draft and interpret European Community tax laws?

Interpretation of European Community law is based on principles that assist in the interpretation and tell you how to deal with details not expressly covered. The point I want to make tonight is that this gives more, not less, certainty when applied to less detailed drafting. I shall illustrate this with VAT. The European Court of Justice has now given a large number of decisions on the interpretation

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<sup>84</sup> For a discussion of the method of interpretation used by the European Court of Justice generally, see the papers presented to a Judicial and Academic Conference, 27-28 September 1976, Luxembourg, particularly 'The case-law of the Court of Justice: a critical examination of the methods of interpretation' by F. Dumon.

<sup>85</sup> Background Paper, Annex 5, para. 32.

<sup>86</sup> The Parent-Subsidiary Directive, the Mergers Directive and, formerly, capital duty are its only fields of contact with European legislation apart from general principles such as discrimination in the EC Treaty itself and the odd tax reference in other matters such as European Economic Interest Groupings.

<sup>87</sup> Background Paper, Annex 5, para. 5.

<sup>88</sup> Interim Report, para. 3.48.

of the VAT directives, and so there is a body of law that can be analysed to see if it leads to certainty. As P. Farmer and R. Lyal<sup>89</sup> say,

In interpreting the Community VAT legislation the Court has relied heavily on the teleological method of interpretation. It has paid close attention to the description of the model system in Article 2 of the First Directive and to the considerations set out in the preamble to the directive in particular the aim of achieving a tax which is neutral in domestic and intra-Community trade. It has been conscious that that neutrality depends first and foremost on its general application. Thus, concepts forming the basis for the tax such as 'supply' and 'taxable person' have generally been construed broadly; conversely, exemptions limiting the scope of the tax have consistently been construed narrowly.

The Court has employed the technique of giving independent Community-law meanings to basic terms....

The Court has also laid great emphasis on the contextual or schematic method of interpretation. Individual provisions of the VAT legislation form part of a complex system of taxation, and their function is often best understood when they are read together with other provisions.

Let us look at a few cases and see how the Court applies principles to the interpretation of the VAT directives and ask ourselves whether the result is less certain than with UK-style legislation. The principle is more important than the drafting, as is illustrated by my first example. Taxable person is defined in the Second VAT Directive to mean any person who independently and habitually engages in transactions pertaining to the activities of producers, traders or persons providing services, whether or not for gain. This case concerns a body which, in order to promote trade with another country, does not charge for its services.<sup>90</sup> The issue is whether it can recover VAT that it pays. Clearly, it does not charge any tax because VAT is chargeable only where there is payment for services. Literally, it is a taxable person. It is carrying on business, though not for gain. The Court approached the issue in this way. It first identified the features of VAT in the light of its purpose. The purpose was found in the preamble — the need to achieve harmonisation of the tax as will eliminate distortion of competition. The Court then looked for a principle, found this time in article 2 of the First VAT directive mentioned in the quotation above from

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<sup>89</sup> *EC Tax Law*, Clarendon Press, 1994, 89. See note 84 on the methods of interpretation adopted by the Court generally.

<sup>90</sup> *Staatssecretaris van Financiën v. Hong Kong Trade Development Council* (Case 80/81) [1983] 1 CMLR 73.

Farmer and Lyal: that VAT involves the application to goods and services of a general tax on consumption exactly proportional to the price, whatever the number of transactions that take place in the production and distribution process. That principle requires deduction of tax paid at each stage from tax charged. When one has reached the end of the chain of production, tax is finally charged but is not deductible. That occurs here. The business, by not charging for its services, is in the same position as a final consumer. There is no distortion of competition in these circumstances; the business in question is providing services different in character from taxable ones. These considerations outweigh the literal interpretation of taxable person:

Consideration of those two articles,<sup>91</sup> a literal analysis of which is not *prima facie* an appropriate way to resolve the issue as to whether or not an organisation which habitually provides services free of charge may be regarded as a taxable person, indicates that it would be advisable to identify the relevant features of the common system of value added in the light of its purpose.<sup>92</sup>

In the next case, it is instructive that the Court looked for the principle first, and only turned to the ordinary meaning of the words after finding no guiding principle. It concerns whether the substantial repair of school books is the making of a book (low rate in the Netherlands, zero rate here) or an ordinary service. The Court said

... it must be stated that the other provisions of the Second and Sixth Directives give no indication of the meaning to be attributed to the word 'made.' [Context first.] Nor is any enlightenment to be gathered by looking at the purpose pursued by the Council in adopting the two directives. [Purpose next.] Their main objective is to determine the basis of assessment of value added tax in a uniform manner according to Community rules. That objective will be attained whatever meaning is given to the word 'made,' provided that that meaning is identical in all the member states. In those circumstances the word 'made' can only be interpreted by reference to common usage. [Ordinary meaning of words last.]<sup>93</sup>

Much the same issue arose in a case in the English courts, about whether pleating fabrics for girls' skirts was zero-rated as being the production of children's clothes.<sup>94</sup> The court went first, as English courts do, to the ordinary meaning of the word 'produces', although it is fair to say that the court had been referred to the European Court case and consequently may not have found it

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<sup>91</sup> Second VAT Directive, art. 2, providing that VAT was payable on services supplied against payment, and art. 4, defining taxable person.

<sup>92</sup> 86.

<sup>93</sup> *Van Dijk's Boekhuis v. Staatssecretaris van Financiën* (Case 139/84) [1986] 2 CMLR 575.

<sup>94</sup> *Customs and Excise Comrs v. Ali Baba Tex Ltd* [1992] STC 590.

necessary to look at the context and purpose before turning to the ordinary meaning.

Another recent example where the European Court went behind the apparent ordinary meaning of the words is a case this year on whether VAT is charged on a payment of compensation made under Community legislation to a farmer for giving an undertaking to discontinue milk production as part of Community measures designed to reduce the oversupply of milk without reducing farmers' incomes.<sup>95</sup> A supply of services is defined to include obligations to refrain from an act.<sup>96</sup> The compensation payment was directly linked to the act of giving the undertaking to discontinue milk production which is a condition for the supply being for consideration. On the wording, therefore, VAT appears to be payable, as indeed the German and Italian governments argued. However, the Court went behind the wording, basing its decision on the principles laid down in the First VAT Directive, that 'the principle of the common system of VAT involves the application to goods and services of a general tax on consumption'. This is another example of the point made by Farmer and Lyal of the Court paying close attention to the description of the model system in article 2 of the First Directive. VAT is a tax on consumption but here there was no consumer. No benefit was received by the Community in return for the payment; it was merely acting in the common interest of promoting the proper functioning of the Community milk market. As the Advocate-General said, the situation is quite different from an undertaking not to compete given on sale of a business, because in that case the purchaser obtains a direct benefit from the undertaking. This is an example of the principle being used to interpret the rule, which appeared to say the opposite when looked at in isolation. It is only by applying the basic principle that the meaning of the rule can be determined.

Another principle is that exceptions are construed strictly in European legislation. It used to be the case that the Court's approach to exemptions was more like the plain words approach that the English courts traditionally use to construe legislation generally,<sup>97</sup> but, even when applying a strict approach, principles are still applied. In contrast, in the UK there does not seem to be any distinction in approach between charging provisions and exemptions. The Sixth Directive exempts 'the leasing or letting of immovable property'.<sup>98</sup> Internal law in the UK originally interpreted this on the plain words approach to mean that the grant of a lease was exempt but the surrender of a lease, which is the

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<sup>95</sup> *Mohr v. Finanzamt Bad Segeberg* (Case C-215/94) [1996] STC 328.

<sup>96</sup> Sixth VAT Directive, art. 6(1).

<sup>97</sup> In *Committee of Directors of Polytechnics v. Customs and Excise Comrs* [1992] STC 873, 884e, Brooke J., in construing an exemption provision of the Sixth Directive, said that the approach to the construction of the Sixth Directive was very similar to the approach taken by English judges to the interpretation of English taxing statutes.

<sup>98</sup> Art. 13B(b).

opposite of letting, was taxable. The European Court decided otherwise.<sup>99</sup> If letting was exempt, so must be any change in the contractual position of the parties. It was not necessary to spell out every detail in the legislation. The way in which the Advocate-General reached this conclusion is interesting. He made three preliminary remarks: first, that exemptions are to be construed narrowly (in legislating the exemption, the UK was following this principle but was interpreting it too narrowly); secondly, exemptions should have a uniform effect throughout the Member States; thirdly, and most interestingly, he looked on property transactions as an economic cycle in which new buildings are subjected to VAT in the normal way, but once a building had been occupied, it had been consumed and future transactions were exempt, although, because of the possibility of opting for taxation, it could re-enter the economic cycle. He then turned to interpret the reference to leasing in the light of the context and bearing in mind the purpose and structure of the directive. His reason is based on his third preliminary remark. Leasing transactions should be either in or outside the economic cycle and not partly outside on the grant of the lease and inside on its surrender with consequent distortions about whether the landlord could recover the tax charged. 'The coherent application of the Sixth Directive and respect for the principle of the neutrality of VAT demand that that should be so.'<sup>100</sup> We would have had difficulty in reaching this conclusion through our plain words approach, which goes to show that if our traditional approach can be too narrow when applied to exemptions, it must be far too narrow in relation to charging provisions. The case is a good example of how legislation can be shorter if one pays attention to the principle rather than the words.

The real benefit of principles is when one is dealing with something not expressly provided for in the legislation. My next example concerns a husband and wife, not otherwise carrying on business, who purchased a building under construction with a view to letting it as showrooms.<sup>101</sup> This was deemed to be an economic activity for VAT as 'the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis'.<sup>102</sup> The question arose whether they could recover input tax on the building work immediately or only when the exploitation took place on receipt of income. The Dutch government took the logical position that, if it was the exploitation that gave rise to its being within VAT, this started when income was received. The Court had no difficulty in deciding that neutrality required that the input tax should be recovered immediately because otherwise VAT would be included in the expenses of the business. The point was taken one stage further in a recent case in which a company intended to carry on a business purifying sea water to

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<sup>99</sup> *Lubbock Fine v. Customs and Excise Comrs* [1994] STC 101.

<sup>100</sup> 119b.

<sup>101</sup> *Rompelman v. Minister van Financiën* (Case 268/83) [1985] 3 CMLR 202.

<sup>102</sup> Sixth VAT Directive, art. 4(2).

turn it into drinking water.<sup>103</sup> It commissioned a feasibility study, the results of which put off the potential investors, and the company was wound up before it had started business. Was the input tax, which had been correctly deducted on the basis of the previous case, now repayable? The Advocate-General regarded the Dutch case as one of timing which did not apply when there was never any economic activity. So, as there was no economic activity, the company had no right to deduct input tax and was in the same position as a private consumer. The Court disagreed with the Advocate-General, a fairly unusual occurrence. It argued that the principle of neutrality applied in the Dutch case did govern this one. The input tax was correctly reclaimed at the time in good faith. It was contrary to the principle of legal certainty that later facts should change this. In addition, neutrality required that there should be no tax burden on a business. There should be no differences between businesses already carrying on business and those starting up. A genuine intention to carry on business was therefore as good as carrying on a business.<sup>104</sup> As before, a wide interpretation was given, based on the principle of neutrality that businesses should not bear any VAT. The Advocate-General had been too literal in not regarding it as a business. All that is shown by the disagreement between the Advocate-General and the Court over which principle was more important is that nothing will ever be completely certain; the issue is whether European Community legislation is more certain than our present methods in the UK.

## **XI. WOULD IT WORK HERE?**

It is, of course, one thing to say that the European Court with its judges from each Member State can deal with European legislation; it is another to say that our own judges can do so. This is no longer an abstract question. Recently, we had the interesting spectacle of the Court of Appeal deciding on whether the English or Scots courts had jurisdiction in relation to a void interest swap transaction by a local authority, 'having regard to any relevant principles laid down by the European Court ... and to any relevant decisions of that Court'.<sup>105</sup> In doing so, it came to a different conclusion from the one it would have done under English law.<sup>106</sup> So far as tax is concerned, it is clear that the courts (in which I include the VAT and Duties Tribunal) are not only coping but by now have a great deal of experience of interpreting European tax legislation in accordance with principles, particularly in the field of VAT. One could argue

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<sup>103</sup> *Intercommunale voor Zeewaterontziltling v. Belgian State* (Case C-110/94) [1996] STC 569.

<sup>104</sup> Incidentally, the VAT Tribunal had come to the same conclusion in *Merseyside Cablevision v. Customs and Excise Comrs* (1987) VATTR 134.

<sup>105</sup> *Kleinwort Benson Ltd v. Glasgow City Council* [1996] 2 WLR 655, applying Civil Jurisdiction and Judgments Act 1982, s. 16(3).

<sup>106</sup> The decision was that an action for restitution of sums paid under a void contract was a matter relating to a contract.

that the approach was not originally on the same lines as the European Court, but it certainly is now. As examples, last year, the House of Lords confidently decided that a self-supply charge to VAT was inconsistent with the Sixth Directive without referring the question to the European Court.<sup>107</sup> This year, the House of Lords has upheld a provision of internal law as being consistent with the directive, containing a clear example of Lord Slynn, a former Advocate-General and then Judge at the European Court, using the method of construing a derogation which the UK was permitted to make from the directive in accordance with its objective of preventing avoidance or evasion, here meaning loss of revenue caused by the method of selling via agents who were below the registration limit, also without referring the question to the European Court.<sup>108</sup> Interestingly, this reversed the majority of the Court of Appeal who had, quite correctly, given the derogation a narrow interpretation, but their interpretation was too narrow as they had not taken the purpose of the derogation into account. Again this year, the Court of Appeal decided a VAT case almost entirely on European law.<sup>109</sup> The High Court has just decided a case using the recitals to the Sixth Directive as the key to its interpretation.<sup>110</sup> In another case, the High Court has had regard to the principle behind the directive in deciding that input tax cannot be reclaimed by a trader if the supply to it was used in making supplies before the trader was registered, even though, under the statutory rule giving the time of supply as the date of invoice, this was after registration.<sup>111</sup> In the VAT and Duties Tribunal, construing European legislation is a daily occurrence.

The approach of the UK courts to the interpretation of European legislation is a moving target to which I cannot do justice in this lecture. I would like to put forward a suggestion for some further research. This is that the Revenue should take a closer look at the results of interpreting the legislation with which Customs and Excise deals, both in its interpretation by the European Court and more particularly in its interpretation by our own courts.

## XII. CONCLUSION

I suggest that the answer to our problems can be found in how they do things in Europe. I predict that the results of the further research that I propose will show that courts in the UK can not only happily construe legislation which is far less detailed than our own in accordance with principles but, in doing so, achieve far more certainty than is currently the case with our internal law. If it works for Community tax law, let us try it for our own tax law. What we need is less

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<sup>107</sup> *Customs and Excise Comrs v. Robert Gordon's College* [1995] STC 1093.

<sup>108</sup> *Fine Art Developments plc v. Customs and Excise Comrs* [1996] STC 246. See in particular 260h, 261e.

<sup>109</sup> *Nell Gwynn House Maintenance Fund Trustees v. Customs and Excise Comrs* [1996] STC 310.

<sup>110</sup> *Diversified Agency Services Ltd v. Customs and Excise Comrs* [1996] STC 398.

<sup>111</sup> *Schemepanel Trading Ltd v. Customs and Excise Comrs* [1996] STI 800.

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detailed legislation construed in accordance with principles, not a continuation of the plague of tax rule madness.

I give the last word to a repetition of the conclusion of the Renton Committee ‘that interpretation of Acts drafted in a simpler, less detailed and less elaborate style than at present would present no great problems provided that the underlying purpose and the general principles of the legislation were adequately and concisely formulated’.<sup>112</sup>

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<sup>112</sup> (See note 12) para. 19.41.