

STUDIES IN THE HISTORY
OF TAX LAW



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EDITED BY JOHN TILEY

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Preface

Over two almost perfect English summer days in July 2004, the second group of 40 interested people gathered together for the second Tax Law History Conference organised by the Centre for Tax Law which is part of the Law Faculty of the University of Cambridge. As with the first, held two years earlier, our days were passed in the beautiful surroundings of Lucy Cavendish College and this time the air was heavy with the scents of a Cambridge Edwardian garden in full summer. This volume is a collection of the papers delivered over those two days. The occasion would have been impossible without sponsorship from the Chartered Institute of Taxation.

Once again I have taken my role as editor very lightly. As I, in my editorial role, look back I am struck by the great richness and variety of the material waiting to be examined. There have always been writers of the history of taxation, especially in the United Kingdom, but the opportunities for new work has never been greater. As the list of papers below makes clear we were 'discovered' by participants from the United States. The success of the days caused a group led by Steve Bank and based at the University of California, Los Angeles to organise their own conference in co-operation with our own Cambridge Centre for Tax Law in July 2005.

The first two chapters were published in the January 2005 British Tax Review special issue to mark the bicentenary of the Special Commissioners. David Duff has widened his researches in the area of wealth transfer to cover New Zealand; his extended article is due to appear shortly in the Pittsburgh Tax Review.

The third Cambridge conference took place in Cambridge in July 2006 and had more participants from continental Europe. The fourth is scheduled for July 2008.

It remains for me as Director of the Centre once again to express my thanks to all those who gave of their time to attend the conference making it the happy event it was and, in particular, to those who shared their scholarly investigations with us by giving papers and thus focussing our thoughts. Special thanks go to Janet Rogers who helped with the administration of the conference.

Sincere thanks go also Christine Houghton and all the staff of Lucy Cavendish College who made us so welcome and to the President and Fellows of the college for allowing us to stay in their college.

Finally thanks go to Richard Hart and his editorial team for taking this publishing project on and to Mel Hamill as the Managing Editor for all the hard work.

John Tiley
Cambridge
July 2006

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Contents

<i>Preface</i>	v
<i>Acknowledgement</i>	vii
<i>List of Contributors</i>	xi
 Part 1 The Income Tax Era	 1
1 The Special Commissioners from Trafalgar to Waterloo.....	3
<i>John F Avery Jones</i>	
2 Access to Justice before the Special Commissioners of Income Tax in the Nineteenth Century	49
<i>Chantal Stebbings</i>	
3 The Rise and Development of the Concept of ‘Total Income’ in United Kingdom Income Tax Law: 1842–1952	87
<i>John HN Pearce</i>	
4 Official Deliberations on Capital Gains Tax: 1955–1960	119
<i>David Stopforth</i>	
5 Excess Profits Tax Litigation <i>Philip Ridd</i>	137
 Part 2 Wider Issues	 181
6 Tax Law and Public Opinion: Explaining <i>IRC v Duke of Westminster</i>	183
<i>Assaf Likhovski</i>	
7 A Book Review of <i>The Saving of Income Tax, Surtax and Death Duties</i> by Jasper More	223
<i>Philip Baker</i>	
8 When is a Tax not a Tax but a Tithe?	235
<i>Andrew Lewis</i>	
9 The Concept of Taxation and the Age of Enlightenment.....	253
<i>Jane Frecknall Hughes</i>	

10 The Abolition of the Taxes on Knowledge	287
<i>Lynne Oats and Pauline Sadler</i>	
Part 3 Commonwealth Essays	307
11 The Abolition of Wealth Transfer Taxes in Canada	309
<i>David G Duff</i>	
12 A Tale of Two Systems: The Divergent Tax Histories of Australia and Canada	335
<i>Rodney Fisher</i>	
13 The Ever-Elusive Definition of Income: A Historical Perspective from Australia	357
<i>Margaret McKerchar and Cynthia Coleman</i>	
Part 4 The US Dimension	375
14 Why was the US Corporate Tax Enacted in 1909?	377
<i>Reuven S Avi-Yonah</i>	
15 Entity Theory as Myth in the US Corporate Excise Tax of 1909	393
<i>Steven A Bank</i>	
16 Voluntarism and Taxation	427
<i>Carolyn C Jones</i>	

Part 1

The Income Tax Era

1

The Special Commissioners from Trafalgar to Waterloo

JOHN F AVERY JONES

ABSTRACT

THE SPECIAL COMMISSIONERS were introduced by Pitt in 1805 to take some of the work away from the general commissioners by dealing with claims for charitable reliefs under Schedules A and C. This was their sole function until the abolition of income tax in 1816. The problems of interpretation of the oddly-worded charitable exemption were not resolved until Pemsel's case in 1891.

*'Practically the Special Commissioners are identical with the Board of Inland Revenue.'*¹

I. INTRODUCTION

THE SPECIAL COMMISSIONERS celebrate their bicentenary in 2005. Their history can be divided into two main eras: the first from their introduction in 1805 to the abolition of income tax in 1816, a period when they dealt with certain claims for exemption from tax (including the still-topical one of determining whether public schools and hospitals qualified for tax relief), relieving some of the burden on the General Commissioners. The second era starts with the reintroduction of income tax in 1842: this time the Special Commissioners also dealt with Schedule D assessments and Schedule D appeals at the option of the taxpayer in order to preserve confidentiality of their affairs from the General Commissioners. This chapter will deal with the first era roughly corresponding to the period from the battle of Trafalgar to that of Waterloo.

¹ *Special Commissioners v Pemsel* (1891) 3 TC 53, 99 *per* Lord Macnaghten. (This was said in relation to their original function of handling claims for exemption, not hearing appeals.)

Originally both assessment and appeals were the province of the General Commissioners and formed a continuous administrative process leading to the correct figure. The Special Commissioners' decisions on claims for exemption were also administrative, but exercised judicially as there was no right of appeal. Although these claims are no longer made to the Special Commissioners, the connection is preserved as the Special Commissioners are the sole appeal body in relation to all such refuted claims.² If one of the original Special Commissioners returned today he would find virtually all³ of these original exemptions still in the Act, and he would even find the statutory wording of them familiar. Remarkably most of the original claims were still being made to his successors until 1965.⁴ The Special Commissioners' assessing function started in 1805 since they assessed tax on Schedule C income where the recipient did not make a return or if he made an arrangement to pay the tax direct to the Bank of England without declaring the income to the General Commissioners. This lasted for only one year, becoming unnecessary in 1806 by the introduction of the paying agent deducting tax at source. As well as the taxpayer's option to have his Schedule D assessment made by the Special Commissioners, many other assessing functions followed. All assessing functions ended in 1965 leaving only the appellate function introduced in the second era with the Schedule D appeals heard by the Special Commissioners at the taxpayer's option: this was subsequently expanded beyond Schedule D.

To put the history of the Special Commissioners into perspective, one must start with the state of development of income tax at the time they were first introduced. Land tax, which had existed since 1688 (and under another name effectively from 1671), was the main direct tax in the eighteenth century. In spite of its name, land tax included a tax on deemed income from personal property, including public offices,⁵ and annuities and other yearly payments, expressions that would later be taken over by

² But see below nn. 169 and 170 for a possible exception.

³ Except the Schedule C exemptions for non-resident aliens, which was not repeated in the 1842 Act, see below n. 148, and for foreign ministers, which was repealed in 1964, see below n. 161.

⁴ Until 1925 for the charitable exemptions, other than for the British Museum, see below n. 120.

⁵ Adam Smith fully understood the meaning of the expression: 'The emoluments of offices are not, like those of trades and professions, regulated by the free competition of the market, and do not, therefore, always bear a just proportion to what the nature of the employment requires. They are, perhaps, in most countries, higher than it requires; the persons who have the administration of government being generally disposed to reward both themselves and their immediate dependants rather more than enough. The emoluments of offices, therefore, can in most cases very well bear to be taxed. The persons, besides, who enjoy public offices, especially the more lucrative, are in all countries the objects of general envy, and a tax upon their emoluments, even though it should be somewhat higher than upon any other sort of revenue, is always a very popular tax. In England, for example, when by the land-tax every other sort of revenue was supposed to be assessed at four shillings in

income tax:⁶ the operation of the tax on personal property was not particularly effective.⁷ The half-way stage in the transition to taxation of actual income was Pitt's Triple Assessment⁸ of 1798. This allowed persons to elect to pay 10 per cent tax on their total income (with lower rates for small incomes and nothing on £60 or below) as an alternative to paying a multiple (not always three times despite its popular name) of the amount of the previous year's tax on various items of luxury expenditure (male servants, horses, carriages, hair powder, etc.), but it contained no provisions for computing such income. In other words, the taxpayer had an option

the pound, it was very popular to lay a real tax of five shillings and sixpence in the pound upon the salaries of offices which exceeded a hundred pounds a year, the pensions of the younger branches of the royal family, the pay of the officers of the army and navy, and a few others less obnoxious to envy excepted': *Wealth of Nations* Bk.V, Ch.2, art.3 (1776, not long before the introduction of income tax).

⁶ In addition to land, land tax taxed: (a) money, debts, goods, wares, merchandises, chattels or other personal estate at the rate of 4s. in the pound based on an annual yield of 1 per cent.; (b) the holding of 'any publick Office or Employment of Profit', wording that was adopted for income tax; (c) 'an Annuity, Pension, Stipend, or other Yearly Payment', also adopted for income tax; and (d) shares 'in the New River Company [which was logical as they were regarded as realty, see *Townsend v Ash* (1745) 3 Atk. 336, on the theory that the company held its assets on trust for its shareholders; later a trust for conversion was implied and is still found in Companies Act 1985 s.182(1)(a)], in the Thames waterworks, or in Marybone or in Hampstead waterworks, in any office or stock for insuring of houses in case of fire, or in any lights, or in the stock or stocks for printing of books in or belonging to the house commonly called the king's printing house', and all companies of merchants in London and the Bank of England (s.57). The items adopted for income tax can be traced back even further to a 1671 Subsidy (22 & 23 Car 2 c.3 ss.2-8) which taxed land, items (a) and (b) and also contained charitable reliefs: see n. 58, and PE Soos, *The Origins of Taxation at Source in England* (IBFD Publications, Amsterdam, 1998) 109 ('Soos'). The Land Tax Perpetuation Act 1798 (38 Geo 3 c.60) changed land tax into a perpetual tax with a fixed quota for each town, parish, etc., and moved the taxation of personal property into another Act which was not perpetual, and like income tax today, had to be renewed every year. The first of such Acts was 39 Geo 3 c.3, which covered the same assets and applied for the year beginning 25 March 1799 (for some reason the land tax year never changed to 5 April) and therefore applied at the same time as Pitt's income tax of 1799. Notwithstanding the Perpetuation Act the land tax on item (d) was made redeemable by the Land Tax Redemption Act 1802 (42 Geo 3 c.116 s.13), also suggesting that this item was akin to realty. See Soos at 140. Land tax was finally repealed by FA 1963. On the history of land tax, see W Phillips, *No Flowers, by Request* [1963] BTR 285.

⁷ Adam Smith had said: 'If the greater part of the lands of England are not rated to the land-tax at half their actual value, the greater part of the [capital] stock of England is, perhaps, scarce rated at the fiftieth part of its actual value' (*Wealth of Nations* Bk 5 Ch.2 art.2 (1776). This resulted from land tax becoming a fixed proportion for each district. M Daunton, *Trusting Leviathan, the Politics of Taxation in Britain 1799 to 1914* (CUP, Cambridge, 2001) at 33 ('Daunton') says: 'In theory, this tax [Land Tax] was a national rate of 1s, 2s, 3s, or 4s in the £ on the income not only of land but also of personal property and office. . . . Reality was different, for the tax was confined to land'. . . . A Hope-Jones, *Income Tax in the Napoleonic Wars* (CUP, Cambridge, 1939) at 11 ('Hope-Jones') also states that the attempt to tax offices and personal property failed.

⁸ 38 Geo 3 c.16. *Simon's Taxes* (3rd edn., Butterworths, London, looseleaf) at A.1403 records that 'it was associated with a scheme proposed by the Speaker, Addington, from an idea by JBowles in 1796 (Two letters addressed to a British Merchant, 4th ed pp 31 and 76) that voluntary contributions in excess of the Triple Assessment might be made to the Bank of England; this scheme raised almost as much as the main tax itself had produced.'

between paying an income tax or an expenditure tax. That the Triple Assessment yielded only £1.8m, less than half its expected yield,⁹ with large numbers of people declaring incomes of under £60, caused Pitt to go back on his promise not to impose an income tax (made in the debates on the Triple Assessment). In 1799 he imposed such a tax (although it was still in relation to land, the main source of wealth and so a tax on deemed income) at 10 per cent,¹⁰ which turned out to be not much more successful than its predecessor, collecting only £6m instead of the estimated £10m, although this was a considerable improvement on the £1.8m yield from Triple Assessment. The income tax removed the voluntary element of the Triple Assessment, i.e. paying tax on one's expenditure without disclosing one's income. It was now necessary to declare one's income; a sensitive issue, particularly so in relation to trading profits, as this was the first time an attempt had been made to tax them. Only 25 years before, Adam Smith had warned:

the state of a man's fortune varies from day to day and, without an inquisition more intolerable than any tax and renewed at least once every year, can only be guessed at. His assessment, therefore, must, in most cases depend upon the good or bad humour of his assessors and must, therefore, be altogether arbitrary and uncertain.¹¹

Income required a definition for the first time; it was divided into four major heads: (1) land (14 Cases, which demonstrates the importance of land at the time), (2) trades, employments and interest and annuities (2 Cases), (3) foreign income (2 Cases¹²), and (4) income not falling under any other head.¹³ The tax return merely required a statement that the tax paid was not less than one tenth of the taxpayer's income, although a return under each head could be required as part of the appeal process.

Addington, who had succeeded Pitt, repealed Pitt's income tax in his budget on 5 April 1802 following the Peace of Amiens on 25 March

⁹ The yield was £1,855,996 (1870 Report of the Board of Inland Revenue); Pitt had expected £4.5m.

¹⁰ 39 Geo 3 c.13 ('1799'), although the Schedule is substituted by c.22, an act that also extended the time limit for making returns. For articles on the 1799 Act see BEV Sabine, 'Great Budgets' [1970] *BTR* 201; W Phillips, 'The Origin of Income Tax' [1967] *BTR* 103 and 'The Real Objection to the Income Tax of 1799' [1967] *BTR* 177; C Stebbings, 'The Budget of 1798: Legislative Provision for Secrecy in Income Taxation' [1998] *BTR* 651.

¹¹ *Wealth of Nations*, Bk V, Ch.2 art.4.

¹² Identical to Addington's Cases IV and V of Schedule D and still effectively unchanged, see the writer's 'Taxing Foreign Income from Pitt to the Tax Law Rewrite—the Decline of the Remittance Basis' in J Tiley (ed.), *Studies in the History of Tax Law* (Hart Publishing, Oxford, 2004), Ch.2. Foreign income was subject to land tax only if it fell within item (a) in n. 6.

¹³ This last feature was the main difference from the schedular taxes (*impôts réels*) to be found later in Europe, which covered a specific list of items, such as immovable property, industrial and commercial establishments (including the case of a branch or agency or permanent establishment, shipping enterprises, railway companies, transatlantic cables, aerial navigation companies and electrical power undertakings, insurance companies, banks), mortgages, directors' fees, earned income, transferable securities, and various credits and annuities (League of Nations, Double Taxation and Tax Evasion, Report and Resolutions submitted by the Technical Experts to the Financial Committee of the League of Nations, 1925).

1802.¹⁴ War with France was declared again, and, little more than a year later, on 18 May 1803 he was obliged to reintroduce an income tax, thinly disguised by the name property tax.¹⁵ Like Pitt's tax, Addington's 1803¹⁶ tax was a schedular tax but, unlike with Pitt's, the tax under each schedule was collected separately so that no return of total income was required, thus removing the main concern about Pitt's tax. Addington's tax owed much more to land tax than to Pitt's income tax: many of Addington's schedules corresponded to items taxed by land tax (such as land, public offices and employments, and annuities and other yearly payments¹⁷), and the tax was administered by General Commissioners chosen from the Land Tax Commissioners. Research by Piroska Soos has shown that claims made (by others) for the originality of Addington's tax have been exaggerated; in particular there was nothing original about deduction of tax at source, a feature of land tax since 1688,¹⁸ the origins of which have been traced back to a lay subsidy granted to Henry VIII in 1512.¹⁹ Three of Addington's 1803 provisions for deduction of tax at source were virtually identical to the 1797 land tax, two were similar and three were new but based on the same principles.²⁰ Addington merely adopted a collection mechanism contained in another tax in force at the time. The surprise is not that Addington used deduction at source, but that Pitt had failed to do so in his 1799 tax. The result was a great improvement on Pitt's 1799 Act, raising almost twice the tax at half the

¹⁴ This was not all gain, since in 1816 the Chancellor said that Addington imposed other taxes of £5m p.a. (HC Deb, vol.33, col.423). This was denied in evidence to the First Report of the Select Committee on the Income and Property Tax in 1852 ('1852 Select Committee') q.54 but I have not investigated which statement was correct. Although there is no actual First Report of the Committee, the minutes of evidence give a useful contemporary view of the tax about nine years after it was reintroduced from the point of view of all the participants, such as the Board, Special Commissioners, General Commissioners and their clerks and surveyors, plus three witnesses from the United States. (The Second Report 1852 is restricted to Schedules A and B.)

¹⁵ The 1803 Act provided a 'Contribution on the Profits arising from Property, Professions, Trades, and Offices'. Even the 1842 Act was 'An Act for Granting to Her Majesty Duties on Profits arising from Property, Professions, Trades and Offices' and it is indexed under Property and Income Tax in *Chitty's Statutes* (5th edn., Sweet and Maxwell, London, 1895).

¹⁶ 43 Geo 3 c.122 ('1803'). For an article on Addington's Act see W Phillips, 'A New Light on Addington's Income Tax' [1967] BTR 271.

¹⁷ See above n. 6 for the items taxed by land tax.

¹⁸ Soos, above n. 6, at 181, traces the origin of this misconception to the official Exposition of the 1803 tax, the purpose of which was to distinguish Addington's from Pitt's tax, and in doing so the Exposition concentrated on deduction at source as a principle. The Inland Revenue annual reports beginning in 1857, particularly the historical survey in the 1870 and 1885 reports from which historians have frequently quoted, contributed to the misconception by quoting from the Exposition and wrongly stating repeatedly that taxation at source started in 1803 (above n.6 at 186).

¹⁹ Soos, above n.6 at 36.

²⁰ The three that were the same as land tax were two in Schedule A and one in Schedule E (deputy receiving payment, or fund for division); the two similar ones related to dividends paid by companies and by the Bank of England, etc.; and the three new ones related to annual payments and two within Schedule E (payments to another person, and payments to a clerk or deputy) see Soos, above n.6, at 152–181.