

# *A conceptual map of tax rule change*

---

Professor Lynne Oats\* and Professor Pauline Sadler\*\*

## **Abstract**

*The purpose of this paper is to present a conceptual map to assist tax scholars in framing their analyses of tax rule change. The map is developed in two stages; the first identifies the various factors that bring pressure to bear on the tax system to initiate rule change. The second stage observes the subsequent effect of change, or a failure to change, in terms of taxpayer response, which in turn becomes a further pressure for more change. The map is illustrated using two vignettes from different periods in time, and it is hoped that it will inspire tax scholars, from whatever disciplinary background, to embrace the complexity and hidden depths of tax as a field of enquiry.*

\* Lynne Oats is Professor of Taxation and Accounting, University of Exeter, UK.

\*\* Pauline Sadler is Professor of Information Law, Curtin University of Technology.

This paper was accepted for publication on 10 April 2011.

## 1 Introduction

The purpose of this paper is to present a conceptual map to aid our understanding of the forces at work in shaping the direction and nature of tax rule changes, and the consequences flowing from such changes (or failure to change) in response to pressure. It is not intended to be a rigid model, but rather a tool for evaluating individual rule changes in a contextualised manner; looking at the 'big picture'. McKerchar<sup>1</sup> observes that such maps are useful as part of the process of identifying research problems and for identifying relationships and linkages.<sup>2</sup>

The map of tax rule change is developed in two stages. In the first stage, pressures for change (or no change) are identified and examined. Understanding the forces at work in eliciting changes to the tax rules is an important part of uncovering the inherent power relationships. Their identification allows us to probe taken for granted assumptions about why change occurs, and to begin to understand the complexities of tax rule change, so often overlooked by policy makers. In the second stage, the outcomes of change are considered. In particular, close attention is paid to the outcomes expected by those designing the actual rules by which the policy change is enacted and the ways in which taxpayers are anticipated to behave in response to the change. It is inevitable, but not always acknowledged, however, that taxpayers will behave in unexpected ways. Contrary to rational actor models, that posit rational calculation on the part of taxpayers which is then amenable to economic analysis and forecasting, taxpayers often respond to changes in the tax rules in an apparently irrational manner, and the better this is understood by policy makers, the more innovative policy decisions can be.

The application of the conceptual map is demonstrated using two vignettes. The first of these concerns the introduction of a new tax in England in 1712 and subsequent developments in its operation. The second is a controversial rule change that occurred in the UK in 2000, which is currently subject to calls for abolition. These two vignettes demonstrate the robustness of the map in providing a platform for analysing tax changes across time.

The paper proceeds as follows. In the next section, the first part of the map is revealed; specifically the identification and analysis of the generic factors that create pressure for tax rule change. This is then used to help understand the conditions leading up to the two rule changes presented in the vignettes. The following section extends the

---

<sup>1</sup> McKerchar, Margaret, *Design and Conduct of Research in Tax, Law and Accounting* (2010), 46.

<sup>2</sup> Also referred to as 'learning maps, or 'mind maps', they allow the researcher to visualise ideas and evaluate the scale and scope of a research project, drawing on right brain thinking. See, for example Quinton, Sarah and Smallbone Teresa, 'Generating, Developing and Mapping Ideas for Research Topics' in Quinton, Sarah and Smallbone Teresa (eds) *Postgraduate Research in Business* (2006), 28-43. The map developed in this paper has also been successfully used by one of the authors as a pedagogical tool in the classroom, particularly when students are invited to contribute to building the left hand side of the map.

map into its second stage, considering the responses to the changes made and the feedback loop thereby created. The vignettes are once again deployed to illustrate the application of the map in practice.

## 2 Conceptual Map Part I: Factors creating pressure for tax rule change

The first stage of the map entails identifying factors that create pressure for a change to the tax rules. What follows is by no means an exhaustive list, and each factor is only given cursory treatment. There is a vast array of tax scholarship that can be found scattered across a variety of disciplinary literatures, and this paper does not attempt in any way to offer an exhaustive analysis. Rather, admittedly eclectic examples are selected based on our own reading, and apologies are extended in advance to readers whose work has been omitted. Many of the examples given emanate from the UK, but readers in other jurisdictions should have no difficulty in imagining examples from their own tax systems; the nature of the conceptual map is such that it transcends jurisdictional boundaries.

It would obviously be possible to conceptualise different headings, different categorisations and a different order of explication, but the important point to note is that all the factors are intertwined and interdependent. Each of the nine factors presented here exerts a pressure for change, or for no change. Not all of the factors exert an equal force, nor do they operate in the same direction; indeed they may pull against one another leading to unsatisfactory compromises. Nested beneath these factors may well be second or even third order influences. The map should be viewed as being fluid and dynamic, and allowing for both synchronic (at one moment in time) or diachronic (across time) analyses.

### Changing economic conditions

The use of the tax system to moderate the economic environment is well documented, and does not need to be further rehearsed here. For example, the current recession creates pressure to use the tax system for corrective action as well as for revenue raising. In the UK, the onset of the recession caused the government to respond, *inter alia*, by legislating a temporary reduction in the rate of value added tax (VAT) from 17.5 per cent to 15 per cent for the period from 1 December 2008 to 31 December 2009 in the hope of stimulating spending.<sup>3</sup> This was later increased to 20%<sup>4</sup> by the

---

3 For a discussion of the role of taxation in intensifying the severity of the recession, see Keen, Michael, Klemm, Alexander and Perry, Victoria, 'Tax and the Crisis' (2010) 31(1) *Fiscal Studies* 43-79.

4 With effect from 5 January 2011.

new coalition government<sup>5</sup> to help plug the huge deficit inherited from the previous government.

Another factor, nested within this broader concept, is the impact of military activity, not only on government revenue requirements, but also on taxpayer willingness to increase their fiscal contributions. Feldman and Slemrod,<sup>6</sup> for example, explore the relationship between voluntary compliance and the presence of military threats across several countries over a period of time using regression analysis, and conclude that many taxpayers show more positive attitudes to compliance during times of conflict, which means the social cost of raising taxes at such times may be reduced.

## **Political objectives**

Tax is a creature of politics.<sup>7</sup> Politicians want to ‘make a difference’; to ‘make their mark’ in all areas of social life, and tax is no different. Yet, as Covaleski et al<sup>8</sup> observe, in their study of the emergence of a US state tax incremental finance programme, the politics of tax legislation is often neglected in tax policy literature. Shaviro<sup>9</sup> notes that ‘fiscal language has a dual character. It is both a purportedly objective descriptive tool, and a weapon of political combat. Its use as a political weapon, however, is parasitic on its claim to offer objective description’. Heij,<sup>10</sup> by reference to her study of tax reform in Asian countries in particular, highlights the symbolic use of tax laws, observing that sometimes changes are symbolic in that, for example, the formal burden of taxes may change but without significant change in the real tax burden.

Under this category could be included the creation of government-appointed committees of enquiry, whose reports litter Australian tax history, the most recent, of course, being the Henry review.<sup>11</sup> Another example is the recent appointment by the incoming coalition government in the UK of an ‘Office for Tax Simplification’,<sup>12</sup> ‘to

5 The coalition between the Conservatives and the Liberal Democrats took office in June 2010, ousting the former Labour government that had held power in the UK for the previous 13 years.

6 Feldman, Naomi and Slemrod, Joel, ‘War and Taxation: When Does Patriotism Overcome the Free-rider Impulse?’ in Martin, Isaac William, Mehrotra, Ajay K. and Prasad, Monica (eds), *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective* (2009) 138.

7 Radaelli, Claudio M., ‘Taxation Research as Political Science Research’ in Lamb, Margaret, Lymer, Andy, Freedman, Judith and James, Simon (eds), *Taxation: An Interdisciplinary Approach to Research* (2005) 85-103.

8 Covaleski, Mark A., Dirsmith, Mark W. and Mantzke, Katrina L., ‘Institutional destabilisation and the new public management: the case of tax incremental financing’ (2005) 1(2) *International Journal of Public Policy* 122 – 147.

9 Shaviro, Daniel N., ‘Rethinking Tax Expenditures and Fiscal Language’ (2004) 57 *Tax Law Review* 187-231, 191

10 Heij, Gitte, (2007) *Who pulls the strings*, Unpublished PhD thesis, University of Groningen, the Netherlands.

11 Commonwealth of Australia, *Australia’s Future Tax System* (‘Henry Review’) 2010. See also Evans, Chris and Krever, Richard, ‘Tax Reviews in Australia: Before and After Henry’ (2009) *British Tax Review* 339.

12 See <<http://www.hm-treasury.gov.uk/ots.htm>>.

provide the Government with independent advice on simplifying the UK tax system. The committee is ‘an independent Office of the Treasury... and draws together expertise from across the tax and legal professions, the business community and other interested parties.’

In considering political agenda in the context of tax policy formulation, however, inertia should not be forgotten as a counterbalance to the desire for change. Rose and Karran<sup>13</sup> posit that inertia is a powerful force for resisting change; as governments inherit a tax system that works (albeit imperfectly), there is pressure to leave it alone: why change the rules and risk voter dissatisfaction? In institutional theory, this notion is captured by the concept of path dependency. Marriott,<sup>14</sup> by reference to Peters,<sup>15</sup> explains that ‘the theory behind path dependency is that policy choices made when an institution is being formed or when a policy is initiated, will have a continuing or constraining influence over the policy into the future.’ In other words, an old tax is a good tax.<sup>16</sup>

### Judicial pronouncements

Most obviously in common law jurisdictions, the role of the courts in shaping the practical application of the tax system is of paramount importance. This does not only mean specific decisions but also obiter dicta. Furthermore, the changing attitudes of the courts, and concomitant evolution of statutory interpretation can exert significant pressure on tax rules.<sup>17</sup> Governments respond to decisions adverse to revenue authorities by modifying the rules. Taxpayers respond to decisions in favour of the revenue authorities by modifying their activities, creating a ‘cat and mouse’ game.<sup>18</sup>

James<sup>19</sup> explores the exercise of power, drawing on Lukes<sup>20</sup> in an analysis of UK tax cases, concluding that current trends towards principle based drafting of tax legislation confers even more power on the judiciary and alters the relationship

13 Rose, Richard and Karran, Terence, *Taxation By Political Inertia* (1986).

14 Marriott, Lisa, ‘Power and Ideas: the development of retirement savings taxation in Australasia’ (2010) 21 *Critical Perspectives on Accounting* 597-610.

15 Peters, B. Guy, *Institutional Theory in Political Science: The New Institutionalism* (2005).

16 See also Steinmo, Sven, *Tax and Democracy* (1993).

17 For a study of judicial decision-making in the US, see Schneider, Daniel M., ‘Using the Social Background Model to Explore Who Wins Federal Appellate Tax Decisions: Do Less Traditional Judges Favor the Taxpayer?’ in Infanti, Anthony C. and Crawford, Bridget J. (eds), *Critical Tax Theory: An Introduction* (2009) 82; Schneider’s work was originally published in (2006) 25 *Virginia Tax Review* 201-250.

18 McBarnet Doreen and Whelan, Christopher, ‘The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control’ (1991) 54 *Modern Law Review* 848-873; Braithwaite, Valerie and Braithwaite, John, ‘Democratic Sentiment and Cyclical Markets in Vice’ (2006) 46(6) *British Journal of Criminology* 1110-1127. See also Picciotto, Sol, ‘Constructing Compliance: Game Playing, Tax Law and the Regulatory State’ (2007) 29(1) *Law and Policy* 11-30.

19 James, Malcolm, ‘Humpty Dumpty’s guide to tax law: Rules, principles and certainty in taxation’ (2010) 21 *Critical Perspectives on Accounting* 573-583.

20 Lukes, Steven, *Power: A Radical View* (2005).

between taxpayer and state, and therefore should be approached with some caution.<sup>21</sup> Edgley,<sup>22</sup> in a critical analysis of judicial decision making in the UK, reminds us of the potential for a relationship between the 'power of the voice that delivers the argument and wealth', suggesting that judges may never be called upon to consider imbalances that arise due to institutionalised inequalities. Litigation is theoretically available to all, but in reality constrained by availability of resources.

Nested within this factor is the language in which tax rules are formally encased, as alluded to by Shaviro above. In regard to its interpretation, Philipps<sup>23</sup> sees tax law as a specialised field of knowledge that confers power through construction of technical discourses as 'scientific', aided and abetted by the disciplines of economics and accounting and their concomitant claims to be scientific, the former perhaps more so than the latter. Through an analysis of two Canadian cases, she demonstrates that the presentation of tax rules as scientific can have the effect of delegitimising value based critiques of tax policy.

In addition to changes in rules necessitating new legislation, a number of jurisdictions have undertaken simplification projects to rewrite legislation into clearer language. Salter,<sup>24</sup> in a review of the outcomes of the tax law rewrite process in the UK, discusses the potential difficulties facing the courts in their deliberations over rewritten legislation in that it becomes more difficult to trace the history of provisions to discern parliamentary intent as part of the interpretive process.

### **Social/cultural attitudinal changes**

The tax system is also a reflection of the social and cultural attitudes prevailing in the country in which it operates. Nerré<sup>25</sup> links 'tax culture' to national culture,<sup>26</sup> the latter being a collective mental model that is in a constant state of flux, so that it can be defined by reference to the tax tradition (for example preferences for direct or indirect

21 See also Freedman, Judith, 'Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited (2010) 6 *British Tax Review* 717-736.

22 Edgley, Carla, 'Backstage in a Legal Theatre: A Foucauldian interpretation of 'Rationes Decidendi' on the question of taxable business profits' (2010) 21 *Critical Perspectives on Accounting* 560-572, 571.

23 Philipps, Lisa, 'Discursive Deficits: A Feminist Perspective on the Power of Technical Knowledge in Fiscal Law and Policy' in Infant and Crawford, above n17, 46; Philipps' work was originally published in (1996) *Canadian Journal of Law and Society*, 11, 141.

24 Salter, David, 'The Tax Law Rewrite in the United Kingdom: Plus Ça Change C'est La Même Chose' (2010) *British Tax Review* 671-687.

25 Nerré, Birger, 'Tax Culture: A Basic Concept for Tax Politics' (2008) 38(1) *Economic Analysis & Policy* 153-167.

26 'Culture' is a problematic concept and is used differently in different disciplines. Some interesting work draws on Geert Hofstede's (1980) cultural framework to try to understand national differences, for example Tsakumis, George T., Curatola, Anthony and Porcano, Tom, 'The relation between national cultural dimensions and tax evasion' (2007) 16 *Journal of International Accounting, Auditing and Taxation* 131-147.

taxes) together with ‘the interaction of the actors and cultural values like “honesty”, “justice” or also a “sense of duty”’.<sup>27</sup> Specifically, Nerré<sup>28</sup> defines a country specific tax culture as ‘the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution, which are historically embedded within the country’s culture including the dependencies and ties caused by their ongoing interaction’. Because of the dynamic nature of national culture, and therefore tax culture, the practical details of any given tax system should arguably be constantly readjusted to reflect prevailing cultural, and social, norms.<sup>29</sup>

There are potentially many strands and layers in this category. For the purposes of this paper, we confine ourselves to two. The first relates to the ways in which the tax system needs to be adapted in the face of changing societies. This can be in demographic terms, for example the rise and rise of multiculturalism. A number of US tax scholars<sup>30</sup> have expressed concern about the way in which US law in practice discriminates against people of colour, for example, calling for closer attention to the hidden biases in existing tax legislation. But it can also be in relation to shifts in other aspects of social life. An example of this is changing views about same sex relationships being treated (for tax purposes) in the same way as marriage. In the UK recently civil partnerships were put on a par with married couples in terms of receiving tax benefits, but in the US, for example, this issue has not been resolved and there are even calls for ‘guerrilla warfare’<sup>31</sup> against the tax rules that discriminate on the basis of sexual orientation.

The second strand is tax morale<sup>32</sup> which generally refers to willingness to pay taxes, or attitudes towards compliance with the tax rules, and which also fluctuate over time. As Braithwaite’s<sup>33</sup> study of aggressive tax planning (to use the US terminology) in the US and Australia shows, propensity to tax avoidance is cyclical, a view echoed by

<sup>27</sup> Nerré, above n25, 155.

<sup>28</sup> Nerré, above n25, 155.

<sup>29</sup> See also Rawlings, Gregory, ‘Cultural Narratives of Taxation and Citizenship: Fairness, Groups and Globalisation’ (2003) (38) *Australian Journal of Social Issues* 269.

<sup>30</sup> Some of the contributions to Infanti & Crawford, above n17, deal with this issue, for example Brown, Dorothy A., ‘Racial Equality in the Twenty First Century: What’s Tax Policy Got to do with it?’ 42; Abreu, Alice G., ‘Tax Counts: Bringing Money-Law to LatCrit’ 109; Uy, Mylinh, ‘Tax and Race: the Impact on Asian Americans’ 130; Brennan, David A., ‘Race and Equality Across the Law School Curriculum: the Law of Tax Exemption’ 42; and Moran, Beverley I., and Whitford, William, ‘A Black Critique of the Internal Revenue Code’ 116.

<sup>31</sup> Infanti, Anthony C., ‘Homo Sacer, Homosexual: Some Thoughts on Waging Tax Guerrilla Warfare’ in Infanti and Crawford, above n17, 215; Infanti’s work was originally published in 2(7) *Unbound: Harvard Journal of the Legal Left* 27 (2006).

<sup>32</sup> See Torgler, Benno, *Tax Compliance and Tax Morale* (2007). For a review of the tax morale literature see Pope, Jeff and McKerchar, Margaret, ‘The Concept of Tax Morale and its Role in Tax Compliance Behaviour’, paper presented to the Tax Research Network Conference, Bangor, UK, 7-8 September 2010.

<sup>33</sup> Braithwaite, John, *Markets in Vice, Markets in Virtue* (2005).

McBarnet & Whelan.<sup>34</sup> Times at which aggressive tax planning is high correlate with low tax morale, and require rule adjustment to tighten things up, usually creating more rules that become more ‘material to be worked on’<sup>35</sup> by taxpayers intent on avoiding taxes.

## International developments

Tax systems do not operate in isolation from those in other jurisdictions, indeed the interactions between different sets of rules is becoming increasingly important in a globalised world. Here we consider three elements, without claiming exhaustive coverage. Firstly, every jurisdiction needs to stay ‘in step’ with developments in comparable jurisdictions and keep a watchful eye on changes in rules and procedures elsewhere. In this respect, tax rules across the globe demonstrate evidence of mimetic isomorphism.<sup>36</sup> Sandford’s seminal work<sup>37</sup> seeks to explain how tax systems develop differently across the world, although as Peters<sup>38</sup> notes, Sandford’s analysis omits institutional features, giving primacy instead to economic considerations. Nonetheless, this is evidence that isomorphism is constrained by inertia and path dependency. Related to this, using the example of black lists of tax havens being copied from jurisdiction to jurisdiction, Sharman<sup>39</sup> discusses policy transfer more broadly. He observes the dysfunctional way in which it operates, perpetuating errors and representing a ‘tempting way of cutting corners for over-committed policy makers facing the incredibly complicated policy environment of [in this case] international taxation, and the pressure to “do something” to stop international tax evasion’. This pressure to ‘do something’ frequently comes from lobby groups, such as NGOs as discussed under the next heading.

Second, and related to the first element, are studies, pronouncements and best practice recommendations by supranational bodies such as the OECD, IMF, G20 and for European Union (EU) member states, the European Commission and European Court of Justice (ECJ). These serve to accelerate diffusion of policy ideas, in part through mere exposure. But these bodies also influence tax rule change in other ways; an epistemic community<sup>40</sup> of tax policy experts traverses the globe helpfully, and

<sup>34</sup> McBarnet and Whelan, above n18.

<sup>35</sup> McBarnet, Doreen ‘When Compliance is not the Solution but the Problem: From Changes in Law to Changes in Attitude’ in Braithwaite, Valerie *Taxing Democracy* (2003) 239.

<sup>36</sup> Powell, Walter W. and DiMaggio, Paul, *The New Institutionalism in Organizational Analysis* (1991).

<sup>37</sup> Sandford, Cedric, *Why Tax Systems Differ* (2000).

<sup>38</sup> Peters, B. Guy, Review of Sandford, Why Tax Systems Differ, (2001) 21(1) *Journal of Public Policy* 99-101.

<sup>39</sup> Sharman, Jason Campbell, ‘Dysfunctional Policy Transfer in National Tax Blacklists’ (2010) 23(4) *Governance: An International Journal of Policy, Administration and Institutions* 623-639, 625.

<sup>40</sup> Braithwaite, John and Drahos, Peter, *Global Business Regulation* (2000).

sometimes not so helpfully, suggesting reform strategies to other jurisdictions.<sup>41</sup> As an example of more direct impact, in the case of the European Union, decisions of the ECJ are increasingly causing member states to evaluate their own legislation and we are seeing more rule change as a consequence. As a result of the *Lankhorst*<sup>42</sup> decision in 2002, for example, which involved the efficacy of German thin capitalisation rules, a number of member states, including the UK, modified their transfer pricing rules to ensure consistent domestic and intra EU treatment.

Another interesting development in recent years has been the increasing cooperation between revenue authorities, such as the formation of the Joint International Tax Shelter Information Centre in 2004, which seems to be speeding up the process of transfer of ideas between jurisdictions referred to earlier.

Finally, we consider the impact of increased globalisation and capital mobility on taxpayer behaviour, most notably, but not confined to, corporate taxpayers and high net worth individuals, which requires rule adaptation to stem the loss of tax revenue. In the UK for example, the increasing tendency for corporate groups to shift operations to other jurisdictions has led to a significant policy shift towards a territorial system, following a lengthy period of worldwide taxation.

### **Lobby group activities**

Lobby groups are a constant and powerful force for initiating rule change to the benefit of specific parts of society, although not always acting in the interests of the greater good. The extent to which policy makers and legislators respond to lobby groups varies across time and space. This factor clearly links to political objectives and the strength, perhaps, of inertia in creating resistance to such pressures for change. In some jurisdictions, lobbying forms an overt part of the institutional framework for tax policy, most notably the US. Kingson<sup>43</sup> for example, examines how the American Jobs Creation Act of 2004 changed the mind-set in the US in relation to taxing international income and traces the shaping of the legislation with particular reference to the lobbying activities of large companies including Intel. In an Australian context, Eccleston<sup>44</sup> reflects on the rocky path to implementation of the GST, observing that the fragmentation of business interests made them less powerful as lobbyists, perhaps, than their US counterparts.

Apart from direct lobbying by business interests keen to secure benefits in any tax rule changes, we have recently seen an upsurge in pressure from NGOs for governments

<sup>41</sup> See Stewart, Miranda, 'Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries', in Infanti and Crawford, above n17, 354; Stewart's work was originally published in (2003) 44 *Harvard International Law Journal* 139.

<sup>42</sup> *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* C-324/00 (2002). More broadly on EU issues, see Miller, Angharad and Oats, Lynne, *Principles of International Taxation* (2009), Chapter 18.

<sup>43</sup> Kingson, Charles I., 'The Great American Jobs Act Caper' (2005) 58 *Tax Law Review* 327-380.

<sup>44</sup> Eccleston, Richard, 'Taxing Times: A Political Retrospective' (2002) 17 *Australian Tax Forum* 287-312.

to tackle tax evasion.<sup>45</sup> This latter form of lobbying is arguably a more subtle form of pressure, not necessarily demanding specific policy change, but certainly raising the profile of tax policy and requiring response from government, often in the form of increased enforcement activity which itself shines light on the efficacy of existing rules.

## **Revenue authorities**

The role of the revenue authorities themselves in initiating proposals for tax rule change should not be underestimated, and regulatory 'styles' vary between jurisdictions as demonstrated by Sakurai.<sup>46</sup> Administering the tax system is a complex process, and unfortunately policy makers often neglect to consider implementation issues. Administrative capacity (or lack thereof) acts as a constraint on tax rule change.<sup>47</sup>

On the other hand, the administrators become aware of 'sticking points' and difficult issues, and may themselves initiate proposals for change in the interests of improving the workability of the tax rules. Revenue authorities in particular have concerns about tax avoidance activity, a form of non-compliance that is difficult and costly to manage given the uncertainties that surround its definition and resolution.

Nested beneath considerations of how the tax system is administered are factors such as technological change.<sup>48</sup> Technological advancements have allowed both revenue authorities and those they seek to regulate to modify their practices, ostensibly in the interests of efficiency, but in the case of taxpayers sometimes also with the aim of minimising tax liabilities. This has led to debates, for example, about the implications for taxing new forms of business such as electronic commerce.<sup>49</sup>

## **Tax practitioners**

Tax practitioners or agents, acting on behalf of taxpayers and intimately concerned with the precise formulation of tax rules, are obviously concerned with how the tax rules operate in practice. They have vested interests that are sometimes difficult to pinpoint,

45 For example, Oxfam, 'Tax Havens: Releasing the Hidden Billions for Poverty Eradication' briefing paper (2000) <[http://publications.oxfam.org.uk/display.asp?k=002P0036&sf1=sort\\_stries&st1=OXFAMBRIEFINGPAPERS&m=13&dc=448](http://publications.oxfam.org.uk/display.asp?k=002P0036&sf1=sort_stries&st1=OXFAMBRIEFINGPAPERS&m=13&dc=448)> 01 December 2010.

46 Sakurai, Yuka, 'Comparing cross-cultural regulatory styles and processes in dealing with transfer pricing' (2002) 29 *International Journal of the Sociology of Law* 173-199.

47 Bird, Richard M., 'Administrative Dimensions of Tax Reform' (2004) *Asia Pacific Tax Bulletin* 134-150.

48 We are grateful to one of the anonymous referees for pointing this out, although admittedly not under this heading.

49 See, for example, Basu, Subhajit, *Global Perspectives on E-Commerce Taxation Law* (2007); Pinto, Dale, *E-Commerce and source based income taxation* (2003).

and vary depending on demographics of their client base.<sup>50</sup> The recent OECD<sup>51</sup> study into the role of tax intermediaries, as an output of the Seoul Declaration,<sup>52</sup> highlights more nuanced understandings of tax planning in practice and shows a desire to better understand their role, in relation to large corporate taxpayers and allegedly aggressive tax avoidance. Sikka & Hampton<sup>53</sup> paint a depressing picture of tax agents, particularly large multinational professional accounting firms, as undermining the future of democracy in their pursuit of profits peddling tax avoidance schemes. This of course harks back to a different point of the cycle to which we referred earlier and arguably does not reflect the current reality of tax planning practices. Braithwaite<sup>54</sup> suggests that tax practitioners who offer ways of avoiding tax while also being 'indifferent to the powers of authority' are practicing dismissive defiance, threatening the legitimacy of the tax system.

Not all tax practitioners are accountants, however, and the balance between tax work performed by accountants and lawyers will vary from country to country. In the US, the tax shelter debate has drawn attention to the role of the tax bar. Rostain,<sup>55</sup> for example, argues that a particular ideology permeates the bar's position such that they are bound together to preserve the integrity of the tax system. Schizer<sup>56</sup> suggests enlisting the help of the tax bar in combating aggressive tax planning. The movement of tax professionals between government and private practice introduces another dynamic here, as discussed by Borkowski<sup>57</sup> in the context of US transfer pricing practice.

In the UK there is no formal system of registration of tax agents, and Her Majesty's Revenue and Customs (HMRC) have recently been investigating their role and seeking ways to enhance relationships with the professional tax agent community and its various representative bodies.<sup>58</sup> There is an emerging culture of consultation in UK tax policy development and tax intermediaries play an important role, as they do in other jurisdictions.

---

50 Sakurai, Yuka and Braithwaite, Valerie, 'Taxpayers' Perceptions of Practitioners: Finding One Who is Effective and Does the Right Thing?' (2003) 46(4) *Journal of Business Ethics* 375-387.

51 OECD, 'Study into the Role of Tax Intermediaries' (2008) available at <<http://www.oecd.org/dataoecd/28/34/39882938.pdf>> 01 December 2010.

52 The Seoul Declaration was developed in 2006 to address the OECD's Forum on Tax Administration's concerns about international tax avoidance.

53 Sikka, Prem and Hampton, Mark P., 'The role of accountancy firms in tax avoidance: Some evidence and issues' (2005) 29 *Accounting Forum* 325-343.

54 Braithwaite, Valerie, *Defiance in taxation and Governance* (2009).

55 Rostain, Tanina, 'Sheltering Lawyers: The Organised Tax Bar and the Tax Shelter Industry' (2006) 23 *Yale Journal on Regulation* 77-120.

56 Schizer, David M., 'Enlisting the Tax Bar' (2006) 59 *Tax Law Review* 331 – 387.

57 Borkowski, Susan C., (2005) 'Turnover in Transfer Pricing Management: Revolving Door or Opportunity for Expertise' 31 *International Tax Journal* 17-30.

58 The 2009 HMRC Consultation Document *Working with Tax Agents* can be found at <<http://www.hmrc.gov.uk/budget2009/tax-agent-6440.pdf>>.

## The media

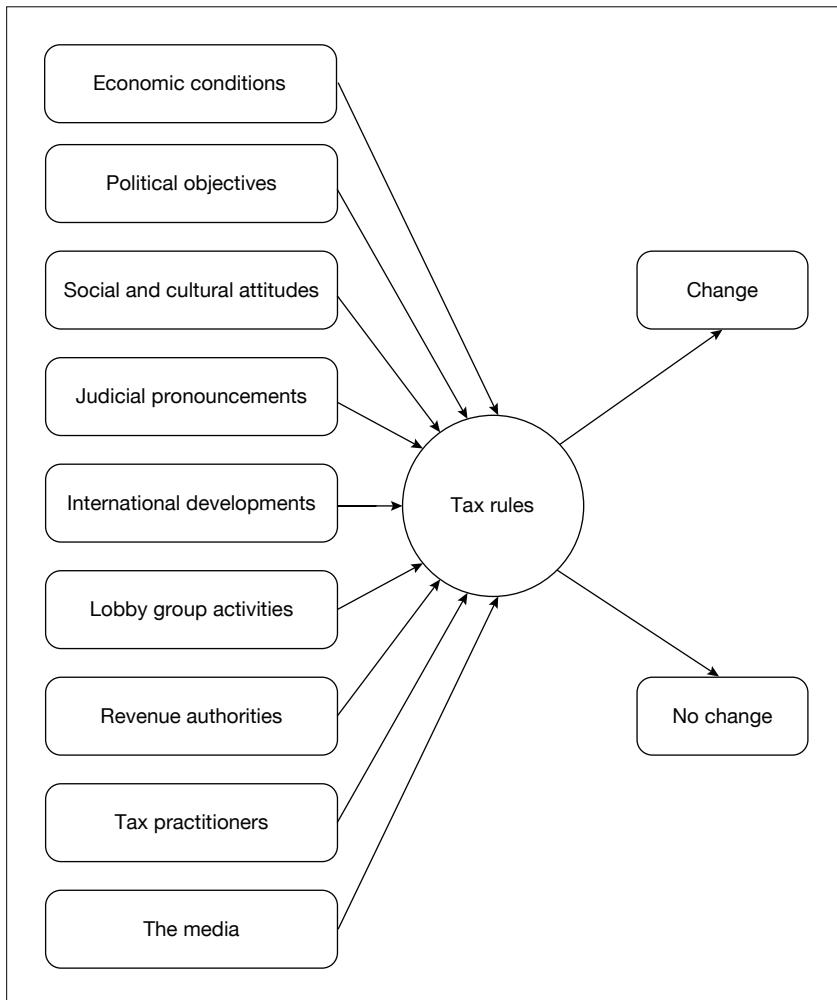
The media are influential in initiating and fuelling debates about specific issues,<sup>59</sup> but as non-experts (on the whole) in relation to the intricacies of the workings of the tax system, they are vulnerable to lobby group interests and polemic. This is evidenced in the UK by *The Guardian* newspaper campaign on tax avoidance by multinational corporations.<sup>60</sup>

In a historical study, Jones discusses the role of the media in influencing the shape of tax policy in the context of the introduction of joint filing in the US for married couples in 1948. She notes in particular that 'newspaper and magazine columnists, editorial writers, and citizens writing to senators and to local papers are individuals who also impact upon tax law, yet are often ignored in legal scholarship. The writings of these people make it clear that these tax-law decisions are cultural artefacts – understood as part of a larger societal structure, and simultaneously, revealing that culture... for historians and legal scholars, the challenge is to expose and analyse that connection'.<sup>61</sup> Kornhauser<sup>62</sup> similarly examines debates around progressive tax rates in the US, noting the dual role of the popular press and political rhetoric.

The influence of these various factors on policy makers' decisions on whether or not to change the tax rules can be diagrammatically represented as follows:

- 
- 59 See, for example, Bougen, Philip D., Young, Joni J. and Cahill, Edward, 'Accountants and the Everyday: Or What the Papers Said about the Irish Accountant and Tax Evasion' (1999) 8(3) *European Accounting Review* 443-461.
- 60 See <<http://www.guardian.co.uk/business/series/tax-gap>> 01 December 2010.
- 61 Jones, Carolyn C., 'Split Income and Separate Spheres' in Infanti and Crawford, above n17, 22; Jones' work was originally published in (1988) 6(2) *Law and History Review* 259-310, 296.
- 62 Kornhauser, Marjorie E., 'The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction' in Infanti and Crawford, above n17, 28; Kornhauser's work was originally published in (1987-8) 86 *Michigan Law Review* 465.

**Figure 1: Influences on tax policy/rules**



The factors are brought to bear on the particular problem being considered and a decision is then taken as to whether or not to change the rules, or to allow inertia to hold sway and refrain from making change. Depending on the issue being considered, the relative weightings and counterbalancing of the factors will differ. To demonstrate the efficacy of this first part of the conceptual map, the following two vignettes are presented.

### 3 Vignette 1: The 18<sup>th</sup> century newspaper stamp

The first vignette concerns the introduction, in 1712, of a tax on newspapers in England. This was by way of a stamp duty such that the paper on which newspapers were printed had to be pre-stamped at the Stamp Office. The emergence of the newspaper stamp duty occurred in a period of significant transition, with a number of contextual factors converging to put pressure for change on tax policy. These included the creation of the national debt, which was accompanied by the need to raise additional revenue to fund military activity,<sup>63</sup> changes in tax policy, the emergence of party politics and the freedom of the press from government restriction.<sup>64</sup>

The national debt first appeared under King William III, and once established, its continued funding became a major concern of government. Under Queen Anne,<sup>65</sup> the first steps to raise funds for the war entailed an increase in the rates of land tax (the only direct tax in operation at the time) and an excise on malt, mum (a form of beer), cider and perry. Additional subsidies and port duties followed.<sup>66</sup> In need of still further revenue, a tax on leather was re-introduced (one had been in place between 1697 and 1700). In addition, a tax on hops was introduced, the first time a tax had been imposed on the grower of the article being taxed. In 1711-12 a number of taxes previously imposed during the Interregnum were revived, including duties on soap, starch, gilt and silver wire. These changes in tax policy marked a shift towards increased use of taxes on consumption that would continue throughout the 18<sup>th</sup> century.

From 1706, a gradual transformation took place in the complexion of Parliament and in 1708 the administration became essentially Whig. In 1710 a general election saw the Whigs defeated and Parliament resume its Tory majority. In 1711 Robert Harley was made the Earl of Oxford and became both Lord of the Treasury and Chancellor of the Exchequer.

Censorship of the press in England, which had been effected by a statutory scheme of licencing, ceased when the relevant legislation lapsed in 1695.<sup>67</sup> One result was an increase in the number of newspapers published.<sup>68</sup> Now unhindered by restrictions on what could be reported, the newspapers were able to facilitate criticism of the activities of both the government and the opposition. This was because they were able

<sup>63</sup> Exacerbated as a result of England's involvement in the war of Spanish Succession (1702-1713) which saw England and the Netherlands joined to support the claim of the Archduke Charles to the Spanish throne.

<sup>64</sup> Sadler, Pauline and Oats, Lynne, 'This Great Crisis in the Republick of Letters – The Introduction in 1712 of Stamp Duties on Newspapers and Pamphlets' (2002) 4 *British Tax Review* 353-366, 359-360.

<sup>65</sup> Queen Anne came to the throne in 1702 following the death of William III.

<sup>66</sup> For a discussion of the emergence and administration of the various taxes at this and other times up to the nineteenth century see Dowell, Stephen, *A History of Taxation and Taxes in England* (1884).

<sup>67</sup> Siebert, Frederick S., *Freedom of the Press in England 1476-1776* (1952), 261.

<sup>68</sup> Holmes, Geoffrey, *British Politics in the Age of Anne* (1967), 32.

to report the news and, for the first time without fear of legal retribution, comment on the news. Newspapers and pamphlets took full advantage of this freedom, and the publication of political rhetoric became both commonplace and popular.<sup>69</sup> As Porter notes, 'English men of letters ... formed part of an emergent culture industry, staking out self identities as critics, knowledge-managers and opinion makers, addressing a growing public and used as well as abused by the authorities'.<sup>70</sup>

In the late seventeenth and early eighteenth century this ability to have a major influence on the political sphere – by injecting opinion into press accounts of current events – was viewed with consternation by government and opposition alike who saw it as threatening political stability.<sup>71</sup> How to reimpose some form of control on the press, without going back to censorship which would have been political suicide now that newspapers could openly publish self serving propaganda, was an important factor in the background to the imposition of the newspaper stamp duty.

Around 1704, a proposal by an unknown author was put to the Treasury to increase the revenue of the Stamp Office. A seemingly careful examination of publication figures for the then existing newspapers was used to compute the possible revenue arising to the government from a penny stamp, estimated at £6,500 per annum. This document may well have been the progenitor of what ensued.<sup>72</sup> At the time it was not unusual for such proposals to be put to the government by private citizens and Brewer explains that many proposals for legislative change then originated outside government.<sup>73</sup> This was part of the separation of politics from the administration when the administration was not yet separated from society as it would be later in the century.<sup>74</sup>

It is thought that it was Henry St John (Viscount Bolingbroke), the Secretary of State, who was behind the imposition of stamp duties on newspapers, 'ostensibly as a means of increasing the revenue, but really as an unwise attempt to interfere with the liberty of the press'.<sup>75</sup> Rather than reverting to the blunt instrument of a prior restraint, an option preferred by some in the government, Robert Harley had instead prevailed

69 Holmes, above n68, 32; Pollard, Albert Frederick (ed), *Political Pamphlets* (1897), 10. Pollard includes two excellent examples from the period of Queen Anne's reign: John Arbuthnot's *The Art of Political Lying* (1712) and Richard Steele's *The Crisis* (1713). Pollard describes the eighteenth century as 'the golden age of pamphleteering' due in no small part to the abolition of licencing in 1695, 15-16.

70 Porter, Roy, *Enlightenment: Britain and the Creation of the Modern World* (2000), 73.

71 Holmes, above n68, 32.

72 The undated document is contained among a series of Treasury papers from 1710-1710 (NA T1/129). Sutherland has suggested that based on the specific newspapers listed in the proposal, it probably was written in 1704: Sutherland, James R., 'The Circulation of Newspapers and Literary Periodicals 1700-1730' (1934) 15 *Library* 110-124.

73 Brewer, John, *The Sinews of Power: War, Money and the English State 1688 - 1783* (1989), 231-249.

74 Brewer, above n73, Chapter 3.

75 Fox Bourne, Henry Richard, *English Newspapers: Chapters in the History of Journalism* Vol. I (1887), 80-81 (quote at 80); Siebert, above n67, 308.

upon the Tories to use the stamp duties for the dual purposes of raising much needed money while at the same time imposing some indirect limitation on the press.<sup>76</sup> This duality of purpose was quickly identified by Daniel Defoe who wrote in his periodical the *Review*: 'If such a Design goes on, it will soon appear whether it be a Proposal to raise Money, or a Design to crush and suppress the papers themselves ...'<sup>77</sup>

Although the notion of imposing a stamp duty on newspapers was a matter for speculation for some time, for example by Defoe,<sup>78</sup> the subject did not make its first formal appearance until 22 April 1712.<sup>79</sup> The prospect of a tax on newspapers alarmed not just the press, but also paper manufacturers who petitioned Parliament in 1712 with their concerns.<sup>80</sup> The petition observed there would be a reduction of income from the excise duty on paper, which was also to be imposed in the prospective legislation, because the number of publications generally would fall away. A second petition was an appeal by the Sun-Fire-Office, an insurer of houses and goods, to have their newspaper the *British Mercury* exempted from the tax.<sup>81</sup> These are clear examples of early lobbying by parties potentially affected by a change in tax policy, another factor influencing the adoption, and design, of tax rule change.

The stamp duties on newspapers came into effect on 1 August 1712.<sup>82</sup> Considering the first official mention of the duty was in April 1712, there was little time for comment, and it is noteworthy that the relevant Commons journals seemingly include no mention of what was said in Parliament about the introduction of such potentially contentious taxes.<sup>83</sup> It would be useful to know what discussion took place during Parliamentary debate on the matter and it is hard to conceive that the provisions

---

76 Sommerville, Charles John, *The News Revolution in England: Cultural Dynamics of Daily Information* (1996), 129.

77 Defoe, Daniel, *Review* (1710-1711), Preface to Volume VII; see also Thomas, Joseph M., 'Swift and the Stamp Act of 1712' (1916) 4(1) *Publications of the Modern Language Association of America* 258-263.

78 Defoe, above n77, Preface to Volume VII.

79 This occurred during a debate in Parliament on 'Ways & Means for raising supply granted to Her Majesty' and it was duly recorded in the Commons' journals of that day, *Commons' Journals* XVII, 196 (in Res 9. 10. 11. 12 of the debate). Fox Bourne describes the relevant sections as being 'smuggled' into the proposed legislation by the ministers: Fox Bourne, above n75, 81.

80 The petition said in part 'Because the prohibiting in this manner the Printing of so many *Sermons*, Small Books of *Devotion*, *Ballads*, *News-Papers*, and *Pamphlets*, as are Daily and chiefly making the Consumption of our *English White Papers*, must of Necessity ruin that Manufacture in this Kingdom, be an *Encouragement to the Dutch*, and the entire Destruction of many Hundreds of Families, such as *Paper-Makers*, *Stationers*, *Printers*, and *Booksellers*, besides many Thousands of other People that can get their Bread by no other Means, but by the Vending such Commodities.' Petition entitled 'Reasons Humbly Submitted to the Honourable House of Commons, against laying a Duty on News-Papers and Pamphlets' (1712) Goldsmiths'-Kress Library of Economic Literature (microfilm) 4928.1.

81 'The Case of the Members of the Sun-Fire-Office, London, relating to the Duties on News-Papers' (1712) Goldsmiths'-Kress Library of Economic Literature (microfilm) 4904.4.

82 By virtue of 10 Anne, c19, CIV, CV, CXI, CXVIII.

83 *Commons' Journals* XVII, 196 (in Res 9. 10. 11. 12 of the debate).

became law without any politicians asking questions about the purpose of the duties or making comment about the likely reaction. One of the most obvious reasons that can be discerned from contemporary (early 1700) sources was that the duties were to be a revenue raiser for Her Majesty, as was stated in the title of the Act.<sup>84</sup> Another reason was that the tax would also serve the purpose of reining in the press; since the lapse of the licencing system the behaviour of the press had become a cause of concern, as mentioned above.<sup>85</sup>

The provisions of the Act imposed the news stamp duty on 'all Books and Papers commonly called Pamphlets, and for and upon all News Papers, or Papers containing publick News, Intelligence or Occurrences, which shall ... be printed in Great Britain, to be dispersed and made publick, and upon ... Advertisements'. The amount for pamphlets and papers taking up to half a sheet was one halfpenny. For more than half a sheet but not more than one sheet the amount was one penny per copy. For more than one sheet but not more than six sheets in octavo or smaller size, twelve sheets in quarto, or twenty sheets in folio, the amount was two shillings for every sheet, but payable only on one copy of each issue.<sup>86</sup>

Parliamentary papers, school books and religious books were specifically excluded by the Act,<sup>87</sup> and there were a number of other exemptions including daily accounts or Bills of Goods imported or exported and the Weekly Bills of Mortality,<sup>88</sup> provided they contained no matters other than their usual subject.<sup>89</sup>

<sup>84</sup> An Act for laying several Duties upon all Sope and Paper made in *Great Britain*, or imported into fame; and upon chequered, and striped Linens imported; and upon certain Silks, Calicoes, Linens, and Stuffs, printed, painted or stained; and upon several Kinds of Stamp Vellum, Parchment, and Paper; and upon certain printed Papers, Pamphlets, and Advertisements; for raifing the Sum of eighteen hundred thoufand Pounds by way of Lottery towards her Majefty's Supply ...'

<sup>85</sup> This concern was expressed by Queen Anne herself, who said 'how great licence is taken in publishing false and scandalous Libels such as are a reproach to any government', to which the Commons replied 'We are very sensible how much the Liberty of the Press is abused, by turning it into such a licentiousness as is a just reproach to the nation; since not only false and scandalous libels are printed and published against your majesty's government, but the most horrid blasphemies against God and religion; and we beg leave humbly to assure your majesty, That we will do utmost to find out a remedy equal to this mischief, and that may effectually cure it' Cobbett, William, *Cobbett's Parliamentary History of England* Vol 6, col 1063 & 1065.

<sup>86</sup> 10 Anne, c19, CI.

<sup>87</sup> 10 Anne, c19, CII.

<sup>88</sup> The Weekly Bills of Mortality, which commenced in the early sixteenth century, were weekly publications listing the burials that had taken place in London. The purpose was to monitor the number of deaths as a sudden rise might indicate the onset of another outbreak of the bubonic plague. Later the bills came to provide additional information, including cause of death, age of the deceased and baptisms.

<sup>89</sup> The *London Gazette*, the official journal of record of the government, was not exempt and after 1 August 1712 copies 'bore the red handsome rose and thistle' of the halfpenny stamp or the lion of the one penny stamp. Handover PM, *History of The London Gazette 1665 - 1965* (1965), 46.

And so, even three hundred years ago, the pattern of tax rule change is clearly seen. A need for change arises. Economic conditions, specifically the need for revenue raising to fund military activity, puts pressure on government to seek new forms of taxation. At the same time, the government of the day is keen to suppress dissent made visible in small polemic publications. Politics therefore helps to shape the form of the new tax, as does the activities of lobby groups. The change, introduction of a new tax on newspapers, is designed to achieve two concurrent, but unrelated goals – revenue raising but also constraining the activities of the polemical press.

#### **4 Vignette 2: 21<sup>st</sup> century personal service companies**

The second vignette takes us into the 21<sup>st</sup> century, and is concerned with new rules introduced in the UK in 2000 to ‘combat’ perceived tax avoidance through the use of personal service companies.<sup>90</sup>

In common with many other jurisdictions, the UK income tax structure contains an imbalance that leads to a tax motivated incentive for incorporation. By channeling income earning activities through the corporate form, significant tax savings ensue vis-a-vis the derivation of taxable profit as either a sole trader, or as an employee. The other key relevant feature of the UK tax system is, also in common with other jurisdictions, the significant compliance costs for employers of having employees, as compared to engaging independent contractors, including the PAYE system as well as liability for national insurance contributions on behalf of employees.

The growing prevalence of personal service companies contributed to the Revenue’s<sup>91</sup> concern that tax motivated incorporation constituted tax avoidance. At the time, the new Labour government was putting pressure on the Revenue to increase the tax take and to stamp out tax avoidance. Thus pressure for change emanated from political pressure linked to ideological visions of the nature and prevalence of tax avoidance.

Proposals for change took the form of a press release from the Revenue, IR35, dated 9 March 1999 announcing the Revenue’s intention to consult with interested parties with respect to the practical application of new legislation. The new legislation would take effect from the commencement of the 2000/01 fiscal year. It appears therefore that pressure for this change also emanated from within the Revenue.

The stated aim of the proposed changes was ‘to ensure that people working in what is, in effect, disguised employment will, in practice, pay the same [income] tax and

90 This section draws heavily on Oats, Lynne and Sadler, Pauline, ‘Tax and the Labour Market: Taxing Personal Services Income in the UK’ (2008) *Journal of Applied Law & Policy* 59–79.

91 The UK revenue authority is currently Her Majesty’s Revenue and Customs (HMRC), however at the time of the introduction of these new rules, it was Inland Revenue. To avoid confusion, the neutral term ‘Revenue’ will be used throughout this part to encompass both incarnations of the department.

national insurance as someone employed directly.<sup>92</sup> It was announced that there was no intention to interfere with the existing boundary between employment and self-employment, and further that a 'primary concern is to minimise any impact of [the] changes on ordinary business not involved in avoidance'.<sup>93</sup>

Part of the motivation for the changes, it seems, was to ensure that measures in support of small and medium sized companies were properly targeted at 'genuine entrepreneurial activity'.<sup>94</sup> In terms of the scale of 'avoidance', the National Audit Office had estimated in 1981 that the result of the existence of 30,000 service companies was a loss of revenue of about £40 million. By 2000/01, this was now estimated to be between 90,000 and 120,000 companies with a revenue loss of some £350 million.<sup>95</sup>

In April 1999 a document entitled 'Summary of a Possible Approach' was issued by the Revenue<sup>96</sup> as a basis for discussion in which it was proposed that the new rules would apply where a worker performs services for a client under the supervision or control of the client and the services are provided under a contract between the client and an intermediary such as an interposed private company. The new rules would not apply where the services were provided as a part of an arrangement for the supply or materials and/or equipment, where the client is an individual, or where a specific exemption applied. A certification scheme would allow potential clients to determine whether the arrangement was one to which the new rules applied. The government, in its regulatory impact statement, indicated the rationale for this as being to allow the use of personal service companies if that is the industry norm, and make the choice of using an intermediary broadly tax neutral.<sup>97</sup>

The result of these proposed new rules would effectively be to ignore the interposed entity and require the client to deduct income tax and national insurance contributions in the same way as for ordinary employees. In the event of default it would be the client that would be held responsible, in the absence of appropriate certification testifying to exemption.

From April 1999, the Revenue distributed information packs and sought feedback from the public. By the end of August 1999 they had apparently sent out 1800 copies

<sup>92</sup> HM Revenue & Customs, 'IR35' (Press Release, 9 March 1999) <<http://www.hmrc.gov.uk/ir35/ir35.htm>> 05 January 2009.

<sup>93</sup> HM Revenue & Customs, 'IR35', above n92.

<sup>94</sup> HM Revenue & Customs, 'IR35', above n92.

<sup>95</sup> *The Queen & Commissioners of Inland Revenue ex parte (1) Professional Contractors Group Ltd (2) Ruud van Zundert (3) Square Mile Projects Ltd* [2001] EWHC Admin 236 (Burton J) (the 'PCG case') para 18.

<sup>96</sup> HM Revenue & Customs, 'Proposed New Rules on the Provision of Personal Services: Summary of a Possible Approach' (1999) <<http://www.hmrc.gov.uk/ir35/origsum.htm>> 05 January 2009.

<sup>97</sup> HM Revenue & Customs, 'Welfare Reform and Pension Bill: Regulatory Impact Assessment — National Insurance: Service Provision through Intermediaries' (Revised October 1999) 4 <<http://www.hmrc.gov.uk/ir35/ria.htm>> 05 January 2009.

of the information pack and held two meetings with 38 representative bodies. Over 1700 written comments and suggestions were received.<sup>98</sup>

Counter pressure for no change arose from a number of sources. The original proposals were not well received and a flurry of vociferous opposition to the measures ensued. Apart from the overall concerns about attacking this particular sector of the economy, a number of specific aspects of the proposals were heavily criticised. In particular, the certification scheme was 'denounced as being bureaucratic and burdensome'<sup>99</sup> and there was considerable concern that the crude control test would operate to bring people within the net who would otherwise have been classified as self-employed were it not for the intermediary. There were significant fears that the UK economy would be damaged by a collapse of the market for contract labour and by economic migration to more benevolent tax regimes such as the Netherlands.<sup>100</sup>

In the face of this opposition, fuelled by the media, the government announced revisions to the proposal so as to avoid 'unnecessary damage to the flexible labour markets where intermediaries are currently used'.<sup>101</sup> The revised approach was designed to narrow the scope of the new rules in the hope of targeting them more accurately to those who were in disguised employment arrangements. In terms of identifying those to whom the new rules would apply, the existing boundary between employment and self-employment would now be used in preference to the alternative test originally proposed. A major change of focus was the shift of responsibility for ensuring appropriate application of the new rules from the client to the intermediary itself which then obviated the need for a certification procedure.

As the legislation proceeded through Parliament, opposition to the measures in the House of Lords was couched in terms of damage to the evolving flexibility in the labour market countered by a commitment to tackling tax avoidance while not interfering with genuine entrepreneurial activity.

In summary, the rules intend to operate so that all money received by an intermediary in respect of a relevant engagement to which the rules apply, net of specified deductions, be treated as having been paid to the worker in the form of salary and wages subject to PAYE and NICs.<sup>102</sup>

<sup>98</sup> According to the Revenue website <[www.hmrc.gov.uk](http://www.hmrc.gov.uk)> 05 July 2001. Copy held by author.

<sup>99</sup> Redston, Anne, 'The Good the Bad and the Indifferent' (1999) 143 *Taxation* 667.

<sup>100</sup> Redston, above n99.

<sup>101</sup> According to Dawn Primarolo, then Paymaster General, quoted in HM Revenue & Customs, 'IR35: Countering Avoidance in the Provision of Personal Services' <<http://www.hmrc.gov.uk/ir35/jreview.htm>> 01 December 2010.

<sup>102</sup> The National Insurance rules were contained in the *Welfare Reform and Pensions Act 1999* (UK), ss 75 and 76 as implemented by the Social Security Contributions (Intermediaries) Regulations 2000 (UK). The income tax rules were contained in s 60 of and sch 12 to the *Finance Act 2000* (UK).

But even the revised proposals met with significant opposition. According to Redston '[t]he proposals were met by almost unanimous opposition, and were condemned as burdensome, disproportionate and damaging to the economy'.<sup>103</sup> Not surprisingly the loudest protestations came from the Professional Contractors Group (PCG), a lobby group representing the contracting community, and it was in deference to these that the dilution of the initial proposals occurred.

The Institute of Chartered Accountants in England and Wales (ICAEW) issued a publication entitled *Towards a Better Tax System* in which it rated the IR35 legislation. The overall 'score' awarded to the legislation was 30 per cent, derived from individual scores out of 10 for each of ten 'tenets' of taxation. In response, the Revenue issued a statement that 'the use of service companies to avoid tax and NIC has been well known to the accountancy profession for years'.<sup>104</sup> The implication from this statement is that the profession has somehow failed to meet a moral obligation to pay as much tax as possible, surely a proposition contrary to the spirit of the Duke of Westminster.<sup>105</sup>

One of the responses to the new rules was an application for judicial review<sup>106</sup> involving three claimants, the PCG, a Dutch national who is resident in the UK and a small contracting company currently established in the UK.<sup>107</sup> The case was heard in the Administrative Court by Burton J and he handed down his decision in favour of the Revenue on 2 April 2001. The PCG was refused leave to appeal initially, however in June 2001 the right to appeal was secured although it subsequently decided not to do so.

The rule change examined in this vignette, that is, the introduction of new rules designed to counter the tax advantage secured through the use of intermediary companies to disguise arrangements that would otherwise be considered to be employment, was prompted by several pressures for change. The Revenue, under pressure from the government, saw a need to tackle this perceived abuse of the tax system, allegedly in the interests of restoring fairness. The initial proposals met with considerable hostility from tax professionals, the media and a specially created lobby group, the PCG, all of whom contributed to shaping the design of the rule change.

<sup>103</sup> Redston, above n99.

<sup>104</sup> The Chartered Institute of Taxation <<http://www.tax.org.uk/showarticle.pl?id=234&n=379>> 05 July 2001. Copy held by author.

<sup>105</sup> *IRC v Duke of Westminster* [1936] AC 1, TC 490. There Lord Tomlin said: 'Every man is entitled if he can to arrange his affairs so that the tax attaching under the appropriate Acts is less than it would otherwise be', *IRC v Duke of Westminster* [1936] AC 1, 19. The doctrine which emerged from this case is that both the Inland Revenue and taxpayers are 'bound by the legal results which the parties have achieved', Tiley, John and Collison, David, *UK Tax Guide 1999*, 60.

<sup>106</sup> The application sought declarations of incompatibility of the IR35 legislation with European Community (EC) law and the *Human Rights Act 1998* (UK).

<sup>107</sup> The latter two were chosen as examples of those affected by the legislation.

## 5 Conceptual Map Part II: Effect of subsequent change/no change

Having described the development of the first half of the conceptual map, and demonstrated it by reference to the two vignettes, the second half of the map can now be explained. In this part, the concern is with the consequences of a change to, or a failure to change, the tax rules in response to the various pressures for change/no change.

Irrespective of whether the response to pressure is for tax rule change or no change, policy makers will have in mind a response that is intended from taxpayers. This will form the rationale for making the change, that is, to effect a particular behavioural change. Increasingly these intended responses are backed up by sophisticated economic modelling.

Government will also be cognisant of other possible behavioural responses, beyond that which the rule change intends to occur. Therefore the map uses the term 'anticipated responses' rather than 'intended response', in recognition that the government may well anticipate a certain range of responses, not all of which are in line with the desired consequences of the rule change. Anticipated responses may include non-rational responses, which are more difficult to build into economic models, but nonetheless can be planned for in devising the detail of the new rules.

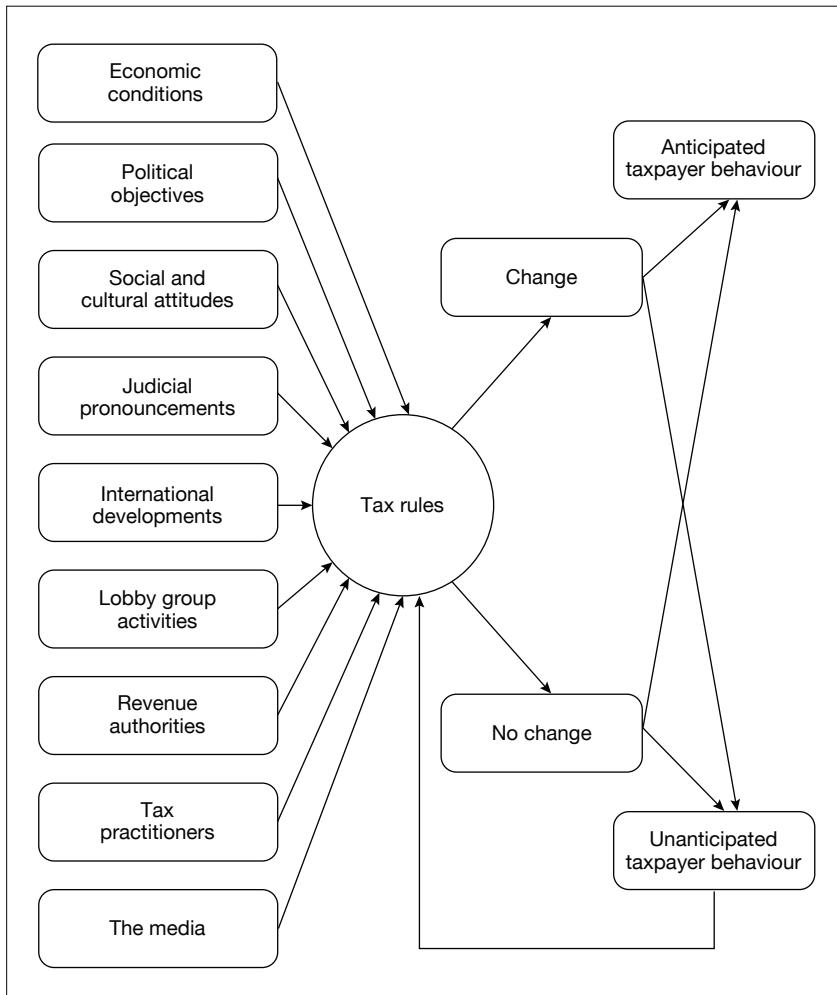
What is particularly problematic, however, is unanticipated behaviour. This arises when taxpayers, for example, seize upon unintended loopholes caused by poor drafting, often with the assistance of astute, even devious, advisers.

As a research community, we have come a long way from thinking about taxpayer behaviour in terms of rational utility maximisation. More sophisticated analyses now take into consideration many more social and environmental conditions. There is also growing recognition that taxpayers are not homogeneous populations; they can be segmented by a variety of attributes and differing policy responses identified for each segment. For example, high net worth individuals respond differently to middle income or low income earners, to the extent that considerable research is now being done in respect of high net worth taxpayer (or non-taxpayers) and revenue authorities, including HMRC, are setting up special units to focus attention on trying to understand their motivations and behaviours better. The regulatory pyramid shows another way of differentiating taxpayers, by their level of engagement or disengagement with the tax system which has a bearing on their attitude to compliance and the regulatory response required to attempt to secure maximum voluntary compliance.

History shows repeated failure to anticipate taxpayer creativity in the face of tax rule change. This unanticipated creativity in turn becomes an additional pressure for subsequent rule change. In addition, failure to change rules in response to pressure can be taken as tacit approval for the current position, leading to increases in creative attempts to push the boundaries of the rules. This is represented in the right hand side

of the now complete conceptual map, and illustrated by returning to the two vignettes introduced earlier.

**Figure 2: Taxpayer responses to tax rule changes/failure to change**



## 6 Vignette 1 (ctd): The newspaper stamp – aftermath

As discussed earlier, when first introduced the newspaper stamp duty was primarily intended as a revenue raiser with censorship as a subsidiary, but not unintended, by-product.<sup>108</sup> In 1712 the press was quick to forecast its own demise as a result of its introduction.<sup>109</sup> Although some publications were later revived, about half of those available immediately prior to the introduction of the Act disappeared as a result of the new impost.<sup>110</sup> This was, of course, anticipated behaviour consequential upon the new tax, that many small, polemical publications would cease to exist and the criticism of the government be thereby reduced, if not eliminated. Surviving publications were anticipated to be subject to the tax at the rates previously noted, that is, ½d per half sheet, 1d per sheet on every half sheet or sheet printed, or, if more than one sheet but less than six, a one off registration fee of 2s., irrespective of circulation.

There was a Tory government in power at the time the Act was implemented, and it seems that because the newspapers which supported the Tory party felt somewhat obliged to comply with the tax, they were the most affected. The Whig press, which was well organised and more likely to avoid the tax where possible, did not feel the same sense of obligation, with the result that the tax had little effect on opposition to the government.<sup>111</sup>

As is often the case with poorly drafted tax laws, the differential between papers of one sheet or less and those comprising more than one sheet opened opportunities for tax avoidance, and newspapers from both sides quickly took advantage of it. The tax was easily reduced by printing more than one sheet; indeed a sheet and a half would be enough, thereby moving the publication into the single registration fee

<sup>108</sup> This is true also for the subsequent increases made to the tax during the eighteenth century when there were identifiable revenue raising reasons in existence to justify an increase, such as economic hardship in times of war. In the nineteenth century, however, the stamp duty became known more accurately as a ‘tax on knowledge’ and it was increasingly criticised as being an overt form of statutory censorship. For references to the stamp duties as being ‘taxes on knowledge’ see, for example, National Archives (NA) IR 56/9: ‘The Memorial of the Newspaper Stamp Abolition Committee’, dated November 1850, and also NA: IR 56/19, letter from Treasury Chambers dated August 1854. See also generally Oats, Lynne and Sadler, Pauline, ‘Securing the Repeal of a Tax on the “Raw Material of Thought” (2007) 17(3) *Accounting Business & Financial History* 355-373.

<sup>109</sup> In the words of Jonathan Swift, ‘Grubstreet has but ten days to live, then an Act of [Parliament] takes place, that ruins it, by taxing every half sheet at a halfpenny’: Swift J, ‘Journal to Stella: Letter dated July 17. 1712’ in Williams, Harold (ed), *Jonathan Swift – Journal to Stella – Vol. II* (1948), 551 [footnote omitted]. Similarly Joseph Addison remarked in the *Spectator* of 31 July 1712, ‘This is the Day on which many eminent Authors will probably Publish their Last Words’: Addison J, *Spectator*, No. 445, Thursday, 31 July 1712, in Bond, Donald F. (ed) *The Spectator - Vol. IV* (1965), 62 [footnote omitted].

<sup>110</sup> Dowell, above n66, 353; Hanson, Laurence, *Government and the Press: 1695-1763* (1936), 11.

<sup>111</sup> Swift, Jonathan, ‘The History of the Last Four Years of the Queen’ in Davis, Herbert (ed), *The Prose Works of Jonathan Swift: Volume the Seventh* (1951), 104.

category.<sup>112</sup> The disadvantage of this was that there was more space to fill, but this was soon overcome by using larger headlines, larger font size generally, and the inclusion of copy that was not strictly news, such as essays, editorials, commercial notifications like shipping news, books in serial form and useful instruction.<sup>113</sup> This impacted most on the daily newspapers which could not manage the cost of additional sheets, or could not find copy to fill them or both, so either had to put their prices up or cease publication. Furthermore, specialist publications such as the *Spectator*, which published essays, suffered greatly now that generalist newspapers were encroaching into their market.

This unanticipated behaviour on the part of publisher taxpayers then created further pressure on the newspaper stamp duty legislation, although it was not until 1725 that this means of circumventing the full effect of the newspaper stamp was stopped. The amending legislation was entitled in part 'for explaining a late act in relation to stamp duties on newspapers', and provided as follows:<sup>114</sup>

... That from and after the twenty fifth day of April one thousand seven hundred and twenty five, the following duties shall be paid to his Majesty, his heirs and successors, upon every journal, mercury or other publick news-paper, which shall be printed and published in Great Britain ... the duties aforesaid are granted or continued (that is to say) for every sheet of paper, on which any journal, mercury or other news-paper whatsoever, shall be printed, a duty of one penny sterling, and for every half-sheet thereof, the sum of one half-penny sterling; any thing in the said recited act, or any other act of parliament, to the contrary thereof in any wise notwithstanding.<sup>115</sup>

During the course of the eighteenth century the rate of the newspaper stamp was increased several times and by 1789 the stamp duty stood at twopence per sheet or half sheet. There was no regulation of the press by any licencing system, or any other form of pre-publication censorship. By 1790 the newspaper stamp was an accepted form of taxation and had become an integral part of the state revenue raising, and any controversy concerned the amount of the increases and not the continuing existence of the tax itself.<sup>116</sup> The stamp duty was eventually abolished in 1855.<sup>117</sup> It is the initial introduction of the tax, and the tax avoidance activity that it spawned, however, that most clearly illustrates the conceptual map. When rules are put in place with some expectation of how taxpayers will respond, unanticipated behaviour creates additional pressure for remedial change.

<sup>112</sup> Sadler and Oats, Lynne, 'This Great Crisis in the Republick of Letters', above n64, 365.

<sup>113</sup> Morison, Stanley, *The English Newspaper* (1961) 83; Sommerville, above n76, 117.

<sup>114</sup> 11 George I, c8, XIII, XIV.

<sup>115</sup> 11 George I, c8, XIII, XIV.

<sup>116</sup> Oats, Lynne and Sadler, Pauline, 'Political Suppression or Revenue Raising? Taxing newspapers during the French Revolutionary War' (2004) 31(1) *Accounting Historians Journal* 93-128, 100.

<sup>117</sup> On the repeal of the newspaper stamp see Oats, Lynne and Sadler, Pauline, 'Securing the Repeal of a Tax', above n108, 359.

## 7 Vignette 2 (ctd): Personal service companies

The introduction of the IR35 personal service company rules was a response to perceptions in the Revenue and government more widely that large numbers of individual taxpayers were avoiding payment of their fair share of tax through the use of intermediary companies to disguise what would otherwise be an employment relationship.

Statements by the Paymaster General made it clear that the anticipated taxpayer behaviour subsequent to the enactment of the IR35 rules would be that taxpayers with personal service companies would either return to being in employment contract, or else retain the personal service company and pay the additional tax required by the rules. Indeed the objective of encouraging workers back into employment status was stated in the Revenue's discussion document in which it was noted that encouraging workers to return to employment allows them to gain the benefit of employment protection legislation.

It soon became clear, however, that the tax profession, and the PCG, actively set about finding mechanisms by which the new rules could be circumvented. There ensued a period of inventiveness where a number of 'arrangements' were devised in order to avoid being categorised under IR35 as being liable for additional tax. These arrangements included the creation of 'umbrella companies'. The application of IR35 relies on essentially common law tests of employment status, and one of those tests is the right of substitution whereby the company retains the right to provide the services of someone other than the consultant. By creating a second layer of company as a collectivity, under which a number of personal service companies could nest, the test of employment could be sidestepped.

Because IR35 looks through the arrangement to see if an employment relationship lies beneath, most of the taxpayers potentially within its scope simply adjusted the contracts under which they were engaged to include clauses to take them out of 'danger'; for example, rights of substitution, or a requirement for the worker to provide his or her own equipment. The difficulty faced by the Revenue in implementing IR35 is evidenced by the outcomes of investigations; only 7 per cent of some 1,500 PCG members investigated were found to be within IR35.<sup>118</sup>

Tax advantages accrue not only to the worker, but also to the client, who is released from employment related obligations, not only tax but also non-tax. These tax advantages provided incentives for employers to encourage, or require, their workforces to join composite companies, later to be referred to as 'managed service companies'. If the Revenue finds that a worker is, in fact, an employee, recourse will be sought in the first instance from the engager, which has prompted many to insist on personal service companies.

---

<sup>118</sup> Quoted in Redston, Anne, 'Keep it, Change it, Bin it?' (2009) 438 *Taxation* <<http://www.taxation.co.uk/taxation/articles/2009/11/04/19554/keep-it-change-it-bin-it>> 31 March 2011.

In practice, it is very difficult for the Revenue, indeed for the contractor also, to predict the outcome of an employed/self-employed status enquiry. Indeed it is arguable that the administration of the IR35 rules has proved to be almost impossible for the Revenue, and has resulted in considerably less additional tax revenue than was first anticipated. The increasing prevalence of managed service companies led to the government introducing further legislation in 2007,<sup>119</sup> following public consultation,<sup>120</sup> this time specifically targeting this device for obfuscating the application of IR35.

The consultation document notes that workers in managed service companies are 'almost invariably not in business on [their] own account and ... not exercising control over the business'. It refers to the managed service company provider as a 'scheme' provider, usually a company which provides a generic corporate structure and administration and numbering about 150 in total. Worker/shareholders in managed service companies obtain work in the normal way, for example through an agency, but the MSC scheme provider handles relations between the worker and the agency including payments, for which a fee is charged. The consultation document admits to a lack of knowledge about the precise extent of the arrangements but nonetheless suggests that the number of workers in MSCs grew from approximately 65,000 in 2002/3 to at least 240,000 in 2005/6. Clearly the extent of participation in MSCs was not anticipated by the government. IR35 is theoretically capable of countering these arrangements, but the sheer scale of them, and the interposition of a further layer of administration requiring investigation, means that the Revenue had almost no chance of tackling the problem without remedial legislation.

The MSC legislation has been described as 'draconian', and has the effect of deeming all payments received by a worker through a MSC to be employment income requiring application of the PAYE and national insurance contribution rules accordingly. Arguably, the MSC legislation has now tackled the 'mischief' of personal service companies to the point where IR35 is otiose; however the latter remains on the statute book notwithstanding calls for its abolition. The issue has been referred to the newly formed Office of Tax Simplification and is still under review at the time of writing.

## **8 Developing the map**

The two vignettes, presented here in two parts reflecting the two strands of the conceptual map, demonstrate how it can allow us to unpick tax rules changes with a more critical eye, challenging taken for granted assumptions about the motivations for, and impact of, changes. There is a danger that tax scholars focus too intently on one factor and overlook others; or fail to understand the way in which the factors

<sup>119</sup> *Income Tax Earnings and Pensions Act 2003* (UK), Chapter 9, introduced with effect from 6 April 2007.

<sup>120</sup> The consultation took the form of a document published in 2006 entitled 'Tackling Managed Service Companies'.

influencing tax rule change pull against one another to precipitate unsatisfactory compromises.

The value of the map is therefore in *contextualising* tax rule change; considering the range of issues brought to bear and the conditions under which policy change emerges. It also, importantly, accommodates a temporal dimension, following through from implementation to outcomes in terms of taxpayer behaviour and subsequent change. The map includes not only actors (the subjective dimension) but also objective environmental conditions. In sociological terms, therefore, it embraces both agency and structure. It works well with tax avoidance, as both of the vignettes demonstrate, because of the incessant search for loopholes by those less risk averse taxpayers who seek any means to minimise, if not eliminate, their tax liabilities. But the map also works for other forms of tax rules changes such as the introduction of special concessions to encourage or discourage particular forms of activity or behaviour. Those with an interest in historical dimensions may find the map useful as an organising guide to unpacking developments and understanding decisions and the events surrounding them.

The map is therefore an important part of the process of theorising tax rule change, but not necessarily the full story. The way in which this and similar maps are used in the research process, depends on the epistemological stance of the researcher.<sup>121</sup> Those with positivist leanings will seek to explore the causality apparent in the map, devising hypotheses and testing them, usually through quantitative forms of analysis. Interpretivists, on the other hand, will be more concerned with adopting analytic tools that bring to the foreground human meaning and social realities.<sup>122</sup>

To fully exploit the interpretive opportunities the map presents for exploring instances of tax rule change, arguably an overlay of theoretical analysis is required, as demonstrated in some of the scholarship to which we have referred. In this way, the analysis can move from descriptive, a worthy enough endeavour in some respects, to contribute significantly to our understanding of the role, function and effects of tax rules in our society. The numerous theoretical lenses<sup>123</sup> through which insights from the map can be analysed are beyond the scope of this paper, but could include, for example, the various forms of institutional theory emanating not only from political science,<sup>124</sup> but also sociology and organisational behaviour.<sup>125</sup> In conclusion, we encourage tax researchers, whatever their epistemological leanings, to embrace, indeed celebrate the complexity of our field of inquiry.

121 In this regard, see McKerchar, above n1, in particular Chapter 5.

122 See Yanow, Dvora, 'Underlying Assumptions of an Interpretive Approach: The Importance of Local Knowledge' in *Conducting Interpretive Policy Analysis* (2000) 1-26.

123 For a flavour of some, see McKerchar, above n1, and also Infanti and Crawford, above n17. In addition, see 'Critical Perspectives on Taxation' (2010), a special issue of *Critical Perspectives on Accounting* for some recent examples of more theoretically informed tax analyses, and Oats, *Lynne Taxation: A Fieldwork Handbook* Routledge (forthcoming).

124 See, for example, Peters, above n15.

125 See, for example, Powell and DiMaggio, above n36.