CHAPTER XIX

ASSESSMENT, REFUND, AND ADMINISTRATIVE APPEAL PROCEDURES

Section A. *Assessment and Audit Procedures*

3.1 *Introductory note*

The assessment procedure adopted by the Inland Revenue Department follows a common pattern, whether the tax involved is income tax, surtax, or profits tax. The taxpayer is required by statute to furnish a return showing the sources of his income and the amount of income derived from each source. The local Tax Office or the Surtax Office then scrutinizes the information supplied, calls for any further information or explanation that appears necessary, and makes arrangements for a formal assessment in the amount that appears to be warranted by the facts.

This common pattern extends beyond cases in which the definitive action to be taken is an assessment. In a country such as the United Kingdom, which applies tax deduction at source—i.e., withholding—to a wide variety of income sources, cases in considerable numbers are bound to arise where the aggregate tax deducted exceeds the amount of the recipient's true liability.

For example, consider an individual whose income is derived primarily from investments, the income of which is subject to withholding at the source. This same individual may be entitled to various personal allowances and reliefs with respect to his dependents, or his business activities may have resulted in a net loss which he is entitled to set off against income from other sources. In such a case, this individual is entitled to a refund and will not receive an assessment. The procedural steps, however, are much the same as in the assessment situation. Such a taxpayer presents the necessary information on a return, and the initial examination is conducted in the same way and, generally speaking, by the same Tax Office which would have handled the matter if an assessment were required.

However, in the case where taxpayers derive their income from wages and salaries, both subject to withholding at the source, the making of a formal assessment on such salaries

or wages is a prerequisite in the process of establishing whatever adjustment may be necessary, whether the amount of such an adjustment represents a refund or an assessment.[1]

In view of the foregoing, it seems proper to regard the making of assessments and the payment of refunds as alternative aspects of a single process. This conclusion is reinforced by the fact that the remedies open to the taxpayer when he disputes the amount of the refund offered to him are fundamentally similar to the remedies which a taxpayer can pursue when he disputes the amount of an assessment. In either type of case, he can make an oral argument before appeal Commissioners having jurisdiction in the matter, and can then appeal, if need be, to the courts on a point of law—as discussed in Chapter XX *infra*.

The tax administration of some countries use the so-called self-assessment system, that is, the field office automatically records as the assessment the tax liability calculated by the taxpayer himself on the return he files. This initial taxpayer-determined assessment is then checked, but only in a selected proportion of the cases, by a subsequent examination—described as an audit—designed to verify the adequacy of the return. The United Kingdom does not use the self-assessment system; some degree of scrutiny is regularly applied to each return before final assessment. Therefore, the audit process is not distinct from the process of assessment.

Every taxpayer's return is processed to establish the correctness of the information stated thereon. For wage earners, who have no other source of income, this is a matter of determining whether or not, in comparison with past years, the taxpayer has reported his dependents correctly and whether the employer has withheld the proper amount under "Pay as you Earn." The same type of verification is applied where a return shows, in addition to earnings, income from another source, i.e., investments. An actual check of the mathematical accuracy to ascertain the totals (other than for incomes subject to surtax) is not necessary because the withholding system will have insured that a taxpayer will have been taxed correctly for each source of income.

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[1] The tax withheld by an employer is calculated on a basis which takes account of the employee's personal allowances and reliefs, to the end, hopefully, of collecting the correct final liability. The system in fact achieves this in the great bulk of cases; and when it does so, the law permits a formal assessment to be dispensed with unless the employee requests one.

Even incomes subject to surtax are given the same processing at the local office. When the case reaches the Surtax Office for processing at that level, the Surtax Office then concerns itself with the exact amount of any income subject to withholding.[2]

3.2 *Details of the assessment and audit procedures*

Ordinarily, the assessment procedure takes as a point of departure the taxpayer's own return of his income. A taxpayer's written claim for a refund (including where appropriate his statement of income) performs a similar role in the refund procedure. Even the "Pay as you Earn" system does not depart completely from this principle. Under that system, a return received from the employee in an earlier year, supplemented by any later information he may have supplied during the current year, is used by the Tax Office to determine the code number to be furnished the employer so the latter can determine from official tax tables how much tax should be deducted from any given wage payment. Thus even if the withholding process is deemed equivalent to a species of provisional assessment, it still is based upon a return by the employee. When the employer, after the end of the year, reports the total amount of tax deducted, the Tax Office's provisional assumptions about the employee's circumstances can be checked against the employee's return for that year. Normally only if the two differ (due, e.g., to a midyear change of circumstances not previously known to the Tax Office and not reflected therefore in the code number which governed the employer's action) will it be necessary to make an assessment. Although the taxpayer's return of income is tremendously important to the Department's procedures, a taxpayer is not allowed to defer his liability by neglecting to make a return. Where he fails to submit his return or submits one which is incomplete or unsatisfactory, the assessing authority is authorized by statute to make an assessment according to its best judgment.

Where surtax or profits tax is also involved, a separate return will not necessarily be obtained. When individuals have incomes sufficiently large to render them liable to surtax, there is a regular procedure by which photocopies of the income tax returns they have delivered to the local Tax Office are passed

[2] It will be recalled that a determination by the local office setting out an assessment of tax on any income not subject to withholding is conclusive. See Chap. XVIII, 2.9 *supra* and 3.2 *infra*.

on to the Surtax Office. Again, a company's profits tax liability is handled by the inspector who handles its income tax liability; the information supplied to him serves for both taxes.

The typical income tax return form provides space for the taxpayer to list all his different sources of income and the actual amount of income derived therefrom in a stated twelve months' period. Space is also provided to enter claims for the various personal allowances and reliefs. In other words, returns are designed to give the Inland Revenue Department as comprehensive a view as possible of a taxpayer's situation. Indeed, if the information requested was supplied with complete reliability year by year, the local Tax Office or the Surtax Office often could compute the proper tax solely by reference to the information in the series of annual returns. To make the computations for any given year may require examination of more than one return in the series. While each return would show the actual income of the tax year just completed, the assessment for certain types of income is measured by the amount received in a different year.

In making out his return, a taxpayer is not expected to resolve interpretative questions. Rather he is expected to present the raw materials which the Inspector will use in the decision-making process. Thus the taxpayer is to record the actual receipt of all kinds of gross income for a given period. Where expenses incurred or other amounts are claimed as a deduction from any one type of the several types of gross income from which the total gross income is derived, the taxpayer must show each class of deduction by a separate entry, to enable the assessing officer to determine whether in fact they are legally deductible. Similarly, in connection with the allowances and reliefs for dependents, etc., the return form asks that the facts be stated, so that the assessing officer can decide for himself whether those facts do confer a legal right to the allowance or the relief.

This approach, however, would hardly be practical with regard to business profits. Theoretically, only the net profit, which is the only chargeable income, needs to be shown in the taxpayer's return. As a practical matter, however, such a taxpayer almost invariably will supplement his return by supplying the local Tax Office with his accounts. In the case of a business of any magnitude, these will consist of a profit and loss statement and balance sheet, both vouched for by a professional accountant. Detailed depreciation schedules will also be included if the nature and scope of enterprise's equipment

suggests this may be essential to a proper assessment. Such business accounts are freely supplied, although the Inspector handling the case has no express statutory power to demand them. One reason for such cooperation is that, if the Inspector believes the information given to him is inadequate, he does have the power to assess the profits on the basis of an estimate. Further, the taxpayer then would be obliged to contest the matter at an oral hearing before the appeal Commissioners. Where the Commissioners hear an appeal as to the chargeable amount of business profits, they do have statutory power to require, under penalty, submission of business accounts.

In examining taxpayers' returns (and any supporting accounts), Tax Offices make methodical use of information returns obtained from third parties. The degree to which an office audits a return naturally varies with the types of income it records. If, for example, a taxpayer earns interest from bank deposits, there can be little room for debate about its effect on his chargeable income. Again, if he is employed, there can be little question about the amount of gross income he derives from this source; correspondence may follow, however, regarding the merits of the taxpayer's claimed personal expenses against the gross remuneration. The type of income which generates most debatable questions is that arising from business profits. In consequence, the Department follows the practice of entrusting examination of business accounts to the senior members of the local Tax Office, i.e., to Inspectors who have completed the technical training program.

An Inspector engaged in the examination of business accounts takes due note of the professional standing of the persons responsible for their preparation. Should a trader submit home-made accounts in support of his return, the Inspector may invite him in for a conference, to obtain an oral explanation of the basis on which they were prepared. On the other hand, he would no doubt place much greater reliance on accounts verified by a qualified professional accountant. Nevertheless, business accounts, however satisfactory, do not resolve all tax questions. They reflect only a profit figure determined according to accepted conventions of commercial accounting. Rules for calculating profits for income tax purposes diverge on some counts from those commercially accepted conventions. For example, a sound but conservative commercial approach may justify deduction of a particular expenditure deemed to be of doubtful value to the business, though for tax purposes the

expenditure may be properly classified as a nondeductible capital outlay. In examining accounts, therefore, an Inspector reviews the possible areas of divergence. With one or more of these in mind, he may ask the accountant to itemize particular entries in the accounts to assist in arriving at a profit figure adjusted to conform to tax rules. In some cases, responsibility for valuation of inventory rests with the proprietor of the business rather than with his accountant. In such cases, the Inspector often requests a certificate from the proprietor specifying the exact basis of valuation—i.e., cost or market—employed. Professional accountants, on the other hand, can anticipate the points likely to be of interest to an Inspector, and many try to shorten the question-and-answer process by submitting suitable supplementary statements beforehand, when the return is filed.

At any stage during an Inspector's examination of accounts the taxpayer or his accountant may indicate an unwillingness to accept the Inspector's view of the law, either as it relates to inclusion of particular receipts or deduction of an expenditure. The Inspector is most willing to outline the reasons supporting his contention and to take into consideration the taxpayer's counter-arguments. In other words, an examination involves more than elicitation of information. The Inspector seeks to arrive at a figure to which the taxpayer will agree if they can reach an accord as to the manner in which the tax code—in the light of the established view of the Inland Revenue—can be applied to any interpretative issue of law arising from the taxpayer's case. To avoid misunderstanding, it may be well to say that the Inspector's very full authority to reach a solution locally of interpretative problems does not extend to giving up or making a compromise settlement with regard to any issue on which he believes, after weighing the competing strengths of the two positions, that the law provides an answer in favor of the Inland Revenue.

The processes described above also are normally applied to income and supplementary statements supplied to a local Tax Office in support of refund claims. When the assessment or refund procedure reaches the point where a final figure is accepted by the taxpayer, the actual assessment or repayment is handled without further formality. There is no comprehensive system of review by officials superior in rank to the official who made the actual decisions on behalf of the Department. In dividing up the workload, the Department seeks to minimize the need for any such review by allocating the work initially to a

senior or junior officer according to its presumed degree of difficulty. Settled cases are scrutinized on a sampling basis by the Inspecting Officer during his inspection visits to a local Tax Office. His purpose in such a case is to appraise both the efficiency with which a particular staff member performed his present duties and his prospective fitness for promotion. The scrutiny is not intended as a countercheck of current work. However, should there be a situation (whether arising from an error in mathematics or interpretation) which is considered to justify an assessment requiring the payment of an additional tax, as long as the six-year statute of limitations has not run, it is possible for such an assessment to be made. Under such circumstances, the Inspecting Officer would call the matter to the attention of the Inspector who then would make the additional assessment—just as he would if he himself had noticed the situation in question.

Much of what has just been said about the procedures adopted in local Tax Offices applies also to the Surtax Office's assessment and repayment procedures. As previously noted, the Surtax Office is supplied with photocopies of returns submitted to local Tax Offices though, if it seems desirable, the office is legally authorized to ask the taxpayer for further details. Attention has also been drawn[3] to a rule which makes the final determination of an income tax assessment conclusive also for surtax purposes to the extent the taxpayer is subject to both taxes. This rule extends also to certain deductions from total income—for example, to the deduction allowed when a net loss from business is set off against income from other sources. Certain of the personal allowances and reliefs for income tax purposes also have counterparts in the surtax sphere—for example, the allowances for children and other dependents. In consequence, it is standard operating procedure for the local Tax Offices to notify the Surtax Office of all decisions made locally which are relevant in calculating surtax liabilities. With all such information as the starting point, examination of the returns for surtax purposes is conducted in a manner corresponding to that used by local Tax Offices in their assessment and repayment work. For example, if need be, the Surtax Office will discuss with the taxpayer or his advisers any problems of interpretation which arise in applying the tax code to the particular case, and every effort will be made to arrive at a legally and mutually acceptable result.

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[3] See Chap. XVIII, 2.9 *supra*.

Section B. *Administrative Appeals*

3.3 *Introductory note*

For the efficient operation of any tax system, there must be some ready means by which a dispute between a taxpayer and an assessing officer can be resolved by a third party. Litigation in a country's regular courts, however, may not provide a sufficiently convenient method in the first instance, particularly with respect to the many small disputes which can arise where tax liability extends to a large fraction of the total community. In consequence, some countries have deemed it advisable to introduce an initial appeal, less formal in character than regular litigation, and typically before an agency within the tax administration itself, hence the characterization administrative appeal.

In the United Kingdom, however, the existence of the General Commissioners and the Special Commissioners[4] has afforded, from the earliest days of the income tax, a convenient and relatively informal procedure for submitting disputes to independent tribunals. Given the existence of these facilities, a felt need for a system of administrative appeals has not evolved. The law which governs appeals to the Commissioners makes it clear that the taxpayer's decision to file a notice of appeal—such notice constituting the commencement of the appeal—does not mean that such an appeal must be carried forward to an actual hearing. It is quite possible for the taxpayer and the representative of the Inland Revenue to reach an agreed settlement after the taxpayer filed his notice and up until the time the matter comes to an actual hearing. The law provides that the same consequences shall follow as if the Commissioners had decided the appeal on the same basis as that reflected in the agreement. This clearly implies that there is still room for administrative negotiation even after the Inland Revenue has made a formal assessment, to which the taxpayer objected (or, in a refund case, after repayment has been offered of a lesser amount than the taxpayer considers to be due him). Accordingly, although the United Kingdom has no formal system of administrative appeals, and though the belated negotiations described above are carried out by the assessing office itself, the arrangement—as described in the succeeding subtopic—has some of the earmarks of the more formalized administrative appeal procedures in other countries.

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[4] See Chap. XX *infra*.

3.4 *Details of procedures analogous to administrative appeals*

At that point where a taxpayer gives formal notice of appeal from the assessing officer's decision regarding his assessment or repayment claim, another official, senior in rank to the first, may be led to intervene in either of two ways.

First, the initial decision-making official may think it appropriate to consult higher authority before making arrangements for the hearing on appeal. For example, a member of the local Tax Office's staff may consult the District Inspector in charge in order to seek confirmation of the position he has hitherto taken. A staff member of the Surtax Office likewise can consult his own superiors. Also on occasion, the District Inspector in charge of a local Tax Office may seek advice at this stage from headquarters; and if an important point of interpretation is at stake, it is possible for the Surtax Office to consult the Board through their secretariat. In any of the foregoing cases, if the higher authority which was consulted advises the lower decision-making official that his position was too extreme, the latter is authorized to make a further attempt to settle the appeal, before a hearing, by direct negotiation with the taxpayer.

Action along the above lines perhaps should be regarded as an extension of the basic assessment procedure; it bears no very close resemblance to administrative appeals available to the taxpayer himself in other countries. There is, however, a rather clearer parallel when it is the taxpayer who takes the initiative after giving formal notice of appeal. Such a taxpayer may think it worth while to write to the headquarters of the Inland Revenue Department, setting out his arguments and enquiring whether in the face of those arguments, the position previously adopted by his District Inspector is supported by headquarters. In this quite informal manner, higher authority within the Department can be asked to express a view of an interpretative question about which the taxpayer and the local decision-making official have hitherto disagreed.

Again this does not mean that the higher authority ever urges the decision-making official to compromise an issue. However, should the senior official, drawing on his years of service and experience, consider that the lower-level official has taken such an extreme position that, considering the facts of the particular case, it is unlikely that the Inland Revenue would prevail in court, he will suggest to the younger man that it would be reasonable under these circumstances to yield to the taxpayer.

Again, the taxpayer may send his letter to his representative in Parliament, asking the latter to approach the Chancellor of the Exchequer (or one of the other Treasury Ministers assisting him) in support of the taxpayer's view of the disputed interpretative question. Often, of course, correspondence addressed to this level goes beyond the mere matter of interpretation. The taxpayer's dominant purpose may be to urge that, if the meaning of the tax law is indeed the one for which local officials have been contending, the government ought to propose an amendment to the law. This wider aspect of such correspondence is obviously beyond the scope of the present study. But to the extent that the correspondent also indicates his disagreement with the departmental interpretation of existing law, the report submitted by the Board of Inland Revenue to the Treasury Minister, to enable him to reply to the member of Parliament, will incorporate any necessary defense of that interpretation. The Minister will not necessarily discuss the technical aspects of the matter in his own reply. He may prefer to take the line that neither he nor his officials have the last word on interpretative questions. By noting that taxpayers have a statutory right to a hearing before the appeal Commissioners and that the correspondent had invoked that right, he may excuse himself from consideration of the legal arguments. Nevertheless, the very fact that a responsible echelon within the tax administration's headquarters was put on notice that a departmental interpretation is disputed will lead appropriate officials to re-examine the question before reporting back to the Minister for the purpose of facilitating his reply. This total process may turn out in any given case to be the informal equivalent of an administrative appeal.

However, the analogy of this and the preceding illustration to administrative appeals in other countries should not be pressed too far. There is no identifiable group of appeals officers. The correspondence is handled simply as part of the general correspondence reaching headquarters on the particular topic concerned. Any disputed question is investigated on behalf of the headquarters office as such, and the departmental reply is likewise sent in the name of the office. Since this type of correspondence is not formally segregated from all other correspondence handled at headquarters, no statistical analysis of the process is possible. Moreover, there is no set procedure; it suffices that the taxpayer or his representative should raise the disputed question in correspondence. His analysis, no doubt, will cover the ground as extensively as he thinks

advisable for the purpose of explaining his case. On occasion a memorandum prepared by the taxpayer's legal advisers may be included, but there is no obligation to do so. When the taxpayer writes to seek intervention by headquarters, he may ask for an oral conference there for the purpose of enlarging on his arguments. In such case, if the disputed interpretation is one which previously has been fully explored in the case of other taxpayers, the headquarters office may indicate to him, in his own interest, that it appears doubtful to the Department that such an interview would serve any useful purpose. If, however, he persists in his request, an interview normally would be accorded. It is left to the initiative of taxpayers to decide whether to bring their own expert advisers to assist in developing the cases they wish to present.

In essence, these correspondents ask headquarters to intervene, by overruling the initial interpretative position taken by the local decision-making official. In the nature of things, the headquarters of the Department does possess the necessary authority. But the staff members at headquarters, no less than the other officials of the Department, are bound by the tax codes. Consequently, they have no special power to compromise a case for the sake of avoiding litigation.

Every official handling a case is bound equally by the same tax code. Hence no power at any level exists to split or trade issues in an effort to reach a settlement.

The foregoing relates to disputed assessments and repayments claims generally. Mention should be made, however, of two classes of repayment claims which are subject to a procedural review which has some similarity to the administrative appeal procedures of other countries.

The two classes of claimants include (1) persons who are not resident in the United Kingdom or whose justification for relief depends in some way on the claimant's residence or domicile, and (2) entities or trusts claiming charitable exemption. Although their claims can be given final approval by the local decision-making officer, the final rejection of any such claim, by statute, must be made by the secretariat at headquarters acting on behalf of the Board. This latter requirement automatically ensures re-examination at headquarters of any claim initially rejected by the local decision-making officer.

Section C. *Extent Administrative Processing of Refund Claims Departs from Administrative Processing of Assessments*

3.5 *Introductory note*

It previously has been indicated that normal repayment claims, where based on overpayments made *during the taxable years*—usually through withholding—are subject to the same procedure as that applied to assessments. Part One, relating to the United States, indicated that there the refund procedure can be used as an alternative method of contesting a controversial question which arises in the setting of a proposed assessment. In particular, it was noted that a taxpayer, *after* the close of the taxable year in question, may actually acquiesce in an assessment with which he disagrees and pay the tax so assessed thus laying the foundation for a refund claim which he can then litigate in a different judicial forum than that which he would have used in contesting the proposed assessment itself. An exact parallel to this does not exist in the United Kingdom. The treatment accorded one class of repayment claims, however, might be fairly compared to the situation which prevails in the United States, but only in the sense that the procedures governing this one class of refund claims are slightly, though only slightly, different from those applicable to normal claims.

This class consists of claims asserted on the ground, as the statute puts it, that "error or mistake" was made. The typical situation which the statute seeks to accommodate is one where, after an assessment has become final and it is no longer possible to invoke an ordinary appeal, the taxpayer discovers that, by inadvertence, he overstated the amount of assessable income in the return he submitted to the Inland Revenue Department, by failing, for example, to claim some expense which legitimately could have been deducted. Where he can show because of his own "error or mistake" an excessive assessment has been made, he is permitted to apply for an appropriate adjustment of his liability for the year concerned.

3.6 *"Error or mistake" claims: Refund procedures prior to an administrative appeal*

Subject to a right of appeal to the Special Commissioners (and, on certain questions of law, to the courts), final decision on an "error or mistake" claim lies with the Board, at headquarters. But to facilitate a preliminary examination, the taxpayer is required to submit his claim to the office which handled

the assessment in the first instance—the local Tax Office if the claim relates to an income tax or profits tax assessment, and the Surtax Office if it relates to a surtax assessment.

The preliminary investigation is not ordinarily a burdensome one. The very existence of the claim implies that the original assessment was based on a return made by the taxpayer or some supporting statement. Attention, therefore, can be concentrated on the particular point on which the return or statement is now said to have been erroneous. The extent of the examination necessarily varies with the character of the alleged mistake. A simple arithmetical slip, on the one hand, may be more or less self-explanatory. On the other hand, a claim alleging that a deductible expense was overlooked in calculating the profits of a business can give rise to a question regarding the legality of any deduction for that expenditure—just as such a question might arise during the procedure which leads to an original assessment on such profits.

The official who considers the claim must concern himself, however, with certain additional matters which need not be considered when an original assessment is in question. In the first place, the legislation authorizing submission of "error or mistake" claims excludes cases where the return or statement, though now seen to have been erroneous, was in fact in conformity with the practice generally prevailing at the time when it was made. This limitation is designed to prevent the Department from having to undertake a wholesale reopening of closed assessments when, for example, a court decision belatedly holds that some type of receipt, hitherto accepted on all sides as taxable, is actually nontaxable. To illustrate a second restriction on "error or mistake" claims, assume that the taxpayer mistakenly reflected an item of income in his return for 1963, but that the item should have been included in his return for the earlier year 1962. Assume further that the assessments for both years were made in conformity with the return as submitted. It would be inequitable to permit the taxpayer to profit from his mistake by allowing him to reopen the assessment for the later year 1963 if, because of the lapse of time, the assessment for the earlier year 1962 could not be reopened. To prevent that type of inequity, the "error or mistake" legislation permits the Inland Revenue to take due account of income tax liabilities for years other than the single year to which the claim relates.

If the official who undertakes the preliminary examination of an "error or mistake" claim is satisfied that it is well

founded and outside the limitations described above, he is empowered to approve it and arrange for the consequent repayment.

3.7 *"Error or mistake" claims: Procedure equivalent to administrative appeal*

It may be, however, that the relief offered by the initial decision-making officer falls short of the amount claimed or that, for one reason or another, he rejected the entire claim. If the claimant desires to contest that decision, the claim is forwarded to the Board's secretariat for a formal determination by the Board. This decision will be transmitted to the claimant in writing. The Board must formally act on the matter before the claimant, if the Board's decision is adverse, can invoke a yet further appeal to the Special Commissioners. Since the secretariat re-examines these disputed claims before seeking the Board's authority to refuse or restrict the claimed refund, the procedure has some points of similarity to the system of administrative appeals found in other countries, for there is a reconsideration by a higher echelon of a dispute between the claimant and the decision-making official in the local Tax Office or the Surtax Office. This is not, of course, peculiar to "error or mistake" claims. As previously noted, certain other claim procedures likewise involve a formal determination by the Board, as the final step before a disputed case can be referred to the independent appeal tribunal.