The Delicate Balance
Tax, Discretion and the Rule of Law

IBFD
Why this book?
Few aspects of revenue law generate stronger feelings than the exercise of discretionary power by tax administrations. A delicate balance often needs to be struck between the legitimate needs of revenue authorities and the equally legitimate interests and rights of taxpayers. On the one hand, the executive and administration need to have sufficient capacity to apply the law; on the other, there is a need to maintain the principle of the rule of law that it is the elected legislature, and not the executive or tax administration, that establishes tax burdens. The chapters in this volume explore that delicate balance.

The Delicate Balance - Tax, Discretion and the Rule of Law considers the critical questions that arise from the intersections of tax, discretion and the rule of law in modern common and civil law jurisdictions: What do we mean by tax discretion and how does it vary in conceptual and practical terms in different tax regimes? What role should discretion play in tax systems that operate under the rule of law and how large should that role be? What are the legal, political, institutional and other constraints that can prevent abuse of discretion? To what extent can, and should, the legislature safely delegate discretionary powers to tax administrations?

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1. Background

Few aspects of revenue law generate stronger feelings than the exercise of discretionary power by tax authorities. The eminent English judge Lord Hewart, writing in 1929, used income tax discretions as an “extreme” illustration of the dangers posed by the ascendancy of government over Parliament and courts:¹

Let it be supposed […] that the power of deciding disputes as to liability to income-tax were vested in the Board of Inland Revenue, without appeal to the Courts. “Oh,” it may be said, “but that is an extreme case which would never be sanctioned by Parliament.”

The Carter Commission reported some rather more sympathetic views, including the following observations of the Canadian Minister of Finance in 1948:²

There are some situations where ministerial discretion is the only fair way to have certain questions settled. It is a device which avoids the rigidity of a written statute, and it is a means whereby real cases of hardship may be avoided. Frequently the law cannot anticipate all the situations which may arise, and in the absence of ministerial discretion there is no alternative to enforcing the letter of the law.

Such widely differing attitudes on the proper quantity and quality of discretion in taxation can be difficult to relate to each other, in large part because there is no generally agreed discourse under which basic questions may be addressed clearly. What is tax discretion? Should it be eradicated or accommodated? How might it be improved? The matter is complicated further by the highly contextual and dynamic nature of tax regulations, as these striking comments of the U.K. Inland Revenue in 1944 illustrate:³

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¹ Lord Hewart C.J., The New Despotism (London: Ernest Benn Ltd., 1929), p. 46. The chapter heading is “Administrative Lawlessness”.
³ Board of Inland Revenue, Notes on Finance Bill 1944, Committee Stage, p. 54.
Even in peace-time it is not unknown to have a definitely extra-statutory taxation arrangement which involves a definite departure from the strict rule of the law, though it has always been the policy of the [government] to challenge any such extra-statutory arrangement and report it as a matter which should be covered by statutory provision in a Finance Act. But the circumstances of war-time are very different, and there have been a large number of extra-statutory concessions relating to Inland Revenue duties.

The powers of tax authorities to determine aspects of liability, and trends in these powers, must therefore be justified in the light of all relevant circumstances. This is not always achieved satisfactorily, and particular vigilance is needed that discretionary powers are not shifted progressively to revenue officials, without sufficient reason and to the detriment of traditional rule of law values. It is important that a common language is developed, with which these matters may be discussed and contested openly.

The present volume represents a sustained attempt to address this problem, as a matter of theory but also with close reference to ongoing controversies in twelve different common and civil law jurisdictions. In line with the comments above, the contributions focus on the relations between tax discretion and the rule of law, within the wider context of constitutional allocations of power and the more general relations of citizen and state. There are certain variations in emphasis and perspective between chapters that result from the differences in fundamental assumptions in the jurisdictions represented. Nevertheless, the common themes are strong, and the following three questions are discussed in almost every chapter of the volume:

1. What is tax discretion?
2. What is the place of discretion within tax systems?
3. How should tax discretion be reformed?

The remaining sections below review each of these items in turn, outlining some of the main issues discussed elsewhere in the volume and starting with the meaning of “discretion”.

2. Defining “discretion”

An explanation of tax discretion might be approached from two directions. First, a descriptive definition might be offered, that explained the source or consequences of the powers in question. Secondly, a normative account
Defining “discretion”

might be favoured, that described an ideal system of tax rules and showed the role that discretion would play within its proper context. Underneath these headings, further distinctions might be made. Discretions explicitly delegated by statute may be compared with those inherent in the interpretation of legislation, or powers exercised by officials but which lack a clear basis in law. A descriptive approach looking to consequences could divide between liability discretions that, potentially, affect the amounts of tax payable; administrative discretions that encompass such matters as tax forms, investigations and time limits; anti-avoidance regimes; temporary rule-making powers in anticipation of detailed statutory regulation; and so forth.4

The views of commentators on the precise content of discretion inevitably differ, but it is critical that these are articulated adequately. This is natural for normative accounts of tax discretion, where the underlying theoretical concerns of the author will be reflected throughout their exposition of the desired structure of tax rules and the place of discretion therein.5 Yet even descriptive approaches require to be explained to the reader. For example, many analysts, drawing upon their understanding of constitutional requirements, would refuse to classify extra-statutory concessions as discretions at all, preferring to regard them as plainly illegal.

This highlights a further point, that apparently objective descriptions of “discretion” appear to be influenced by the underlying structure of tax rules. Wide delegations of power to the authorities, in particular, would seem to blur the conceptual lines between the exercise of delegated authority and other activities such as interpretation or extra-statutory concession. The Fleet Street Casuals decision in the U.K., for instance, confirmed that the power of “care and management” enjoyed by the Inland Revenue authorized the selective enforcement of existing tax liabilities.6 That the problem reached the House of Lords, the highest domestic court, illustrates the difficulty of distinguishing strictly between lawful delegation and unlawful concession. The position of the United States is also noteworthy in this regard, the Treasury exercising a general power to promulgate tax

4. See Walpole, Michael and Chris Evans, “The Delicate Balance: Revenue Authority Discretions and the Rule of Law in Australia” (this volume).
regulations despite a nondelegation doctrine in the U.S. Constitution that is arguably applicable.7

In other jurisdictions, by contrast, the transfer of power from the legislature to the tax authorities is much more strictly circumscribed, whether by an ingrained culture of seeking a clear statutory justification for administrative action, the intervention of courts or for other reasons. In these instances there seems to be a much sharper conceptual separation between “discretion”, which is equated with authority specifically delegated by the legislature, and the varied other functions of the tax administration. The implication of this is that descriptive definitions of discretion are not immune from normative considerations, on what administrators should be permitted to do within the constitutional context and how this should be authorized. Even this first stage of defining the word discretion, then, is laden with values.

3. Discretion and legal systems

The detailed discussion in later chapters on the position of tax authority discretions within legal systems is dominated by three closely associated ideas, namely the separation of powers; consent to taxation through the democratic process; and the rule of law. The emphasis to be placed on each of these concepts varies depending on the outlook of each author, and on the constitutional discourse that prevails in different jurisdictions. A recurring theme throughout this volume, however, is a basic insistence that tax discretions should be treated as an integral part of the legal system and judged to the same – if not higher – standards of legitimacy as other forms of administrative law. These matters are discussed conveniently under two broad headings, as follows: first, is the discretion legitimate in its source; secondly, is the discretion legitimate in its exercise in practice?

3.1. The source of discretion

In many jurisdictions the source of discretionary power is associated closely with the doctrine of separation of powers. The starting point, at least under a pure version of the doctrine, might be that rule-making should

be reserved entirely to legislators. It is widely appreciated, nevertheless, that the demands of modern administration justify a level of delegation to the tax executive. The spirit of the separation of powers doctrine, it is felt, may be upheld provided that the courts enjoy both legal and practical wherewithal to police the activities of tax authorities. In other words, the decrease in the influence of legislators would be compensated for by the enhancement of judicial power. This line of reasoning is not adopted universally and in some jurisdictions there is a strong tradition of direct appeal to the need for democratic consent to taxation. The natural forum for tax debate, on this view, is the legislative body, even if it is accepted that legislators enjoy formal powers of delegation. Tax authority discretions represent a departure from this general principle and need therefore to be explained and justified.

It is interesting to speculate on whether such direct appeals to democracy entail a greater intolerance of delegated discretion than a separation of powers analysis. A deficit of democratic debate would, on its face, be less susceptible than a breach of the separation of powers doctrine to “cure” through the oversight of the courts. There is a possibility, though, that discretionary decisions of the tax authorities might be enhanced with procedures for taxpayer or citizen participation that could replicate many of the democratic advantages of conventional legislation. In other words, the risk of unfairness would be alleviated by imposing democratic discipline upon subordinate decision-makers. The opposite process is also possible, unfortunately, whereby robust regulatory procedures are sidestepped by the routine use of informal rules, which may or may not have binding legal effect. Care must be taken, moreover, that improved structures for the performance of discretionary responsibilities are not used as a mere pretext for the more general shift of power from the legislature to the tax authorities.

3.2. The exercise of discretion

Assuming that discretionary or regulatory power has been delegated validly, it may, nonetheless, be used in better or worse ways. In the course of preparing their chapters in this volume, authors have found it useful to

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8. See section 3.3.1, infra.
9. See Hickman (this volume), text at nn. 29-38.
refer to the seminal legal and constitutional theories of Fuller, Dicey, Raz and Krygier, and to the official advice of the United Nations, in order to articulate concrete standards for the exercise of discretion. A more detailed exposition of these matters can be located in the chapters by Dourado, Freedman and Vella, Walpole and Evans, Griffiths and Mazansky, but some common themes are as follows. The law of taxation, including its discretionary elements, should be clear; capable of guiding taxpayers; stable; fairly enforced; non-retrospective; capable of implementation; and open to adjudication before an independent tribunal.

These requirements, which are typically discussed in connection with the “rule of law”, could impose deep limitations on the exercise of delegated power. This may hold its attractions, but it seems equally certain that rule of law values do not express every characteristic that is desirable in a tax system. On the contrary, they may need to be balanced against other considerations such as the efficient administration of the tax system, the distribution of burdens in accordance with ability to pay or otherwise. It would also be mistaken to equate the rule of law with exhaustive primary legislation, and indeed there is an argument that an excess of statutory detail is counterproductive, makes the law overly complicated and is difficult for taxpayers to follow. Furthermore, detail does not necessarily resolve problems of interpretation and application, which may resurface in the guise of inflexibility or in uncertainties around the treatment of gaps in the law. Less detailed primary legislation does not necessarily leave any more power in the hands of the administration.

11. Dicey, Albert V., Introduction to the Study of the Law of the Constitution (London: Macmillan, 1885) (and later editions), cited in Freedman and Vella (this volume), n. 31, Griffiths, Shelley, “Revenue Authority Discretions and the Rule of Law in New Zealand” (this volume), text at nn. 5-6, Dourado (this volume), text at n. 42, Walpole and Evans (this volume), n. 10.
15. See discussion in Walpole and Evans (this volume), text at nn. 6-8; Dourado (this volume), text at nn. 4-9 and 23-25.
16. See Dourado (this volume), text at nn. 28 and 33-34.
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