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CENTRE FOR
BUSINESS TAXATION

The Delicate Balance

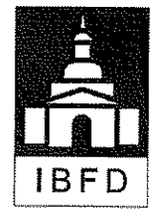
Tax, Discretion and the Rule of Law

Editors

Chris Evans
Australian School of Taxation and Business Law,
University of New South Wales;
International Fellow, Centre for Business Taxation
Oxford University

Judith Freedman
Professor of Taxation Law, Faculty of Law;
Director of Legal Research,
Centre for Business Taxation
Oxford University

Richard Krever
Taxation Law and Policy Research Institute,
Department of Business Law and Taxation,
Monash University;
International Fellow, Centre for Business Taxation
Oxford University



IBFD

Visitors' address:
H.J.E. Wenckebachweg 210
1096 AS Amsterdam
The Netherlands

Postal address:
P.O. Box 20237
1000 HE Amsterdam
The Netherlands

Telephone: 31-20-554 0100
Fax: 31-20-622 8658
www.ibfd.org

ISBN 978-90-8722-103-4
NUR 826

Preface

The complexity of tax law, like the complexity of the commercial world to which it applies, often seems to increase in an exponential fashion, placing ever more pressure on taxpayers, tax advisers and tax administrators. The problems are compounded many times by the inevitable shift of tax administration towards self-assessment models in which taxpayers have primary responsibility for correctly reporting information to the tax authority and face penalties for incorrect or incomplete reporting. This, in turn, requires taxpayers to rely increasingly on advice by tax authorities and, as a consequence, requires tax authorities to articulate their view of the law publicly.

In some cases, where relevant statutory authority, case law precedents (where used) or interpretation doctrines are clear, this process is purely one of interpretation. In other cases, the basis for interpretation is less certain and the interpretation function leaves more room for discretion by the tax authority. Finally, in other cases, the legislature may delegate discretionary powers to the tax administration which effectively result in the authorities having a power to make law. This delegation may be bestowed expressly or implicitly, the latter by ignoring cases where the tax administration fills in gaps in the legislation using its own views.

Such instances of discretionary law making powers arising explicitly or implicitly sit beside regimes that explicitly delegate to the executive the power to make law in selected areas by way of regulation. The extension of discretionary powers to make law to the executive, and in particular the tax administration, raises important questions about the delicate balance between the need to provide the executive and administration with sufficient room to apply the law and the need to maintain the principle of the rule of law that it is the elected legislature, and not the executive or tax administration, that establishes tax burdens. The chapters in this volume explore that delicate balance.

These chapters derive from a project sponsored by the Oxford University Centre for Business Taxation (OUCBT) together with the Department of Business Law and Taxation at Monash University and the Australian School of Taxation and Business Law, University of New South Wales. OUCBT is an independent academic centre supported financially by the Economic Social Research Council (grant RES-060-25-0033) and by donations from a number of companies. The full list of corporate donors is provided at www.sbs.ox.ac.uk.

The editors are pleased to be able to make the outcome of this project available to a wider audience. We are grateful to Frans Vanistendael, academic chairman of the IBFD, for his strong support for this publication, Jane Kerr, publisher at the IBFD, for her continuous assistance with the volume, and Peter Mellor for his invaluable editing contributions.

Chris Evans
Australian School of Business Law and Taxation,
The University of New South Wales; and
International Fellow,
Oxford University Centre for Business Taxation

Judith Freedman
Faculty of Law,
Oxford University; and
Director of Legal Research,
Oxford University Centre for Business Taxation

Richard Krever
Taxation Law and Policy Research Institute,
Department of Business Law and Taxation,
Monash University; and
International Fellow,
Oxford University Centre for Business Taxation

August, 2011

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experimentations with a variety of rulings systems that appear to have improved the experience of many taxpayers. The contribution that tax discretions can make towards good taxation is mentioned in a number of the chapters in this volume, with particular emphasis on the resolution of fact-heavy disputes; maintenance of flexibility within tax systems; furtherance of statutory purposes; reduction in statutory detail; and alleviation of the harshness in strict enforcement of legislation. As for potential improvements to discretionary power, it was related above that the democratic advantages of primary statute could be replicated in sub-statutory rules through enhanced participatory procedures.[37] Further reforms might include better publication practices; strengthened taxpayer charters; reforms in the judicial review and appeals systems; removal of penalties on taxpayers who dissent from official interpretations; continued relations of trust; and sound working practices amongst tax authorities. Even with additional protections, though, some might prefer an overall reduction in the power of administrators, and the experience in a number of jurisdictions suggests that this can be achieved with some success.[38]

5. Conclusion

It may be helpful to refer to the opinion of Dourado, in this volume, that discretion should be restricted to hard cases in which legal arguments fail to generate a single correct solution.[39] Not every author represented in this volume would assent to such a position, which in particular appears inconsistent with the view that acceptable hybrid rules might be formed with both legislative and discretionary elements. Nevertheless there is a persistent belief throughout the entire study that fundamental questions on the appropriate structure of tax law and the position of discretion therein should not be avoided. Such matters are only rarely brought into the open, and it is refreshing to encounter the twelve very different views that follow this chapter. Yet more encouraging, there is a general optimism that tax administration can be improved.

37. See section 3.1, supra, citing Hickman (this volume).
38. See Mazansky (this volume), text at nn. 28-29, Griffiths (this volume), text at nn. 8-22, and Halkyard (this volume), text at nn. 77-80.
39. See the *Conclusions* in Dourado (this volume).

The Delicate Balance: Revenue Authority Discretions and the Rule of Law – Some Thoughts in a Legal Theory and Comparative Perspective

Ana Paula Dourado*

1. Introductory remarks: Is discretion exercised by the revenue authorities?

The pragmatic approach of common law, based on the individual assessment of cases, in contrast to the dogmatic approach of continental law, is illustrated by the expression "revenue authority discretions" in the title of this chapter. The first reaction of a Continental lawyer would probably be that the title is provocative, that revenue authority discretion does not exist in a rule-of-law state where the legislature has the exclusive competence to pass tax legislation, or that it is prohibited because the constitution grants the power to tax to the legislature and application of tax law by the tax administration is to be controlled by the courts.

The fact that many chapters in this volume stress the relevant uncontrolled revenue authority decisions implies that authors here discuss and take the limits of the revenue authority powers seriously. Discussing revenue authority discretions implies specifying the tax elements in respect of which such discretion is prohibited, the borderline between the creation and application of tax law (and therefore defining the competences of the legislature, the administration and the courts) and the meaning of determinacy, indeterminacy and the consequences of indeterminacy in tax laws.

As this chapter seeks to demonstrate, the differences between common law and civil law countries are not relevant any longer in respect of the topic under analysis, at least in its basic framework. Since the second part of the 20th century, legal families have become closer regarding the way they face the role of parliament, administration (and the courts) and in respect of the way they understand legal determinacy and indeterminacy. The precedent in common law countries and the general language used in civil law countries are no longer equivalent to uncertainty in the former case and to

* Faculty of Law, University of Lisbon, Lisbon, Portugal.

certainty in the latter.[1] Throughout, there will be references to some concrete legal systems belonging to both law families.

2. The rule of law

2.1. The legal type of tax

In legal systems governed by the rule of law, the principle of people's sovereignty implies that what could be called the *legal type of tax* (the tax object, the tax subject, the tax base and its quantification, the tax rates and every rule that influences the final amount of tax) is to be passed by parliament. For the sake of clarity, this analysis excludes elements that do not belong to the aforementioned *legal type of tax*. In fact, not every tax aspect or element has to be passed by parliament and, in many jurisdictions, collection and management of taxes do not need to be exclusively passed by the latter, as long as the taxpayers' rights are not at stake; moreover, taxpayers' rights connected with administrative, procedural or judicial process rights, even if subject to parliamentary law, are not to be here considered as tax rules *stricto sensu,* since they do not belong to the tax constitution.[2] Extra-statutory concessions are also out of the scope of the *legal type of tax*, if aimed at solving minor or transitory anomalies and do not imply formulating policy in respect of that legal type.[3] For the purposes of this chapter, "tax law" and "tax system" are to be identified with the "*legal type of tax*", unless specified otherwise.

2.2. Validity and legitimacy

Tax law receives its legitimacy from democratic procedures, characterized by public discussion and argumentation and from disagreement and

1. Hart, Herbert L. A., *The Concept of Law* (Oxford: Oxford Clarendon Series, 1961), pp. 121-123.
2. Dourado, Ana Paula and Rainer Prokisch, "*Das steuerrechtliche Legalitätsprinzip im portugiesischen und deutschen Verfassungsrecht*", *Jahrbuch des Öffentlichen Rechts der Gegenwart* (1999), Bd. 47, p. 58; Tipke, Klaus and Joachim Lang, *Steuerrecht* (Köln: O. Schmidt, 20th ed., 2010), point 17, pp. 25-27.
3. Analysing both collection and management of taxes and extra-statutory concessions under H.M. Revenue & Customs discretion, see Freedman, Judith and John Vella, "HMRC's Management of the U.K. Tax System: The Boundaries of Legitimate Discretion" (this volume).

compromise in parliament, i.e. in a context of free communication and political plurality.[4] The validity, legitimacy and authority of tax laws are connected with procedure, pluralism and compromise and that is the reason why they are accepted by their recipients as potential participants in a rational discourse.[5]

This chapter assumes that the rule of law involves principles of legality, following to some extent Lon Fuller's approach: generality, promulgation, non-retroactivity, clarity, non-contradiction, possibility of compliance, constancy through time and congruence between official action and declared rule.[6] Inherent in this concept of rule of law is the ability of law to guide behaviour and, in contrast to Fuller, it does not assume there is any constraining inner morality of law.[7] In respect of taxes, the rule of law does not guarantee that the tax system observes other principles such as the ability to pay, net taxation of income, efficiency or practicability. Some of the abovementioned principles of legality such as clarity and constancy through time are clearly not observed by tax systems and it has been suggested that simple laws and some legal vagueness are the best way to accomplish that purpose.[8] Moreover, pluralism in democratic societies contributes to legal vagueness.[9]

4. Habermas, Jürgen, *Faktizität und Geltung, Beiträge zur Diskurstheorie des Rechts und des Demokratischen Rechtstaats* (Frankfurt am Main: Suhrkamp Verlag, 1992), p. 15 et seq. and p. 151 et seq.; Waldron, Jeremy, *Law and Disagreement* (Oxford: Oxford University Press, 1999).
5. Habermas, supra, n. 4, p. 138.
6. Fuller, Lon L., *The Morality of Law* (New Haven: Yale University Press, 2nd ed., 1969); Dyzenhaus, David, "The Rule of Law as the Rule of the Liberal Principle", in Arthur Ripstein (ed.), *Ronald Dworkin* (Cambridge: Cambridge University Press, 2007), p. 72.
7. Raz, Joseph, *The Authority of Law: Essays on Law and Morality* (Oxford: Clarendon Press, 1979), ch. 11 ("The Rule of Law and its Virtue"), pp. 210-229; Hart, Herbert L. A., *Essays in Jurisprudence and Philosophy* (Oxford: Clarendon Press, 1983), pp. 350-352; Dworkin, Ronald, "Philosophy, Morality and Law: Observations Prompted by Professor Fuller's Novel Claim", 113 *University of Pennsylvania Law Review* 5 (1965), p. 668.
8. Dourado, Ana Paula, "General Report – In Search of Validity in Tax Law: The Boundaries between Creation and Application in a Rule-of-Law State", in Ana Paula Dourado (ed.), *Separation of Powers in Tax Law,* European Association of Tax Law Professors (EATLP) Congress, Santiago de Compostela, 2009 (Amsterdam: IBFD, 2010), sections 1.2.4, 1.3 and 1.4.3.
9. Cf. Marmor, Andrei, "The Rule of Law and its Limits", 23 *Law and Philosophy* 1 (2004), pp. 26-27 (and 12-15).

2.3. The rule of law and parliamentary laws

In some countries more than in others, the parliament has an active role in respect of tax legislation, in terms of discussing draft Bills and introducing changes to them, in a way that enhances the idea that creation of law belongs to it (e.g. Belgium,[10] Denmark,[11] Israel,[12] Turkey,[13] the U.K.,[14] and the United States[15]). In those constitutional systems where the government has delegated legislative powers, as in the case of some European civil law countries after the Second World War, such as Italy,[16] Portugal[17] and Spain,[18] it is still for the parliament to decide upon the essential aspects of taxes.

Although it is a common feature of every legal system that the powers of the tax administration and the government are overwhelming,[19] comparison

10. Peeters, Bruno and Elly van de Velde, "Belgium", in Dourado (ed.), supra, n. 8, pp. 67-68.
11. Graff Nielsen, Jacob, "Denmark", in Dourado (ed.), supra, n. 8, section 2.4.1.
12. See questionnaire responses to the Seminar on Separation of Powers in Tax Law at the Santiago de Compostela EATLP Congress, 2009, available at: http://www.eatlp.org/uploads/public/santiago/sop/Israel%20-%20Yoseph%20M%20Edrey.pdf (accessed on 1 July 2009).
13. Yalti, Billur, "Turkey", in Dourado (ed.), supra, n. 8, section 2.16.1.2.
14. Eden, Sandra, "United Kingdom", in Dourado (ed.), supra, n. 8, section 12.17.2.
15. Barker, William, "United States of America", in Dourado (ed.), supra, n. 8, section 2.18.2. See, however, a different interpretation of the U.S. tax system, taking into account the "delegated legislative authority" to the executive and the Treasury: Hickman, Kristin, "The Promise and the Reality of U.S. Tax Administration" (this volume).
16. Greggi, Marco, "Revenue Authority Discretions and the Rule of Law: The Quest for a *Recta Ratio*" (this volume), text at nn. 53-61; Del Federico, Lorenzo, Riccarda Castiglioni and Francesca Miconi, "Italy", in Dourado (ed.), supra, n. 8, pp. 129-130.
17. Dos Santos, António Carlos and Paulo Nogueira da Costa, "Portugal", in Dourado (ed.), supra, n. 8, pp. 181-183.
18. Pardo, M. Luisa Esteve, "Spain", in Dourado (ed.), supra, n. 8, pp. 203-206.
19. See, for example, in Freedman, Judith and John Vella, "HMRC's Management of the U.K. Tax System: The Boundaries of Legitimate Discretion" (this volume, section 4), the reference to the U.K. revenue authority's general discretionary powers in back-duty agreements, guidance and advance clearances and to make extra-statutory concession in some circumstances. See also in Walpole, Michael and Chris Evans, "The Delicate Balance: Revenue Authority Discretions and the Rule of Law in Australia" (this volume), text at nn. 39-53, the reference to the Commissioner's powers (characterized by the authors as "discretions") to remit penalties for late lodgement, to cancel benefits under a tax avoidance scheme, to determine a reasonable amount to replace another amount and administrative discretions to smooth operation of the tax system.

among some legal systems has allowed me to conclude in my previous research, that in those systems where the parliament is actively involved in discussing legislative proposals, whether in plenary sessions or in specialized commissions, the validity of law is better achieved.[20] In fact, very often specialized parliamentary commissions discuss the draft Bills in detail and that seems to be an efficient procedure that does not preclude the result that laws are being in effect passed by parliament. This aspect is not necessarily weakened by the fact that tax law Bills are often so complicated and extensive that the parliament cannot in reality take all the aspects into consideration.[21] Moreover, in systems where the checks and balances among the three branches – legislative, executive and judicial – function in a good efficient manner, predictability and certainty seem to be better achieved (see the example of Canada;[22] in respect of the United States, authors do not seem to agree[23]).

In the above-mentioned cases, courts can and must control the application of tax law by the tax authorities, since the latter are bound by it. Although tax law, as with any other legislation, is often vague, and thus sometimes results in indeterminacy in hard cases, courts are competent to control that indeterminacy and have the final word in the event of a dispute between the tax administration and the taxpayer, unless the law grants discretion to the tax administration. The latter must be exceptional, due to the requirements of the rule of law in tax law. Consequently, the term "revenue authority discretions" is a broad expression, that can essentially mean an active role by the revenue authorities in applying vague rules, either adopting general rules that contribute to progressive determinacy and legal certainty – regulations and rulings, for example in transfer pricing matters – or assessing a specific case,[24] but it can only exceptionally mean that the courts will not control that application. However, the assessment of whether the

20. Dourado (ed.), supra, n. 8, pp. 32-33.
21. See for example, in this sense, Graff Nielsen, supra, n. 11, section 2.4.1.
22. O'Brien, Martha, "Canada", in Dourado (ed.), supra, n. 8, for example sections 2.3.2. and 2.3.3; see also Brooks, Kim, "A Reasonable Balance: Revenue Authority Discretions and the Rule of Law in Canada" (this volume).
23. For an interpretation of the US tax law as granting a good level of predictability and certainty, see Barker, "United States of America", in Dourado (ed.), supra, n. 8, section 2.18.3.1; but for a contrary interpretation, see Hickman, "The Promise and the Reality of U.S. Tax Administration" (this volume).
24. See the meaning granted to the term discretion, in the context of their chapter, in Walpole and Evans, "The Delicate Balance: Revenue Authority Discretions and the Rule of Law in Australia" (this volume), text at nn. 39-42.

courts are in fact fulfilling their task is often negative, as many contributions to this volume testify.[25]

3. Legal determinacy and creation vs. application

In order that the rule of law is not deprived of content, tax legislation as passed by the parliament must be sufficiently determinate. Determinacy ensures democracy as opposed to dictatorship, equality, due to the characteristics of the generality of law, and predictability of governmental decisions (and also administrative and judicial ones) since it governs the rights and obligations of the taxpayer.[26] Legal determinacy is recommended on the basis that the enforceability of judicial decisions is justified exclusively on the basis of legal arguments (excluding extra-legal ones[27]) so that taxpayers are able to adapt their behaviour to the law.

25. Hickman, "The Promise and the Reality of U.S. Tax Administration" (this volume), text at nn. 37-54; Greggi, "Revenue Authority Discretions and the Rule of Law: The Quest for a *Recta Ratio*" (this volume), text at nn. 81-83; Happé, Richard and Melvin Pauwels, "Balancing of Powers in Dutch Tax Law: General Overview and Recent Developments" (this volume), text at nn. 18-19.
26. On equality achieved by law, see Rawls, John, *A Theory of Justice* (Cambridge, MA.: Belknap Press of Harvard University, 1971), p. 237; and Dworkin, Ronald, *Law's Empire* (Cambridge, MA.: Belknap Press of Harvard University, 1986), pp. 95-96.
27. On the meaning of extra-legal rules, including cultural rules and shared practices, see Coleman, Jules and Brian Leiter, "Determinacy, Objectivity, and Authority", in Andrei Marmor (ed.), *Law and Interpretation, Essays in Legal Philosophy* (Oxford: Oxford University Press, 1994), pp. 235-240; Endicott, Timothy, *Vagueness in Law* (Oxford: Oxford University Press, 2000), pp. 188 et seq.; on the contrary, Dworkin includes such rules in legal arguments, integrating the departure point of the interpreter: Dworkin, Ronald, *Law's Empire*, supra, n. 26, pp. 154 et seq., 160-161 et seq., and especially. 164 et seq. and ch. VI; cf., differently, Esser, Josef, *Precomprensione e scelta del metodo nel processo di individuazione del diritto, Fondamenti di razionalità nella prassi decisionale del giudice, traduzioni della Scuola di perfezionamento in diritto civile dell'Università di Camerino a cura di Pietro Perlingieri* (1983 [1972]), pp. 54 et seq. (contrary to Dworkin, Esser refers to the judicial discretion in the cases of legal indeterminacy); commenting on Dworkin and Esser, Günther, Klaus, *The Sense of Appropriateness: Application Discourses in Morality and Law* (Albany: State University of New York Press, 1993) (tr. J. Farrell), pp. 276 et seq.; what the Gerrman literature calls *Rechtsfortbildung*, implying interpretation beyond the meaning of the law, is a different phenomenon: see, for example, Tipke, Klaus (ed.), *Grenzen der Rechtsfortbildung durch Rechtsprechung und Verwaltungsvorschriften im Steuerrecht* (Köln: O. Schmidt, 1982).

Determinacy, however, is an ideal and as such is not fully achievable, since legal language is characterized by vagueness that can lead to indeterminacy and indeterminacy can also result from overly detailed laws, in the sense that it can lead to legal gaps or to over-complex solutions resulting in difficulties of interpretation.[28] An example of the latter situation has been given by the U.K., where the judiciary has not applied legislation on the basis that it is incomprehensible (in the words of Lord Simonds in the House of Lords in 1946).[29]

This chapter takes it as a given that tax law is determined when the weight of legal arguments is sufficient to justify the judicial decisions or the decisions of the powers applying the law.[30] A community will no longer be governed under the rule of law and governance will be arbitrary if there is a high deficit of legal determinacy.[31]

Whereas the previous observations are valid in respect of any legislation in a rule-of-law state, they acquire special significance in domains where written constitutions require that some matters are subject to the exclusive competence of parliament even if they can be delegated to the government. Constitutional courts or other courts with equivalent functions, are supposed to control whether the law is sufficiently determined, and can declare unconstitutionality in the event of indeterminacy.[32] However, even in the absence of a written constitution, as is the case with the U.K., the rule of law associated with the aforementioned principle of people's sovereignty implies that the law must be determined and the judiciary could ultimately refuse to apply it, on the basis that in the case of indeterminacy that would require the courts to create, instead of apply, the law.

Thus, when a field of law is subject to the reserved competence of parliament, the law has to be as determined as possible, in order that democracy,

28. Endicott, supra, n. 27, pp. 29 et seq., 188-190 et seq.
29. Eden, supra, n. 14, section 22.17.3, citing *Inland Revenue Commissioners v. Ayrshire Employers Mutual Insurance Association Ltd.* (1946) 27 T.C. 344. See also the Danish report and the reference to indeterminacy caused by overly detailed rules: Graff Nielsen, supra, n. 11, section 2.4.2.
30. Coleman and Leiter, supra, n. 27, pp. 235 et seq.
31. Endicott, supra, n. 27, pp. 186-187.
32. Dourado (ed.), n. 8, p. 47.

equality and predictability of governmental decisions (and also administrative and judicial) are assured.

In every rule-of-law state, the *legal type of tax* (the tax object, the tax subject, the tax base and its quantification, the tax rates and every rule that influences the final amount of tax) must be approved by parliament.[33] Those elements universally correspond to the elements of taxation, in respect of which predictability is required and they are the reason for submitting the regime to the legislatures.

In tax law, determinacy and the aims it fulfils have, however, to be combined with the principles of ability-to-pay and practicability which may recommend some vagueness. Moreover, the rule-of-law and the reserved competence of the parliament to enact legislation on some occasions counsel vagueness, in order to increase the number of the situations that are covered by the rule. In contrast, very detailed rules can lead to inaccurate and even absurd results, which are the opposite of the purpose that they are supposed to achieve.

Expressions such as "any other capital income", "cession of the contractual position", "expenses related to income", "transactions at arm's length" and cross-referral to "accounting standards" are common to tax codes all over the world, and their vagueness is considered to be recommended in terms of the principles of rule-of-law and ability-to-pay. Criticism of this technique is normally related to the lack of legal certainty, since broader powers are in this way granted to the tax administration, a view expressed in many of the chapters in this volume.

Due to the principle of people's sovereignty, in the case of legal gaps leading to indeterminacy, in most legal systems the courts cannot decide by analogy, although this is not the case in the United States,[34] and even if this position is open to dispute, especially where the tax courts play an active

33. Common law systems are not different in this respect, as illustrated in the U.K. case of *Vestey v. Inland Revenue Commissioners* [1980] A.C. 1148 (H.L.).
34. Barker, supra, n. 15, pp. 248-249.

role.[35] Teleological interpretation in tax law is generally accepted,[36] in spite of respected academic commentators arguing against it.[37]

35. For example, in German tax literature, contending in favour of analogy in tax law, Tipke, Klaus, "*Rechtfertigung des Themas; Ziel der Tagung*", in Klaus Tipke (ed.), *Grenzen der Rechtsfortbildung durch Rechtsprechung und Verwaltungsvorschriften im Steuerrecht,* supra, n. 27, pp. 1 et seq.; Tipke, Klaus, "*Über teleologische Auslegung, Lückenfeststellung und Lückenausfüllung*", in Franz Klein and Klaus Vogel (eds.), *Der Bundesfinanzhof und seine Rechtsprechung, Grundfragen – Grundlagen, Festschrift für Hugo von Wallis* (Bonn: Stollfuss, 1985), pp. 133-135; Walz, Rainer, *Steuergerechtigkeit und Rechtsanwendung, Grundlinien einer relativ autonomen Steuerrechtsdogmatik* (Heidelberg: Decker, 1980), pp. 136 et seq. See the discussion between Tipke ("*Rechtfertigung des Themas*"), arguing in favour of analogy and, arguing against it, Friauf, Karl, "*Möglichkeiten und Grenzen der Rechtsfortbildung im Steuerrecht*", in Klaus Tipke (ed.), *Grenzen der Rechtsfortbildung durch Rechtsprechung und Verwaltungsvorschriften im Steuerrecht,* supra, n. 27, pp. 53 et seq.; cf., arguing in favour of interpretation close to the wording, Kruse, Heinrich, "*Steuerspezifische Gründe und Grenzen der Gesetzbindung*", in Klaus Tipke (ed.), *Grenzen der Rechtsfortbildung durch Rechtsprechung und Verwaltungsvorschriften im Steuerrecht,* supra, n. 27, pp. 71 et seq., and Kruse, Heinrich, *Lehrbuch des Steuerrechts, Vol. I* (Munich: C.H. Beck, 1991), pp. 25-28. Also arguing against analogy, see Vogel, Klaus and Christian Waldhoff, *Grundlagen des Finanzverfassungsrechts* (Heidelberg: C.F. Müller, 1999), pp. 313-315; Vogel, Klaus and Christian Waldhoff, "*Vorbemmerkungen zu Art. 104 a-115*", in Rudolf Dolzer and Klaus Vogel (eds.), *Bonner Kommentar zum Grundgesetz* (Heidelberg: C.F. Müller, 1997), pp. 392-394; Vogel, Klaus and Hannfried Walter, in Rudolf Dolzer, Christian Waldhoff and Karin Graßhof (eds.), *Bonner Kommentar zum Grundgesetz, Loseblattsammlung* (Heidelberg: C.F. Müller, 2009), Art. 105 (Zweitbearbeitung Februar 1971) Rdnr. 39; Vogel, Klaus, "*Grundzüge des Finanzrechts des Grundgesetzes*", in Josef Isensee and Paul Kirchhof (eds.), *Handbuch des Staatsrechts, Finanzverfassung-Bundesstaatliche Ordnung, Vol. IV* (Heidelberg: C.F. Müller, 1990), pp. 47 et seq.; Vogel, Klaus, "*Vergleich und Gesetzmäßigkeit der Verwaltung im Steuerrecht*", in Brigitte Knobbe-Keuk, Franz Klein and Adolf Moxter (eds.), *Handelsrecht und Steuerrecht: Festschrift für Georg Döllerer* (Düsseldorf: IDW, 1988), pp. 310 et seq.; Papier, Hans-Jürgen, "*Der Bestimmtheitsgrundsatz*", in Karl Friauf (ed.), *Steuerrecht und Verfassungsrecht* (Köln: O. Schmidt, 1989), pp. 72-74. Arguing in favour of simple and determined legal rules, see Kirchhof, Paul, "*Vertrauenschutz im Steuerrecht – Eröffnung der 28. Jahrestagung und Rechtfertigung des Themas*", in Heinz-Jürgen Pezzer (ed.), *Vertrauensschutz im Steuerrecht* (Köln: O. Schmidt, 2004), pp. 1 et seq.
36. See, however, the discussion on the "transplanted categories in the anglo tax jurisprudence" and "the U.S. courts looking at the purpose of income tax law" in Krever, Richard, "Interpreting Income Tax Laws in the Common Law World", in Markus Achatz, Tina Ehrke-Rabel, Johannes Heinrich, Roman Leitner and Otto Taucher (eds.), *Steuerrecht, Verfassungsrecht, Europarecht, Festschrift für Hans Georg Ruppe* (Wien: Facultas wuv, 2007), pp. 359-363. Interpretation of the "transplanted categories" meant to ignore the purpose of the tax rule/regime.
37. Klaus Vogel excludes teleological interpretation of tax laws, on the basis that the purpose of the tax rule is always exterior to it and, in the case of tax law, that purpose is always linked to obtaining tax revenue: "*Die Besonderheit des Steuerrechts*", *Deutsche Steuer-Zeitung/A* (1977), p. 9; "*Vergleich und Gesetzmäßigkeit der Verwaltung im Steuerrecht*", supra, n. 35, pp. 312-314; Vogel, Klaus and Christian Waldhoff, *Grundlagen des Finanzverfassungsrechts*, supra, n. 35, pp. 388-390.

In some legal systems, the general anti-abuse clause is considered to authorize the exercise of analogy.[38] A better view might be that it affirms a principle that tax law is to be interpreted according to the criteria of any other legal field, so that any interpretation restricted to the literal meaning of the wording is rejected.[39] At the same time, it also reminds us that tax law is to be interpreted according to its own aims and principles, and is not limited to the original meaning of a concept imported from another legal field, such as private law (for example, concepts such as interest, dividend, contract, etc.). This is an illustration of a "substance over form" approach to understanding the meaning of terms used in tax law.[40]

The rule of law requires determined tax legislation and that determinacy implies that the core cases which it aims at are expressly foreseen and addressed in the tax legal rule. This leaves the possibility of indeterminacy only in the hard cases that were unforeseeable at the moment the law was drafted.

Validity of the law implies that it takes into account the typical situation and devalues the particularities of any specific case, and therefore some vagueness is inherent in creation of law. However, if the law is so vague that the institutions that are supposed to apply it are instead deciding the essential policy choices, then regulations, rulings and case law are not applying the law, but creating it.[41]

4. The framework for delegations to the government and to the revenue authorities

Delegation of legislative competences as well as the role of the administration has puzzled legal theory authors who do not find a role for the administration in the rule-of-law state. Dicey, Hewart, Hayek (hereinafter referred as the libertarians) and Dworkin (an egalitarian liberal) agree that the rule of law is observed if judges protect the core of certain liberal principles.[42]

38. See, for example, in Portugal, Nabais, José Casalta, *O Dever fundamental de pagar impostos* (Coimbra: Livraria Almedina, 1998), pp. 382 et seq., esp. 392-394.
39. See Krever, supra, n. 36, pp. 371-377.
40. Id.
41. Dourado (ed.), supra, n. 8, pp. 35-37.
42. Dyzenhaus, supra, n. 6, pp. 69-72.

Both libertarians and Dworkin agree that the rule of law exists when judges protect the core of liberal principles from majoritarian decision-making and all of them grant to parliament the monopoly on making law and to judges a monopoly on its interpretation. It is clear that the administration, including revenue authorities, has no authority over legal principles, but that does not imply that it does not take them into account. In this sense, Dworkin's rigid distinction between principles and policies[43] only means that the free space left to the revenue authorities is reduced – both in respect of policy (creation) and principles (interpretation). As is noted below, this free space is relatively large in respect of tax assessment and quantification issues. Legal theory studies have not acknowledged that governments, in contrast to the administration, have indirect democratic legitimacy, since they stem from parliamentary majorities and delegated legislative competence is not incompatible with the rule-of-law. The following section looks more closely at this controversy.

5. Delegation to the government

In some civil law countries, such as Italy, Portugal, Spain, and to some extent France,[44] the governments have delegated legislative competence, and in most of the legal systems governments are entitled to pass regulations that rule on the technical aspects of the legislation. In Germany, the government has delegated competence to pass regulations on some tax issues, implying powers that are similar to the delegated legislative power in other countries.[45] The aforementioned delegations are normally granted in respect of the tax base – assessment and quantification of the particular tax.

Delegation to governments can be justified by its indirect legitimacy, since, in the post-Second World War constitutional systems, they are derived from

43. Id.
44. "Another key point is the scope of Article 34 of the Constitution, which mentions that the French Parliament has to determine the rules concerning the 'base, rates and methods of collection' of 'all type of taxes'. As the concept of 'all type of taxes' does not cover fees and social security taxes or payroll taxes, the French Parliament in practice has a reduced competence in tax matters": De Crouy-Chanel, Emmanuel and Maitrot de la Motte, "France", in Dourado (ed.), supra, n. 8, p. 98.
45. Dourado (ed.), supra, n. 8, p. 34.

parliamentary majorities, contrary to what happened during the constitutional monarchies of the 19th century/beginning of the 20th century.[46]

The rule of law continues to be honoured if the parliament makes policy decisions and assigns policy guidelines on the essential elements of taxes (which have been referred to in this paper as the legal type of tax) to the executive, so that the amount of tax is still foreseeable by the (expert) taxpayer. Examples of such guidelines include regulations concerning depreciation rates, inventories, withholding taxes, and provision for risks.

The next step is to ask what is the scope and level of determinacy required for the delegated legislation. Once more, if the government opts to keep some vagueness, the main aspects of the object, subject and quantification (the *Tatbestand* elements) have to be determined by its decree-laws, so that the only cases that are not covered are the hard ones. In this sense, the legal authorization by parliament has to practically coincide with the decree-law. Very frequently it will be the government presenting the draft Bills to parliament, and thus, the fact that the approved decree-law essentially coincides with this authorization is the only way to ensure the effectiveness of the rule of law.

Determinacy of law as a requirement, instead of prohibition of vagueness (or absolute determinacy), is currently invoked by courts in legal systems belonging to different legal traditions. For example, the German Constitutional Court departed from a rigid position on the *Tatbestandsmässigkeit* (every essential element of taxes was to be exclusively determined by law) and is now applying the principle of determinacy, in respect of delegations to governmental regulations, and has never declared a tax law unconstitutional, by virtue of its indeterminacy.[47] German tax literature still very much relies on the *Tabestandsmässigkeit*.[48]

In common law systems, legal vagueness is progressively reduced by the tax courts and the latter fully integrate that task in their interpretative function.[49] It is common to every Member State of the EU, the OECD and other

46. Dourado, Ana Paula, *O Princípio da Legalidade Fiscal, Tipicidade, conceitos jurídicos indeterminados e margem de livre apreciação* (Coimbra: Livraria Almedina, 2007), pp. 380-395.
47. *B.Verf.G.E.* 7, p. 302. Dourado and Prokisch, supra, n. 2, pp. 39, 40 et seq.
48. Vogel, Klaus, "*Grundzüge des Finanzrechts des Grundgesetzes*", supra, n. 35, section 87, paras. 68, 70 et seq.
49. See Barker, supra, n. 15, pp. 248-249; Eden, supra, n. 14, pp. 238-239; O'Brien, supra, n. 22, pp. 83-84.

countries, that rules involving transactions among multinational companies, such as transfer pricing rules, thin capitalization, deduction of expenses and advanced pricing agreements, are vague and often lead to indeterminacy, which is progressively determined by regulations, administrative rulings and (other) soft law instruments.[50] Their compatibility with the law, as well as the interpretation of such administrative rules, are to be checked by the courts and any remaining indeterminacy is to be progressively determined by case law.[51]

Finally, taking into account the increasing complexity of tax law, it is not possible to claim any longer that legal determination will allow the lay-taxpayer to foresee the amount of tax to pay.[52]

6. Vagueness and indeterminacy in tax law

The next question is then whether tax law can be so vague that it leads to indeterminacy, and if it leads to indeterminacy whether it is unconstitutional or not. If it is not unconstitutional, it is then necessary to assert the consequences in terms of the revenue authorities' powers.

Moreover, if the revenue authorities opt to exercise their broad powers applying vague laws, analysis will determine whether they can do it

50. See these and other examples not considered to be unconstitutional by the German *B.Verf.G.*, in Tipke, Klaus, *Die Steuerrechtsordnung I: Wissenschaftsorganisatorische, Systematische und Grundrechtlich-rechtsstaatliche Grundlagen* (Köln: O. Schmidt, 2nd ed., 2000), pp. 138-139.
51. See eg, Kruse, Heinrich and Klaus-Dieter Drüen, in Klaus Tipke and Heinrich Kruse (eds.), *Abgabenordnung - Finanzgerichtsordnung, AO/FGO Kommentar* (Köln: O. Schmidt, 2001), section 4, points 54-79, pp. 21 et seq.; Osterloh, Lerke, *Gesetzesbindung und Typisierungsspielräume bei der Anwendung der Steuergesetze* (Baden-Baden: Nomos, 1992), pp. 66 et seq.; Brockmeyer, Hans-Bernhard, "*Typisierungen im Einkommensteuerrecht durch die Rechtsprechung*", in Paul Kirchhof, Wolfgang Jakob and Albert Beermann (eds.), *Steuerrechtsprechung, Steuergesetz, Steuerreform, Festschrift für Klaus Offerhaus zum 65. Geburtstag* (Köln: O. Schmidt, 1999), pp. 22 et seq. On the activity of the German *Bundesfinanzhof*, see Woerner, Lothar, "*Die Steuerrechtsprechung zwischen Gesetzeskonkretisierung, Gesetzesfortbildung und Gesetzeskorrektur*", in Klaus Tipke (ed.), *Grenzen der Rechtsfortbildung durch Rechtsprechung und Verwaltungsvorschriften im Steuerrecht*, supra, n. 27, pp. 28 et seq. See further, Hahn, Hartmut, *Die Grundsätze der Gesetzmäßigkeit der Besteuerung und der Tatbestandsmässigkeit der Besteuerung in rechtsvergleichender Sicht* (Berlin: Duncker & Humblot, 1984), pp. 31 et seq.; Trzaskalik, Christoph, "*Steuerverwaltungsvorschriften aus der Sicht der Rechtsschutzes*", in Klaus Tipke (ed.), *Grenzen der Rechtsfortbildung durch Rechtsprechung und Verwaltungsvorschriften im Steuerrecht*, supra, n. 27, pp. 318-319, 320-322 et seq.
52. See Tipke, Klaus, *Die Steuerrechtsordnung I*, supra, n. 50, pp. 140 et seq.

through regulations and rulings, as has been the case over recent decades in most OECD countries, and whether that implies interpretation or legislative creation.

My premise is that vagueness in law does not necessarily lead to indeterminacy and, as a rule, it does not lead to this: only in hard cases does it lead to indeterminacy. Legal indeterminacy is an indeterminacy of legal arguments, and this normally occurs when the available number of legal arguments is insufficient to explain one and only one result achieved by the courts in important or difficult cases, and it will normally only occur in important and hard cases (Coleman and Leiter's formulation[53]). A decision on the latter will be a result not only of legal arguments and principles (as happens in respect of easy cases) but also implies the harmonization of contradictory principles and values, with several solutions being possible. In the latter case, a discretionary decision will occur, but it will still imply formal rationality: consistency must be observed, binding legal rules must be respected, any evidence produced cannot be disregarded, and the fundamental arguments must still be legal arguments (based on rules and principles) and not extra-legal ones.[54]

The second meaning of indeterminacy that is relevant to this chapter can also take place when legal arguments are not adequate to guarantee any result. This situation occurs in the case of legal gaps,[55] and although in a mature legal system genuine legal gaps seldom occur, because they can be overcome by all legal players (by all powers),[56] in fields such as tax law, where the exclusive legislative competence belongs to the parliament even if it can be delegated, legal gaps both in parliamentary law and government-delegated decree-laws occur, and they imply that in that situation no taxes may be levied.

Discretion is related to the first meaning of indeterminacy as described above, whereas filling legal gaps by analogy relates to its second meaning. The rule of law is achieved if legal rules on the legal type of taxes are determined in the easy cases, allowing other principles to be taken into account, and when the final results aimed at by the law are more predictable because of some vagueness than by detailed and supposedly precise rules.

53. Coleman and Leiter, supra, n. 27, pp. 226-227.
54. Dworkin, Ronald, *Taking Rights Seriously* (London: Duckworth, rev. ed., 1977), pp. 105-107; Atienza, Manuel, *Tras la justicia, Una introducción al derecho y al Razonamiento jurídico* (Barcelona: Editorial Ariel, 1993).
55. In the sense used in Raz, supra, n. 7, pp. 70-74.
56. See Coleman and Leiter, supra, n. 27, pp. 226-227.

If, however, in some cases vagueness does lead to indeterminacy, because hard cases often occur in tax law, as a rule the courts will control the application of this by the tax administration. If the vagueness is so broad that several answers are admissible, then some margin will in practice be available to the revenue authorities, as seems to be the case in many OECD countries.

7. Legal techniques and the rule of law: Tax law between "typifying" and vagueness

The tax legislator can choose between two legal drafting techniques: general rules and standards, corresponding to the identification of classes and classifications, and principles, aimed at the typical case. This technique might be referred to as "typifying". This approach must be the main instrument of social control in any field of law since it aims at large groups and its typical cases.[57] This should also be the prevailing technique in tax law, since aiming at the typical case implies a higher level of success in achieving equality and predictability.[58]

There is an additional reason for it being the prevailing technique in tax law, related to the fact that taxation is a field of mass administration: tax law aims at reaching typical wealth phenomena, and the revenue authorities aim at reaching mass facts through the adoption of massive assessment Acts.[59] Rates, deductions, allowances and amortization rates often correspond to typical amounts and do not take into account the particularities of the case. Legal typifying can either be achieved by illustrative conditions or detailed rules.

57. Hart, supra, n. 1, p. 121; Günther, supra, n. 27, pp. 270-271; Henkel, Heinrich, *Introducción a la Filosofia del Derecho – Fundamentos del Derecho* (Madrid: Taurus, 1968) (tr. Enrique Gimbenart Ordeig), pp. 575 et seq.
58. Dourado (ed.), supra, n. 8, pp. 42-44; Henkel, supra, n. 59, p. 588; Kirchhof, Paul, "*Der verfassungsrechtliche Auftrag zur Steuervereinfachung*", in Wilhelm Bühler, Paul Kirchhof and Franz Klein (eds.), *Steuervereinfachung, Festschrift für Dietrich Meyding zum 65. Geburtstag* (Heidelberg: C.F. Müller, 1994), pp. 9 and 13.
59. Kirchhof, Paul, "*Der verfassungsrechtliche Auftrag zur Steuervereinfachung*", supra, n. 60, pp. 5 et seq.; Isensee, Josef, "*Vom Beruf unserer Zeit für Steuervereinfachung*", *Steuer und Wirtschaft* 1 (1994), pp. 10-11; Isensee, Josef, "*Verwaltungsraison gegen Verwaltungsrecht. Antinomien der Massenverwaltung in der typisierenden Betrachungsweise des Steuerrechts*", *Steuer und Wirtschaft* 3 (1973), p. 204; *B.Verf.G.E.* 11, p. 254; 17, p. 23; 63, p. 121; 71, p. 157; 82, pp. 151 et seq.; 84, p. 359.

The precedent method in common law countries, as well as the methodology based on the illustrative typifying of the main characteristics of that type, can in theory lead to greater uncertainty. Vagueness can be recommended in order to cover the individual case and therefore better comply with the ability-to-pay principle and allow control of tax abuse. However, all of the techniques mentioned above are now common to both legal traditions[60] and they are complementary methods.[61]

On the other hand, the fact that welfare states in the second half of the 20th century have been legislating in every social domain can lead to a political parliamentary halt and/or to excessively detailed and complex rules. This is true in tax matters where the law cannot take into consideration fundamental differences concerning the tax object and subject. The more detailed the law becomes, differentiating among several types of taxpayers, the more complex and therefore less constant and less predictable it will be: clarity, non-contradiction, possibility of compliance, and constancy through time as required by legality and the rule of law will not be achieved.

8. The meaning of revenue authority discretions

Administrative discretion in its stricter sense can be defined as the choice between two or among several different alternatives granted by law, and that choice implies a subjective assessment of the specific circumstances of the case which is not to be controlled by the courts. Discretion or subjective assessment presupposes the following elements: that it is either explicitly or implicitly granted by law and, whereas in the former case there will be an express authorization by the law or statute in that direction, in the latter case that will stem from vagueness and indeterminacy; that it requires a case-by-case assessment; that the subjective assessment goes beyond interpretation, and that it must be exercised by the tax administration and

60. Hart, supra, n. 1; Henkel, supra, n. 59, pp. 575 et seq.; Kaufmann, Arthur, "*Analogie und 'Natur der Sache', Zugleich ein Beitrag zur Lehre vom Typus*", *Vortrag gehalten vor der Juristischen Studiengesellschaft in Karlsruhe am 22 April 1964, Juristische Studien Gesellschaft Karlsruhe, Schriftenreihe Heft 65/66* (Karlsruhe: C.F. Müller, 1965), p. 9; cf. Barker, supra, n. 15, pp. 248-249; De Crouy-Chanel and Maitrot de la Motte, supra, n. 44, p. 100.

61. Engisch, Karl, *Die Idee der Konkretisierung in Recht und Rechtswissenschaft unserer Zeit* (Heidelberg: C. Winter, 1953), pp. 275-276. See also Henkel, supra, n. 59, p. 586; Kaufmann, supra, n. 62, p. 37.

therefore is not to be controlled by the courts, since, otherwise, a subjective assessment would be substituted for another subjective assessment.[62]

9. Common law vs. civil law countries

In common law countries, the role granted to the legislatures (creation of law) and to the courts (interpretation of law) covers the needs of a rule-of-law state and therefore there is no place for administrative discretion in such state.[63]

In civil law countries, discretion started to be an area outside the law in the aftermath of the French Revolution – a free area where the government and the administration had autonomy in selecting their policies and were not subject to judicial control – and was progressively made subject to judicial control. Administrative discretion appeared as a distinct phenomenon from interpretation (or application of law). Whereas the latter belonged to the courts and signified the bound application of law, the former was not a juridical activity, but external to it, possibly a technical activity.[64] Constitutional and administrative law formed the basis of this understanding. Since the law did not cover the whole activity of the state in the constitutional monarchies of the civil law countries, discretion coincided with legal indeterminacy, and the latter opened a sphere external to the law.[65]

Through the 20th century, the first step in the civil law tradition was to recognize that discretion was granted by law and was not an area outside the law, and the next steps aimed at establishing legal limits to the exercise of discretion.

This movement led to an approximation of the position in both common law and civil law countries. In other words, in civil law countries, discretion implies an assessment that is not in itself controlled judicially, but can only be exercised within the limits expressly foreseen in the law granting that discretion, and within the general constitutional and administrative law principles such as equality, impartiality and proportionality.

62. Bachof, Otto, "*Beurteilungsspielraum, Ermessen und unbestimmter Rechtsbegriff im Verwaltungsrecht*", *Juristenzeitung* (1955), p. 99, n. 4.

63. Dyzenhaus, supra, n. 6, pp. 69-72.

64. Rupp, Hans Heinrich, "'*Ermessen*' '*unbestimmter Rechtsbegriff*' *und kein Ende*", in Walter Fürst, Roman Herzog and Dieter Umbach (eds.), *Festschrift für Wolfgang Zeidler* (Berlin: Verlag Walter De Gruyter, 1987), pp. 460-461.

65. Id.

The former imply identifying at least the competent authority and the purpose to be fulfilled. The introduction of these limits has normally resulted from the courts' case law: using the rule of law and separation of powers principles, the courts have been increasingly controlling administrative activity.

This movement also led to consequences that did not coincide with constitutional reality and the role played by the administration(s) in the increasingly complex welfare state: when indeterminacy ceased to (automatically) coincide with administrative discretion, one possible logical consequence would lead the latter to the same place that is granted to it by legal common law theorists: it would not belong to the rule-of-law state.[66]

From the moment that it was recognized that every activity of the state or public bodies is subject to the rule of law, or that the rule of law is incompatible with areas or activities lying outside the law, administrative discretion would logically disappear and every administrative action would be subject to the control of the courts. This logical step did not happen and subjective assessments either characterized as discretion or as a margin of free administrative assessment are still recognized by the legal literature and the courts in civil law countries.

Alternatively, following the Merkl/Kelsen approach, every state institution when applying the law exercises discretion and therefore interpretation would always imply (some) discretion.[67] The current distinction between easy and hard cases adopted in this chapter was unknown to Merkl and Kelsen.

As was noted in the opening paragraphs of this chapter, the trend in both civil law as well as in common law countries led to a flexible approach: the recognition and effective exercise of judicial control over administrative application of vague rules, leading to indeterminacy, especially in the legal fields where the exclusive legislative competence belongs to

66. Id.

67. Kelsen, Hans, *What is justice?, Justice, Law and Politics in the Mirror of Science, Collected Essays* (Berkeley: University of California Press, 1957), chs. 15 ("Science and Politics") and 8 ("Value Judgments in the Science of Law"); Kelsen, Hans, *Teoria pura do Direito* (Coimbra: Arménio Amado, 6th ed., 1984 [1960]) (tr. J. Baptista Machado); Kelsen, Hans, *Théorie générale du droit et de l'État, suivi de La Doctrine du droit naturel et le positivisme juridique* (Paris: LGDJ, 1997 [1945, 1928]) (tr. Béatrice Laroche and Valérie Faure); Merkl, Adolf, *Allgemeines Verwaltungsrecht* (Wien: Springer, 1927).

parliament; and recognition of some discretion, where the courts considered that they would not contribute to a better result by substituting the administrative assessment of the vague rule, based on extra-legal arguments, with their own assessment which is equally based on extra-legal arguments.

In civil law countries such as Germany and others under its legal influence, the period since World War II has been characterized by a legal positivist approach to tax law, where any discretion was denied by the legal literature and the courts. In Germany, the last word on indeterminacy in tax law belongs to the courts since it implies an interpretative activity,[68] whereas in other civil law countries legal indeterminacy in tax legislation is often denied.[69] However, as recalled in this chapter, indeterminacy is an inevitable consequence of the constraints of legal language.

10. Administrative and judicial typifying

It has been suggested that legal vagueness implies a complementary administrative and judicial activity in a rule-of-law state. Inherent in the law as passed by legislatures is the policy choice and guidance on the essential elements of taxes, and the government and revenue authorities will both interpret the law and reduce its vagueness using hermeneutical criteria, and use some policy elements inherent to their administrative function in the case of legal indeterminacy. In turn, courts are exclusively guided by

68. Papier, Hans-Jürgen, *Die finanzrechtlichen Gesetzesvorbehalte und das grundgesetzliche Demokratieprinzip* (Berlin: Duncker & Humblot, 1973), pp. 93 et seq.; Vogel, Klaus, "*Vergleich und Gesetzmäßigkeit der Verwaltung im Steuerrecht*", in Brigitte Knobbe-Keuk, Franz Klein and Adolf Moxter (eds.), supra, n. 35; Vogel, Klaus, *Der offene Finanz- und Steuerstaat, Ausgewählte Schriften 1964 bis 1990* (Heidelberg: C.F. Müller, 1991) (ed. Paul Kirchhof), pp. 312-313; Drüen, Klaus-Dieter, in Klaus Tipke and Heinrich Kruse (eds.), *AO/FGO Kommentar* (Köln: O. Schmidt, 2003), section 3, pp. 28-29, ss. 33 and 33A; Drüen, Klaus-Dieter, "*Zur Rechtsnatur des Steuerrechts und ihrem Einfluß auf die Rechtsanwendung*", in Walter Drenseck (ed.), *Festschrift für H. W. Kruse zum 70. Geburtstag* (Köln: Roman Seer, 2001), pp. 206-211; Vogel, Klaus and Christian Waldhoff, *Grundlagen des Finanzverfassungsrechts*, supra n. 35, pp. 307 et seq.; Vogel, Klaus and Christian Waldhoff, "*Vorbemmerkungen zu Art. 104 a-115*", supra, n. 35, pp. 384 et seq., especially 390.

69. See Dourado, supra n. 46, pp. 159-222, 259-272, 516-534; Dourado and Prokisch, supra n. 2, pp. 38 et seq.

hermeneutical criteria and, even when applying extra-legal arguments, they aim at determining legal meaning.[70]

Taking into account the fact that the principle of people's sovereignty and legal certainty are major aspects of legality in respect of tax law, regulations and rulings are the appropriate way for reducing legal vagueness, but if the government and revenue authorities do not use this approach, it is for the courts, in a subsidiary way, to progressively reduce that vagueness by way of coherent and consistent case law so that predictability is achieved.

As has been noted, there is a trend in law to deal with the typical cases. All powers in a rule-of-law state will contribute to such progressive reduction of legal vagueness and indeterminacy, mainly through taking into account the characteristics of the typical case, but in some cases, taking into account the details of the specific case. Tax rules providing for a possible tax concession, if the particular case recommends it, based on justice and equity considerations are allowed, but should be exceptional in order to be compatible with the rule of law. Ultimately they are to be controlled by the courts, in accordance with the principles of equality, non-discrimination and proportionality.

11. Conclusions

It has been suggested that legal vagueness is quantitative and it can lead to more or less indeterminacy and therefore to the use of a larger or smaller number of extra-legal arguments. Contrary to what happens in administrative law, in tax law, legal indeterminacy does not aim as a rule at an application according to the circumstances of the specific case, but it is recommended that the former is reduced by a general and abstract rule and

70. Raz, Joseph, *Between Authority and Interpretation: On the Theory of Law and Practical Reason* (Oxford: Oxford University Press, 2009). Cf. on administrative law, Wolff, Hans, Otto Bachof and Rolf Stober, *Verwaltungsrecht I* (Munich: C.H. Beck, 11th ed., 2000), pp. 446-448; Schmidt-Eichstaedt, Gerd, "*Der Konkretisierungsauftrag der Verwaltung beim Vollzug öffentlich-rechtlicher Normen*", *Deutsches Verwaltungsblatt* (1985), p. 645; Badura, Peter, "*Gestaltungsfreiheit und Beurteilungsspielraum der Verwaltung, bestehend aufgrund und nach Maßgabe des Gesetzes*", in Günter Püttner (ed.), *Festschrift für Otto Bachof* (Munich: C.H. Beck, 1984), p. 170; Brohm, Winfried, "*Die staatliche Verwaltung als eigenständige Gewalt und die Grenzen der Verwaltungsgerichtsbarkeit*", *Deutsches Verwaltungsblatt* 101 (1986), pp. 327-328, 330; Ossenbühl, Fritz, "*Tendenzen und Gefahren der neueren Ermessenlehre*" (DöV 1968), pp. 626-627.

by consistent case law.[71] Unless the law provides otherwise, legality, practicability and a second-best equality recommend such reduction of indeterminacy due to the fact that tax law implies mass administration.

The government and the revenue authorities are the first recipients of the legal rules and the responses to the consequences of legal vagueness and legal indeterminacy are linked to the difference between the administrative and the judicial function. Although the revenue authorities are not allowed to create rules in a rule-of-law state, their function allows them to apply extra-legal arguments linked to policy arguments.

It is for the courts to control the interpretation of the vague rules by the revenue authorities, taking into account all of the relevant legal principles, and accepting the solution adopted by the revenue authorities, if it is a valid interpretation among several other alternatives.

In respect of the taxpayer and the tax object, any legal indeterminacy will raise a yes or no question. Is the relevant person a taxpayer or not? Is the object a taxable fact or is it not a taxable fact? Every tax lawyer is familiar with issues raised by entities without legal personality, partnerships, charities, any informally organized group of entities, irregularly constituted bodies, the qualification of independent agents vs. permanent establishments, among others. Also, qualification of income or transactions between private parties, income raised by hybrid financial instruments, investment funds (for example, whether it is interest, dividends, capital gains), is on the basis of relevant opinions balancing between tax planning and abuse. In the aforementioned cases, it is necessary to determine the limits of legitimate interpretation and the border of prohibited analogy and the creation of law. The decision as to whether the facts are covered by the law or not exclusively belongs to the courts, and if they decide that the law does not give an answer to the case, no analogy will be possible. Moreover, these are cases where the details of the case exclusively are to be considered, because the mass administration arguments, connected to the tax assessment of the due amount of tax, are not applicable here.

In other words, this is neither an issue concerning discretion on the part of the revenue authorities nor a place for the complementary role of regulations and rulings. In those countries where the government has delegated legislative powers, as long as the legislatures define the tax object and the

71. Larenz, Karl and Claus-Wilhelm Canaris, *Methodenlehre der Rechtswissenschaft* (Berlin: Springer, 3rd ed., 1995), p. 117.

tax subject in its authorization to the government, it may be admissible that the government clarifies any legal vagueness of the authorization, but no more than what is acceptable under the rule of law.

In respect of the tax base and its quantification, such as evaluation of immovable property, deductions, allocation of costs and profits, anti-abuse clauses, application of indirect methods, and behaviour that implies mass administration, the principles of ability-to-pay, second-best equality and practicability recommend that the revenue authorities reduce any legal indeterminacy by progressive regulations or rulings covering the typical cases. In this context, the courts should accept the authorities' decisions as long as those decisions are defensible and comply with all legal principles – in other words, are not illegal (that is the case with "necessary, reasonable or indispensable expenses", "expenses related to the activity", the arm's length principle, controlled foreign corporations (CFC) clauses).

This appears to be the best way to achieve the goal of legal certainty. The alternative would be forcourts to substitute one possible (legal) interpretation with another one on the basis of extra-legal arguments, an approach that would only generate uncertainty.

The aforementioned administrative activity by regulations and rulings must be exercised based on a frequent or average typical case and not on the basis of exceptional although conceivable cases. If, in most legal systems, there is reluctance to recognize rulings as binding on taxpayers, at least they should be binding on the revenue, so that the taxpayer can count on them. Ideally, rulings should also be binding on the courts, provided that their regime complies with one of the possible meanings of the vague law.

In this context, any legal indeterminacy in respect of the tax base elements and tax rates is only to be applied according to the individual circumstances of the case if the latter does not correspond to the typical case (e.g. CFC rules). In this instance, some leeway is to be left to the individual assessment, with the final word thus belonging to the courts. Ability-to-pay has then to be balanced with practicability.

In contrast to the revenue authorities, courts should, as a rule, adjudicate according to the individual circumstances of the case, but consistent case law will bring some predictability to subsequent identical or similar cases and therefore also contribute to "typifying" and to legal certainty.

Although the rule of law in tax law does require that the law is sufficiently determined in respect of the essential elements of the tax, judicial decisions are in most cases foreseeable even in non-common law countries[72] and therefore legal vagueness does not necessarily lead to arbitrary application of the law.[73]

72. Coleman and Leiter, supra, n. 27, p. 233.
73. Coleman and Leiter, supra, n. 27, pp. 230-235; Endicott, supra, n. 27, p. 187.

The Promise and the Reality of U.S. Tax Administration

Kristin E. Hickman*

Contemporary tax administration in the United States relies heavily upon extensive delegation of discretionary power to unelected officials in the Department of the Treasury and the Internal Revenue Service (IRS). The Internal Revenue Code (IRC) contains a number of specific delegations of rulemaking authority to Treasury.[1] Some of these delegations are narrow, for example authorizing Treasury to prescribe income tax tables each year within fairly precise statutory parameters.[2] Others are much broader, including for example discretion to allocate income among businesses with common ownership as "necessary to prevent evasion of taxes or clearly reflect [their] income",[3] and to prescribe the regulations Treasury "deem[s] necessary" for affiliated corporate groups to prepare and file consolidated income tax returns "in such manner as clearly to reflect" their tax liabilities and "to prevent avoidance" of the same.[4] The IRC also gives Treasury the general and significantly more open-ended power to "prescribe all needful rules and regulations for the enforcement" of the tax laws.[5] Treasury, with the assistance of the IRS, adopts annually hundreds of pages of temporary

* Professor of Law, University of Minnesota Law School. Thanks to Mary Lou Fellows, Amy Monahan, Brian Bix, participants in the University of Minnesota Law School Squaretable workshop series, and participants in the symposium for which this chapter was written, *The Delicate Balance: Revenue Authority Discretions and the Rule of Law*, Monash Prato Centre, 23-24 September 2010, for helpful comments and suggestions.

1. The New York State Bar Association Tax Section in 2006 published a helpful report in which they claimed and categorized more than 550 specific delegations of rulemaking authority in the IRC. See New York State Bar Association Tax Section, *Report on Legislative Grants of Regulatory Authority 2–6* (3 November 2006), available at http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1121Report.pdf (accessed on 12 March 2011).
2. See IRC, s. 3 (2006).
3. See IRC, s. 482. This short IRC section covers roughly one-third of a page of the United States Code. By comparison, Treasury has adopted more than 200 pages of temporary and final regulations interpreting and implementing this provision. See Treas. Reg. ss. 1.482-0 to 1.482-9T; Treas. Reg. ss. 1.482-1A to 1.482-7A.
4. See IRC, s. 1502. This IRC section consists of two sentences totalling 112 words. By comparison, Treasury has exercised its authority under this provision to adopt more than 350 pages of temporary and final regulations. See, for example, Treas. Reg. ss. 1.1502-0 to 1.1502-100.
5. IRC, s. 7805(a).

and final regulations detailing the legal rights and obligations of taxpayers. The IRS further issues hundreds of less formal documents each year to guide taxpayers in complying with the tax laws. Treasury regulations and IRS guidance documents resolve many of the day-to-day details left unresolved by the IRC. They adopt rules interpreting ambiguous statutory terms and clarifying whether, when, and how statutory language applies to particular facts and circumstances. Inherently, these efforts require agency officials to make policy choices, both in prioritizing rulemaking targets and in developing rule content.

This system of statutory delegation and agency administration is not unique within the U.S. government. For well over one hundred years, the U.S. Congress has enacted scores of regulatory statutes granting agency officials extensive power to adopt legal rules for, among other things, protecting workers, consumers, and the environment; providing government benefits; and monitoring and managing a range of industrial and other economic activities. As with the IRC, some of these authorizations are specific and relatively narrow, explicitly instructing agencies to fill congressionally identified statutory gaps;[6] some are specific but broader;[7] still others are general and open-ended, giving agencies the power to adopt the rules and regulations they deem necessary or appropriate.[8] Like Treasury and the IRS, other U.S. government agencies exercise both specific and general authority to adopt regulations and rules defining legal requirements for

6. See, for example, Public Utility Act of 1935, ch. 687, s. 301, 49 Stat. 847 (codified at 16 U.S.C. s. 825(a)) (giving the Federal Power Commission, subsequently replaced by the Federal Energy Regulatory Commission, the power to "prescribe a system of accounts" for licensees and public utilities to use in maintaining books and records).

7. See, for example, Occupational Safety and Health Act of 1970, Pub. L. No. 91-596, ss. 3 and 6, 84 Stat. 1590 (codified at 29 U.S.C. ss. 652(8) and 655(a) (2006)) (instructing the Secretary of Labor, inter alia, to promulgate rules containing "occupational safety or health standard[s]", defined by reference to whatever are the "practices, means, methods, operations, or processes reasonably necessary or appropriate to provide safe or healthful employment and places of employment").

8. See, for example, Federal Food, Drug, and Cosmetic Act, ch. 675, s. 701, 52 Stat. 1040 (1938) (codified at 21 U.S.C. s. 371) (granting the Secretary of Health and Human Services "the authority to promulgate regulations for the efficient enforcement" of the statute); Securities Exchange Act of 1934, ch. 404, s. 23(a), 48 Stat. 881 (codified as amended at 15 U.S.C. s. 78w) (authorizing the Securities and Exchange Commission and Federal Reserve Board to "make such rules and regulations as may be necessary for the execution of the functions vested in them" by the statute).

primary behaviour, clarifying statutory requirements, and making policy choices.[9]

The power of U.S. government agencies to define rather than merely interpret and enforce the law is extensive but not unconstrained. Congress, through the Administrative Procedure Act (APA) and other statutes, has imposed procedural requirements upon agency exercises of rulemaking power and given the courts tremendous latitude to police agency behaviour.[10] The courts, in turn, have employed the APA to fashion a compromise of sorts that allows delegation in the name of efficiency and flexibility but utilizes procedural requirements and judicial review to achieve a respectable level of public participation, transparency, and accountability when agencies employ delegated power to adopt legally binding regulations and rules. Significantly, at least in practice if not in law, U.S. tax administration has moved away from the balance that the Congress and the courts have achieved for other areas of administrative law.

The purpose of this chapter is not to evaluate the doctrinal validity or the wisdom of the U.S. model of delegation and administration; a robust academic

9. U.S. government agencies also shape the law's contours and advance policy preferences by means of adjudication, both at the agency level and through enforcement actions in the courts. Without minimizing the impact of these actions on the law or parties subject to it, my principal concern in this chapter is rulemaking by U.S. government agencies. Agency exercises of discretionary power in the rulemaking and adjudication contexts raise different issues and concerns. Space considerations in this chapter preclude a full exploration of the implications of agency discretion and adjudication. Although some U.S. agencies like the National Labor Relations Board prefer to implement their policy preferences through case-by-case adjudication, Treasury and the IRS, like many agencies, employ rulemaking as the principal means of guiding primary behaviour. Finally, over-generalizing somewhat, while judicial opinions and agency adjudications often have precedential value and thus encourage compliance with their conclusions, they also tend to be relatively limited in their scope and effect when compared with the breadth and consequences of many agency rulemaking efforts.

10. See Administrative Procedure Act of 1946, 5 U.S.C. ss. 551-559, 701-706 (2006). Although this chapter focuses principally on APA requirements in the tax context, other relevant statutes for controlling federal agency action include the Freedom of Information Act of 1966, 5 U.S.C. s. 552; the Privacy Act of 1974, 5 U.S.C. s. 552a; and the Government in the Sunshine Act of 1976, 5 U.S.C. s. 552b.