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The Parameters of Uncertainty In Revenue Law

Mohsin Hingun, Nafiu Olaitan Safaradeen

Dept of Civil Law, AIKOL, International Islamic University Malaysia, Malaysia.

ABSTRACT

Certainty in law is a much valued attribute and is fundamental to upholding the rule of law. In revenue law, tax payable must be certain and not arbitrary but can we interpret statutory provisions with certainty in the absence of important terms and concept purposely left out of the definition section. The problem is compounded by the wide discretionary powers given to tax officials in the execution of their functions. The lawyer’s definition of a term may not converge with definitions from other disciplines. A good example being the concept of profit but these disciplines may provide assistance; however the matter is resolved legally by examining the facts and applying the law as envisaged by Parliament. The essence of this contradiction underlines the difficulty in interpretation of language as used in the legislation by the legislators, which ultimately sheds light on the causes of uncertainty in law. However, uncertainty has a utilitarian role, leaving the courts latitude to find the appropriate legal solution, either in defining terminologies and concepts or in the application of legal rules as long as the courts approach is predictable.

Key words: revenue law, uncertainty, definition, discretions, legal language, predictable.

Introduction

At every stage of legal development, the word - ‘certainty’ - has always been described as fundamental to the rule of law and more than any other area of law; certainty should be the lynchpin of revenue law. As far back as 1776, Adam Smith had raised the importance of certainty to taxation when he assigned it the second position out of the four basic canons of taxation he laid down in one of his momentous classical works (Smith, 1776). According to him: “The tax which individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person (Smith, 1776).” So much has since been written on the subject matter, the focal point of the majority upholding the view that certainty is significant to law and the law should be “clear, easily accessible, comprehensible, prospective rather than retrospective, and relatively stable (Raz, 1977).

Tax legislation, like any other law, ought to be clear, as clear and “as coherent as possible (Brooks, 1997).” The goal should be well developed and encapsulated in a principle-based legislation providing greater integrity, simplicity and certainty [the proposals for a “principle-based structure” to tax law (Review of Business Taxation, A Tax System Redesigned, 129-130 (July 1999); and for the use of ‘general principles in preference to long and detailed provisions”, Treasurer, Tax Reform, Not a New Tax, a New Tax System, 149, (August 1998)]. However, the central question which is constantly begs for an answer is: are statutory provisions in general and in revenue law in particular clear and certain as they should be? Attempts to answer such question remain an uphill task, but while not disputing the essence of certainty to law, the aim of this essay is to draw attention to the utility and benefits of uncertainty. It will be argued that despite accounting for the complex nature of law, uncertainty possesses some qualities that serve the interest of law well, and we should start appreciating it for what it is. Uncertainty is indeed an indispensable part of revenue law, carefully nurtured by the legislative draftsman to enrich the coffers of the treasury.

The Issues arising from Uncertainty:

Notwithstanding Adam Smith’s recommendation many centuries ago and countless researched efforts, including numerous writings on revenue law, it remains doubtful if tax law has overcome the problems of uncertainty. It has become an irremovable tag in the field of tax law and as the title suggests it has acquired quite an importance in sustaining revenue law more than any other area of law.

Essentially, the tax system operates in a continually changing business environment and as such, it is not possible to draft detailed rules applying to every situation that has arisen and may arise. In other words, there are no detailed rules that provide specific solution to every existing legal tussle or those on the horizon.
As D’Ascenzo argued, detailed complex rules can often frustrate the lawmaker’s intention to deal effectively and fairly with business transactions generally. He was of the view that the preferable course is for the legislation to establish clear principles of parliamentary intent and for the courts to explain how the rules apply to particular instances (D’ascenzo, 2000).

In another publication, Richardson submitted that resigning to the proposition that effective implementation of the tax law is possible only with an all-knowing and infallible legislator (which does not exist in reality) (Vanistendael, 1997), is likely to lead to a sub-optimal, and in some cases dysfunctional operation of the tax laws as illustrated in different cases in which issues relating to revenue law were raised as the primary cause of litigations (Federal Commission of Taxation v Wes-Traders Proprietary Ltd).

Pearce and Geddes had also written on the fact that the drafting of legislation is a difficult task (Pearce, and Geddes 1996) and this same ground informed the argument of Allerdice that: “unfortunately, it is just not possible for the legislative drafter to cover all possible factual situations. The more the drafter tries to do so, the more complex and prolix the legislation will become and, almost invariably, the less clear the meaning of the legislation will become” (Alerdice, 1996).

This is more applicable to revenue law as a complex subject and its complexity is reflected in the legislation relating to taxation. “So, no matter how detailed, the legislation can never be a complete code. Accordingly, its application depends on the relationship between the legislation and accounting principles and practices; on the exercise by the commissioner of his statutory power and responsibilities; and on the approach of the courts in construing and applying tax legislation (Richardson, 1994).

Causes of Uncertainty and its Inherent Value:

Most often the lawyer’s tools of statutory construction may be the reason for some of the uncertainty in tax laws. It has been suggested that the drafting of some of the statutory provisions has sought to overcome the effect of rules of construction and that, some uncertainty may have been intended as a design feature in the system of taxation. A question was raised if it is a good thing to do so while attention is also drawn to the view that rewards and penalties linked to unpredictable outcome is an important part of ordinary economic behaviour in ordinary life (Straffin, 2001).

There are examples of structured uncertainty in tax law; for instance, there are numerous provisions where liability of a taxpayer is made to depend upon the exercise of discretion by the Commissioner of Revenue. As illustrated in (Giris Pty Ltd v Commissioner of Taxation), Parliament may constitutionally enact a law with respect to taxation by reference to which the amount of tax payable is made to depend upon the formation by the Commissioner of an opinion about whether the application of some provision is unreasonable, even when the basis of that opinion is in part dependent upon the Commissioner having a discretion to take into account such “matter, if any, as he thinks fit (Giris Pty Ltd v Commissioner of Taxation).” This raises the issue of delegating the task of making law.

On this issue of delegated power, it was held in (Kruse v Johnson) and subsequent cases that delegated legislation may be declared invalid if, upon proper construction, it is found to be uncertain, (Kruse v Johnson) but the duty of a court in relation to Acts of Parliament is to find and apply meaning in the words no matter how difficult they may be to interpret (Pearce and Argument, 2005 and Pearce and Geddes 2006).

Despite the desire for clarity, certainty and predictability, there are valid reasons for discretions to be given in tax legislation (Wheatcroft, 1969 and Davis, 1979) and these are seen as inherent value in uncertainty. One such reason may be to have a tax outcome dependent upon commercial, business or economic considerations that non discretion rules might not allow (Pagone, 2009). It is reasonable to appreciate economic criteria as the determinants in transfer pricing discretions or in the debt/equity rules and as held in (Inland Revenue Commissioners v Bew Estates Ltd), the complexity of drafting is such that “what seems obvious at first sight quickly recedes into obscurity (Inland Revenue Commissioners v Bew Estates Ltd). It means we should not be carried away with the gilt-edge on the surface, bearing in mind that all that glitters may not be gold and indeed, appearance could be quite deceptive.

Furthermore, the social evil of tax avoidance as described by Ross (Ross, 1969) often necessitates the permission of discretions to serve as a response to such unpleasant and unforeseen consequence of tax avoidance. This underscores the essence of uncertainty in revenue law bearing in mind that the statutory provisions designed to arrest tax avoidance are not distance from the language of uncertainty in addition to the fact that such provisions are not meant to be applied “as primary taxing provisions (Pagone, 2009),” rather “they are intended to apply only when the ordinary provisions have failed to achieve the purpose which, somehow, they were intended to achieve but failed to achieve (Pagone, 2009).”

Moreover, the difference between the lawyer’s tools and the meaning the economists and accountants attached to the statutory words may be regarded as one of the causes of uncertainty in revenue law. The reason for this is not far-fetched: the root of accepted business principles in is the methodology of financial accounting and as held in Symes v Canada (1993, 4 S.C.R. 695), these business principles are motivated by factors that are
different from revenue law. In addition to this, the concern of financial accounting is to provide a comparative analysis of business income from year to year, as a result, it strives for methodological consistency for the benefit of the audience for whom the financial statements are meant for and the audience includes but is not limited to shareholders, investors, lenders from finance sector and the financial regulators while on the other hand tax computation from legal perspective “is solely concerned with achieving an accurate picture of income for each individual taxation year for the benefit of the taxpayer and the tax collector (Canderel Ltd v Canada).” For a better appreciation of this difference between accepted business principles and legal principles, let us look at the concept of profit which underlines the essence of the difference under consideration.

The liability to pay tax does not arise until income has been derived and as Taylor J rightly observed in Newton (Federal Commissioner of Taxation v Newton), “even after it has been derived, no strict liability to pay any specific amount of income tax arises until it is seen whether the taxpayer has a taxable, as distinct from an assessable, income and until the tax has been assessed... (Federal Commissioner of Taxation v Newton)” This underscores the genesis of complexity inherent in issues relating to taxation.

Meanwhile, income tax legislation in the majority of common law jurisdictions provides that a business is subject to income tax for a taxation year on its gains or profits for that year (Malaysian Income Tax Act, 1967), but importantly, there is no definition of ‘profit’ in the Income Tax Act which seems to be a deliberate legislative choice bearing in mind that the Act contains exhaustive definition of other concepts and terms that feature in the Act. As a judge once remarked, “this choice reflects the reality that no single definition can adequately apply to millions of different taxpayers bound by the Act (Canderel Ltd v Canada).” What then is the true meaning and nature of ‘profit’ from the legal point of view which would distinctly stands on its own if compared with its rendition in economics?

The most concise articulation of the concept can be found in Minister of National Revenue v Irwin, where profit in a year was taken to consist of “the difference between the receipts from the trade or business during such year... and the expenditure laid out to earn such receipts (Minister of National Revenue v Irwin).” Jackett P endorsed this fundamental definition in Associated Investors of Canada Ltd v Minister of National Revenue when he said: “Ordinary commercial principles dictate, according to the decisions, that the annual profit from a business must be ascertained by setting against the revenues from the business for the year, the expenses incurred in earning such revenues (Associated Investors of Canada Ltd v Minister of National Revenue).”

The difficulty confronting the courts in the assessment of profit for income tax purposes informed the need for as much clarity as possible in formulating a legal test that will serve as a guideline and the starting point is that the determination of profit under the Income Tax Act is a question of law, not of fact. Bowman J upheld this view in Ikea Ltd v Canada where he opined that the “accounting treatment does not affect the determination is one of law based upon a consideration of all facts (Ikea Ltd v Canada). The legal determinants of profit are said to be two in number: “first, any express provision of the Income Tax Act which dictates some specific treatment to be given to particular types of expenditure or receipt... and second, established rules of law resulting from judicial interpretation over the years of these various provisions (Canderel Ltd v Canada).”

Besides these two legal determinants, any other tool of analysis would only provide assistance in reaching a determination of profit and such tools have been described as interpretive aids (Canderel Ltd v Canada), among which are ordinary commercial principles or well-accepted foundations of commercial trading. A formal codification of these principles is known as Generally Accepted Accounting Principles - GAAP - developed by the accounting profession for use in the preparation of financial statements. Peter and Joanne noted in a book that these principles are accepted by the accounting profession as yielding accurate financial information about the subject of the statements and become ‘generally accepted’ either by actually being followed in a number of cases, by finding support in pronouncements of professional bodies and in writings of academicians and others (Hogg and Magee 1997), but as Iacobucci J observed, these are non-legal tools and as such are external to the legal determination of profit; nevertheless, when it comes to the relationship between tax law and business principles, he was of the view that in the absence of a statutory definition of profit, it would be unwise for the law to eschew the valuable guidance offered by well-established business principles. He said:

Indeed, these principles will, more often than not, constitute the very basis of the determination of profit. However, well-accepted business principles are not rules of law and thus a given principle may not be applicable to every case. More importantly, these principles must necessarily take a subordinate position relative to the legal rules which it governs (Canderel Ltd v Canada).

Similarly, Bowman J considered the role of accountants and GAAP in the court’s determination of income tax matter; he viewed such evidence as potentially useful in indicating the underlying commercial and economic reality that the transaction represents, free of tax considerations, but viewed accounting evidence as only of “marginal assistance” in tax cases (Ikea Ltd v Canada), while the provisions of Income Tax Act and other established rules of law form the foundation of defining what constitutes profit.

As Iacobucci J observed, depending on the taxpayers’ commercial activities during the year, unlike methodological consistency of financial accounting, the methodology used to calculate profit for tax purposes may be substantially different from that employed in the previous year, which in turn may be different form that
which was employed the year before. He said: “while financial accounting may, as a matter of fact, constitute an accurate determinant of profit for some purposes, its application to the legal question of profit in inherently limited. Caution must be exercised when applying accounting principles to legal questions (Canderel Ltd v Canada).

Similarly in (Friedberg v Canada), it was held that though well-accepted business principles are recognised by the law, however, there may be occasions on which they will differ, and on such occasions the latter should prevail (Friedberg v Canada).

Therefore, the correct approach to the determination of profit for tax purposes is adopting a method of compilation which is consistent with the Income Tax Act, with established rules of law, and well-accepted business principles which gives an accurate picture of the taxpayers’ income for the taxation year in question (Ikea Ltd v Canada).

We should also note that there is difference between the lawyer’s tools and the meaning the economists and accountants attach to statutory words in deducing the distinction between the quintessential revenue law concepts of capital and income. Such difference may be of interest to accountants and economists but the difference is more important to a tax legal advisor due to the fiscal effect that may flow from the different legal character ascribed to each kind of transaction.

For instance, an investor and a lender who both provide capital to a company are not treated the same way by tax law. The investor is seen to have risked capital into the company’s venture and has no legal right to require repayment of the capital if the company liquidates. But if the business is going on well, in return for his investment risk, the investor is entitled to profit sharing in form of dividends should the company decide to redistribute some or all of the profits. On the other hand, the lender’s risk is different from that of investor in the sense that, unlike the latter, the former is entitled to a financier’s return on the fund he lent the company without reference to the issue of profit in relation to what the loan is used on. In addition, the lender is also legally entitled to require repayment of the fund. Unlike the shareholder, he is a creditor.

Moreover, the cost to the taxpayer company seeking finance, either through the issuance of shares or via borrowing will impact its tax position. The economic outcome of allowing deductibility of interest component of the payment is that the cost to the taxpayer is reduced. Also, allowing a deduction shifts the economic burden of raising the fund from the taxpayer-company or individual to the public revenue. In most decided cases, for example, in Macquarie Finance, the courts determined the substance of the transactions by the legal rights created in preference to reliance on economic or accounting analysis. Thus, the resolution of such cases is not “governed by the broader economic or accounting realities of the transactions, but by the lawyer’s tools of analysing and classifying the legal rights between the parties (Pagone, 2009).

In addition, we should also acknowledge that in law, the use of figure of speech such as simile, metaphor, personification, etc carrying its share of uncertainty. For instance, one metaphor which has featured prominently at the heart of tax law is the metaphor of tree and fruits in explaining the difference between capital and income.

We would recall that the metaphor used by Pitney J in Eisner v Macomber, was accepted in Federal Commissioner of Taxation v Montgomery, and it was endorsed in McNeil’s case. Similarly in Newton, when describing a method of impressing a dividend with the character of the capital in the process of passing it from the company to the taxpayer, Fullagar J held that the apparent difficulty of the case was created by the complexity of the operations involved. He then employed the metaphor to draw home his point when he said: “There are so many trees that the view of the forest is obscured (Federal Commissioner of Taxation v Newton).

Furthermore, commenting on the benefit derived from the five transactions involved in the case, his Lordship sarcastically said: “The sands of the Lydian river were indeed gold, but there was no gold which did not come from the profits of the motor companies... (Federal Commissioner of Taxation v Newton) Therefore, the use of the metaphor has become an acceptable analogical means of explaining legal related issues. However, in Berkey v Third Ave Railway Co, Cardozo J warned that “metaphors in law are to be narrowly watched, for starting as devices to liberate thought; they end often by enslaving it (Berkey v Third Ave Railway Co). Nevertheless, it may be difficult to deny their use in figure of speech as it enriches the language of the law and underlines the inherent value of uncertainty it brings along.

Although it may be argued that the complex nature of revenue law is largely attributable to tax uncertainty, such uncertainty is said to be in part an inevitable feature of language (Pagone, 2009). Words are frequently capable of many meanings, some of which were not, or at least may not have been intended when used is a particular context (Pagone, 2009). For instance, an issue raised in Bourne v Norwich Crematorium Limited, was whether the cremation of human remains were goods and materials subjected to a process. In the judgment of Stamp J “it would be a distortion of the English Language to describe the living or the dead as goods or material... one must construe a word or phrase in a section of an Act of Parliament with all the assistance one can derive from decided cases and, if you will, from the dictionary, is not in doubt; but having obtained all that assistance, one must not at the end of the day distort that which has to be construed and give it a meaning which in its context one would not think it can possibly bear... (Bourne v Norwich Crematorium Limited). Furthermore, in Federal Commissioner of Taxation v Newton, Taylor J held that: “The facts under review are of a complicated
nature, but the principal difficulty in the case arises from the circumstances that the section referred to is
couched in language which does little to reveal the intention of the legislature with any real degree of precision
(Federal Commissioner of Taxation v Newton).

When the case went on appeal to Privy Council, Lord Denning who delivered the judgment of the court
seemed to contradict himself when at a point he said: “It would be useless for the commissioner to avoid the
arrangement and leave the transactions still standing... ( Newton v Federal Commissioner of Taxation)" At
another point in the same judgment, he said: “It is quite clear that nothing is avoided as between the parties but
only against the commissioner. As against him the arrangement is ‘absolutely void’ in so far as it has the
purpose or effect of avoiding tax. This is not a very precise use of the words ‘absolutely void’. Ordinarily if a
transaction is absolutely void, it is void against the entire world. In this case what is meant is that the
commissioner is entitled completely to disregard the arrangement and ensuing transactions – so far as they have
the purpose or effect of avoiding tax (Newton v Federal Commissioner of Taxation).

The essence of this contradiction underlines the difficulty in interpretation of language as used in the
legislation by the legislators, which ultimately sheds light on the causes of uncertainty in law.

As remarked in a legal dispute involving Trade Practice Commission, on the inherent ambiguity in
language, we may also add determined obfuscation, nurtured by self interest or institutional objective
(Pyneboard Pty Ltd v Trade Commission and Bannerman) which, to a large extent, account for the distortion
of law, to achieve target goals.

Consequently, we may claim that another cause of tax uncertainty is a mismatch between the underlying
objectives expressed in the statutes and the potentially distorting tools used by lawyers to determine the meaning
of the words used and their application (Pagone, 2009). Such mismatch is seen in many contexts in tax law and
can be attributed to the fact that the tools used by the law to discern or apply meaning to words may not reflect
the non lawyer’s intention or meaning when the words were used or adopted (Pagone, 2009). For a better
illustration of this view, again, let’s take a look at the distinction between the capital and income on which most
of the common law jurisdictions’ system of income taxation seems to depend.

Whether a receipt has the character of income or capital should be an issue of common sense based on the
assumption that the character is obvious enough to note or discern; also the legal stand is likely to recognise the
economic or accounting outcome which the statutory language is intended to express; but it is not always the
case due to the fact that the lawyer’s tools to determine the character of capital or income are different from that
of an accountant or an economist. For instance, in Federal Commissioner of Taxation v Newton, the trial judge,
Kitto J held: “To remove from a case an existing reason for holding a receipt to be a capital nature is one thing;
to find in what is left of the circumstances a sufficient reason for holding the receipt to be of an income nature is
quite another. The first is within the competence of a statutory provision... but the second is not... (Federal
Commissioner of Taxation v Newton)" This case underlines the challenges confronting the courts in determining
whether a receipt should be treated as income or capital in nature while using legal prism to analyse complex
transactions. “It is a truism that the nature of a receipt is not determined by the nature of the fund out of which
the money received is taken (Federal Commissioner of Taxation v Newton).”

Looking at issue from this perspective, the courts have held in many instances that income and allowable
deductions are matters of legal analysis rather than being determined by accountant or economist,
notwithstanding that the legal measure adopted in the statute might be thought to have been the expressions of
the accounting or economic concept by reference to which profit and loss was traditionally measured by
ordinary concepts (The Commissioner of Taxes (South Australia) v The Executor Trustee and Agency Co of
South Australia Ltd).

Conclusion:

It is therefore important that we begin to recognise the unacknowledged value of uncertainty but this should
not erase the sense in the argument of those canvassing for law to be certain in terms of its formulation,
application and interpretation. Uncertainty and the application of wide discretionary powers to determination of
legal questions, more so in revenue law, is necessary but as Davis has argued such powers,” should be
structured, confined, reviewable (Davis, 1979) and of course predictable, as laws tend towards tyranny when
they are not predictable (Pagone, 2009).

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