



The Constitutionality of Revenue Investigations

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Introduction

There are certain aspects of business life that can be unpleasant. High on the list of these is the notification from the Revenue Commissioners of an impending Revenue audit. Although such news may invoke anxiety, the taxpayer can at least take some level of comfort from knowing that the intrusion by Revenue is not an investigation.

Notification of a Revenue audit is bad enough; however, selection for a Revenue investigation is far more traumatic. Both instil fear – of financial loss, public humiliation and possible incarceration.

Under the rules governing Revenue audits, there is always an opportunity to mitigate penalties and avoid publication and possibly a jail sentence. However, this is not the case for the person who is or will be the subject of a Revenue investigation.

A Revenue audit is regarded by Revenue as an examination of a tax return “based on informed selections from the risk profiling of cases, including computer-assisted profiling as well as local knowledge”.¹ A Revenue investigation is defined as “an examination of a customer’s affairs where Revenue has strong concerns of serious tax offences having occurred”.²

1. 2010 Code of Practice for Revenue Audit, para. 1.2.

2. *Ibid.*, para. 1.6.

There can be subtle differences in the manner in which a taxpayer is selected for an audit as opposed to an investigation. It is in this regard that a significant anomaly arises whereby the Revenue Commissioners, by denying an individual under investigation the opportunity to mitigate penalties and to avoid publication, could be acting *ultra vires* and disregarding the individual's constitutional right to equality.

This article explores the constitutionality of Revenue investigations and whether taxpayers are treated equally in the same circumstances. Although there are substantial penalty mitigation benefits to the making of an unsolicited voluntary disclosure of a tax default, I have restricted the parameters of the article to situations where the Revenue Commissioners have notified an individual of an impending audit or investigation.

Revenue Audit Letter

In the absence of a statutory definition,³ the Revenue Commissioners define a Revenue audit as an examination of:

“> A tax return

- > A declaration of liability or a repayment claim
- > A statement of liability to Stamp Duty
- > The compliance of a business with tax and duty legislation.”⁴

The examination may include the review of all of the issues in a particular case or concentrate on a single issue. It may also include a review of cases where returns have not been submitted or an examination of the books, records and compliance with tax obligations so as to establish the correct level of liability.

A taxpayer on receipt of an audit notification letter has the opportunity to mitigate penalties and to avoid publication and prosecution by making of a full declaration to the Revenue Commissioners of any tax default, usually in the form of income suppression. For that declaration to be regarded as a qualifying disclosure, it must be in writing, contain a signed declaration together with complete information and full particulars of all current and historical tax defaults, and be accompanied by a payment in respect of the undisclosed tax liability and associated interest penalty.

The window of opportunity to make the upfront declaration of any tax default, or what the legislation defines as a “prompted qualifying disclosure”, to the Revenue Commissioners is in the period between:

- “(a) the date on which the person is notified by a Revenue officer of the date on which an investigation or inquiry into any matter occasioning a liability to tax of that person will start, and
- (b) the date that the investigation or inquiry starts.”⁵

The new Code of Practice for Revenue Audit (the “Code”) came into effect from 1 October 2010. The Code significantly modifies the statutory definition of a “prompted qualifying disclosure” by replacing the word “investigation” with “audit”. As such, the Code defines the window of opportunity for making a prompted qualifying disclosure to be in the period between:”

- “(a) the date on which the person is notified by a Revenue officer of the date on which an audit will start, and
- (b) the date that the audit starts.”⁶

For the purposes of clarification, the Code further explains that a “prompted qualifying disclosure” is a disclosure made after an audit notice has issued but before an examination of the books and records or other documentation has begun.

Where a desk audit notification letter has issued, the examination of the books and records will be regarded as having commenced on the day after the period of notice has expired.

Statutory Penalties

Where there are serious omissions in a tax return or where the taxpayer has engaged in deliberate behaviour to defraud the Exchequer, the tax-gearred penalty could be as high as 100% of the tax default. However, to encourage taxpayers to make a voluntary disclosure and to provide assistance during the Revenue audit, the legislation provides mitigating provisions that significantly reduce the exposure to tax-gearred penalties. Entitlement to the mitigating provisions depends on the actions of the taxpayer and the extent to which a complete declaration in writing has been made. The taxpayer must provide details of the quantum and nature of the

3. The power to undertake a Revenue audit appears to derive from s956(1)(b) TCA 1997 to the extent that a Tax Inspector is not precluded from making enquiries or taking such actions to ensure the accuracy of a tax return.

4. 2010 Code of Practice for Revenue Audit, para. 1.2.

5. Section 1077E(i) TCA 1997.

6. 2010 Code of Practice for Revenue Audit, para. 2.8.

default and must also pay the outstanding tax, together with the appropriate amount of interest.

Revenue Investigation Letter

Revenue's Investigations and Prosecutions Division is responsible for developing, implementing, managing and co-ordinating all of Revenue's investigation and prosecution policies, strategies and practices in relation to serious tax evasion, smuggling of goods and illegal drugs. Its function includes the review of the following type of cases:

- › where issues have arisen during a Revenue audit suggesting a serious tax offence,
- › unexplained capital growth,
- › single-issue transactions,
- › issues arising from legacy cases,
- › suspicious transaction reports and
- › third-party information.

The Code defines a Revenue investigation as “an examination of a customer's affairs where Revenue has strong concerns of serious tax offences having occurred”.⁷ Where there are strong indications of serious tax evasion, Revenue has stated that a taxpayer will be the subject of an investigation rather than an audit. It has also stated that, during an audit, Revenue auditors may refer the continuing review of the taxpayer's affairs to the Investigations and Prosecutions Division where undisclosed transactions constituting serious tax offences have been discovered.

The view of Revenue is that an investigation is initiated or has commenced when a taxpayer has received notification in writing that his or her tax affairs are under investigation. The consequence of receiving such a letter is that the taxpayer will no longer be able to benefit from the following:

- “› *The opportunity to make a qualifying disclosure*
- › *The avoidance of publication if the final settlement meets the publication criteria...*

- › *Assurance from Revenue that the case will not be investigated with a view to referral for criminal prosecution.”⁸*

Revenue's Annual Report

According to the Annual Report of the Revenue Commissioners for 2009, 12,419 Revenue audits were completed in 2009. The number of random audits completed by the end of that year was 210, representing or 1.7% of the total.⁹ Therefore, based on these statistics, 98% of Revenue audits would appear to have been initiated for specific reasons.

Tax Defaulter List

Revenue is required to publish a quarterly list of the tax defaulters to include name, address and occupation.¹⁰ A review of the published lists from January 2009 to June 2010 reveals that Revenue has published the names of 527 tax defaulters. Although most of the published names relate to Revenue audits and special investigations associated with funds held in financial institutions, 28 cases arose as a result of Revenue investigations. Despite the fact that some of the settlements from Revenue investigations were substantial, seven (or over 25%) of those cases involved tax liabilities of less than €10,000. Within the same period, there were 16 Revenue audit cases where the tax liability, excluding interest and penalties, exceeded €500,000.

Special Investigations

The pursuance of taxpayers who held bogus non-resident accounts, offshore assets and single-premium policies falls within some of Revenue's special investigations categories. To date, Revenue has collected over €2.6 billion¹¹ in unpaid tax, interest and penalties from these investigations.

Mindful of the scale of the evasion and the resources available to Revenue, a decision was taken to incentivise taxpayers to make voluntary disclosures of previously undeclared tax liabilities. Those incentives included the opportunity to mitigate penalties and to avoid publication and prosecution. The decision to offer such incentives was pragmatic, as it would have taken Revenue many years to identify the tax defaulters and collect all of the outstanding tax. With the corresponding reduction in workload,

7. 2010 Code of Practice for Revenue Audit, para. 1.6.

8. *Ibid.*, para. 1.6.

9. Revenue Annual Report 2009, Goal 1 – Ensure Everyone Complies, Strategy 1.2, page 30, tables 6 and 7.

10. Section 1086(3) TCA 1997.

11. www.revenue.ie/en/press/yields.html.

Revenue was in a better position to pursue the non-compliant taxpayers.

The Constitution

The Irish Constitution is the fundamental legal document that sets out how the State should be governed. The doctrine of separation of powers is the cornerstone of the Irish Constitution, imposing a tripartite separation of powers involving the legislature, the executive and the judiciary. This doctrine instils a certain degree of independence between the parties whereby a system of checks and balances can operate. Any incursion by one institution of State to usurp powers exclusively reserved to another institution would be an unconstitutional invasion of the powers of that body.

The Oireachtas, or legislature, makes the laws. Article 15.2.1 of the Constitution provides that the sole and exclusive power of making laws for the State is vested in the Oireachtas, and no other legislative authority has power to make laws for the State.

Article 28.2 provides that the executive power of the State “shall be exercised by or on the authority of the Government”. Therefore the Government is the executive organ of the State and collectively responsible for all of the Departments of the State, which are administered by individual members of the Government.

The function of the courts is to interpret the law. Article 34.1 requires that justice shall be administered in courts established by law, by judges appointed in the manner provided by the Constitution, and, save in such special and limited cases as may be prescribed by law, shall be administered in public.

The Constitution also ensures that its citizens enjoy fundamental rights and freedoms and precludes the State from acting in contravention of those rights and freedoms. Articles 40 to 44 set out the fundamental rights to be enjoyed by all citizens. Personal rights are set out at Article 40. Article 40.1 provides that all citizens shall, as human persons, be held equal before the law. Further rights are afforded by Article 40.3.1 to the extent that the State guarantees in its laws to respect and, as far as practicable, by its laws to defend and vindicate the personal rights of the citizen. In the case of unjust attack or injustice done, Article 40.3.2 requires the State to vindicate the life, person, good name and property rights of every citizen.

According to Hogan & Whyte,¹² Irish jurisprudence on the guarantee of equality in comparison to international jurisprudence is remarkably underdeveloped. Most of the Irish jurisprudence considers whether statutory provisions discriminate against citizens. In *Joseph Purcell v AG Ireland & The Minister for the Environment*¹³ the implementation of a statutory instrument and the arbitrary method in which it was implemented were explored. That case concerned the implementation of the Farm Tax Act 1985, which provided for a farm tax to be imposed on every agricultural holding with an adjusted acreage of not less than 20. Lists of all taxable holdings were to be compiled by a Farm Commissioner, and the imposition of the tax was to begin in such year as might be prescribed. It was envisaged that it would take four to five years to determine all of the taxable farms. By Statutory Instruments, the Farm Commissioner was entitled to confine himself for the year 1987 to farms exceeding 80 adjusted acres, but the year 1986 had been prescribed as the first year for the imposition of the tax on farms of more than 150 adjusted acres.

Blayney J held that it was not the intention of the Oireachtas to impose the farm tax until the Farm Commissioner had completed the classification of all farms in excess of 20 adjusted acres and that the Statutory Instrument making the tax payable in 1986 discriminated unfairly between farm owners and was unconstitutional. In citing O’Higgins CJ in *Cassidy v The Minister for Industry & Commerce*,¹⁴ the learned judge stated at page 293:

“Under the constitution the sole and exclusive power of making laws for the state is vested in the Oireachtas and there is no other legislative authority. As a consequence where, as in this case, a statutory instrument made by a Minister is impugned, the courts have the duty to enquire whether such instrument had been made under powers conferred, and for purposes authorised, by the Oireachtas. If the powers conferred by the Oireachtas on the Minister do not cover what was purported to be done then, clearly, the instrument is ultra vires and of no effect. Equally, if the rule making power given to the Minister has been exercised in such a manner as to bring about a result not contemplated by the Oireachtas, the courts have a duty to interfere.”

Therefore the power given to the Minister for the Environment was exercised in such a manner as to bring about a result not

12. Gerard Hogan and Gerry Whyte, *Kelly: The Irish Constitution* (Dublin: LexisNexis Butterworths, 4th ed., 2003), 7.2.05.

13. 5 ITR 288

14. [1978] IR 297.

contemplated by the Oireachtas and, accordingly, the Statutory Instrument prescribing the year 1986 as the year when the farm tax should begin to be charged was invalid.

Commentary

Section 1077E of the Taxes Consolidation Act 1997 (TCA 1997) defines the timeframe within which a person can make a prompted qualifying disclosure for the purposes of mitigating penalties as the period between the date on which the person is notified by a Revenue officer of the date on which an investigation or inquiry into any matter occasioning a liability to tax of that person will start and the date on which the investigation or inquiry starts. However, the 2010 Code of Practice for Revenue Audit defines that period as any time up to the day on which the Revenue official arrives to undertake the audit. Therefore, it is the view of Revenue that such an investigation starts only on the day of the audit. However, for taxpayers who are the subject of a Revenue investigation, the notification letter also constitutes the date on which the investigation starts, thereby excluding that category of taxpayers from the benefits of mitigating penalties.

Revenue makes no secret of the basis on which taxpayers are selected for audit. The Revenue Annual Report 2009 states that, of the 12,419 audits completed by year-end, only 210 were selected randomly. Therefore, the vast majority of cases selected for audit were attributable to specific factors.

Taxpayers are generally selected for audit “based on informed selections from risk profiling of cases, including computer-assisted profiling as well as local knowledge”.¹⁵ Strangely, however, the work of identifying appropriate cases for audit is not regarded as the commencement of the audit. Rather, the critical time as defined by the Code is when Revenue begins the review of the books and records, invariably on the day of the audit.

It is highly likely that the same process of selecting cases for Revenue audit is also applied to Revenue investigations. The crucial difference, of course, is that under the Revenue investigation process there is no opportunity to mitigate penalties and avoid publication. Therefore it would appear that Revenue does not regard all taxpayers as equal before the law.

As noted from the tax defaulter list, 25% of the taxpayers who were the subject of a Revenue investigation were found to have

tax defaults of amounts of less than €10,000. It is submitted that this level of tax settlement should not have given rise to “strong concerns of serious tax offences having occurred” or, if it had, that those concerns were seriously misplaced.

However, there were 16 published tax defaulters in the 18 months to June 2010 whose affairs were dealt with under the Revenue audit system. Each of those defaulters had tax liabilities in excess of €500,000, thereby constituting the occurrence of “serious tax offences”. It is therefore difficult to reconcile why some taxpayers were the subject of Revenue investigations while others, with substantial tax liabilities, had their tax affairs reviewed under the more benign Revenue audit system.

Based on such findings, it is submitted that a Revenue investigation cannot start in earnest until the first meeting with the taxpayer. Before that meeting, Revenue may have suspicions or have received uncorroborated evidence, but it is unlikely that there is tangible evidence until the initial interview with the taxpayer and the subsequent review of the books and records has begun.

The Code highlights situations where an audit can evolve into an investigation in instances where a Revenue official encounters strong indicators suggesting a serious tax offence.¹⁶ In such cases, the taxpayer would have had ample opportunity to make a prompted qualify disclosure during the Revenue audit but would have failed to do so. Such a taxpayer could have few complaints about the failure of Revenue to offer an opportunity to mitigate penalties and avoid publication.

Even taxpayers who have been the subject of Revenue’s special investigations, such as bogus non-resident account holders, were afforded an opportunity to mitigate penalties despite Revenue’s suspicions that serious tax offences had occurred. Although it is assumed that the purpose of offering the mitigation opportunities was to encourage tax defaulters to make voluntary disclosures, thereby reducing the potential workload of Revenue, it still remains that Revenue offered people engaged in serious tax evasion an opportunity to mitigate penalties.

The legislation is quite clear in defining the requisite time period in which a prompted qualifying disclosure can be made and does not distinguish between audits and investigations. It is the Revenue Commissioners that have extrapolated a meaning from

15. 2010 Code of Practice for Revenue Audit, para. 1.2.

16. *Ibid.*, para. 1.6.

the statutory provision to exclude taxpayers on whom a notice of investigation has been served from making a prompted qualifying disclosure. It is the Revenue Commissioners that have determined that the identification and profiling of cases does not constitute the commencement of an inquiry or investigation for Revenue audit purposes. It is the Revenue Commissioners, as opposed to the Oireachtas, that have determined that taxpayers under the Revenue audit system can mitigate penalties at any time up to the day of commencement of the audit. It is the Revenue Commissioners, and not the Oireachtas, that determine when certain investigations begin, thereby restricting the entitlement to mitigate penalties.

As noted in *Joseph Purcell v AG Ireland & The Minister for the Environment*,¹⁷ it was not the Farm Tax Act 1985 that was considered to be unconstitutional but the Statutory Instrument

made by the Minister for the Environment bringing the farm tax into operation in 1986. Blayney J held that the effect of the Statutory Instrument was to discriminate unfairly against certain farmers who were brought within the charge to tax while other farmers who were also within the ambit of the Act escaped liability. The Minister had therefore acted *ultra vires*.

It is therefore submitted that the Revenue Commissioners have exceeded their powers by creating a less punitive type of investigation in the form of a Revenue audit as outlined in the Code of Practice for Revenue Audits. The effect of creating a different type of investigation and offering penalty mitigation opportunities solely to that class is, firstly, *ultra vires* and, secondly, discriminatory. Furthermore, it appears to the author from the list of tax defaulters that the basis on which Revenue selects taxpayers for Revenue investigation can be arbitrary.

Conclusion

If all Revenue audits were conducted on a random basis, it would be logical to assume that the investigation starts on the day on which the Revenue official arrives to undertake the audit.

However, Revenue has stated that virtually all cases are selected for audit based on informed selections from risk profiling of cases, including computer-assisted profiling as well as local knowledge. As such, it is possible that all taxpayers selected for audit on such grounds should be denied the opportunity to mitigate penalties. It is therefore submitted that the proper interpretation of an unprompted qualifying disclosure requires a window of opportunity for the purposes of disclosing any tax defaults and should be extended to all taxpayers in respect of the initial notification by Revenue of an impending “investigation or inquiry”. To construe otherwise would be counterproductive and put into disarray the whole Revenue audit process.

In the author’s view, it is clear from the TCA 1997 that it was not the intention of the Oireachtas to differentiate between a Revenue audit and a

Revenue investigation; otherwise, a specific statutory provision would have been inserted in the Act. It is therefore submitted that the power usurped by the Revenue Commissioners in differentiating between an audit and investigation and the associated consequence for each is *ultra vires* and brings about a result not contemplated by the Oireachtas.

Offering certain taxpayers who are the subject of “an investigation or inquiry into any matter occasioning a liability to tax” the opportunity to mitigate penalties and to avoid publication discriminates against those individuals whose initial contact from Revenue is the notification of an impending investigation. As the statutory provision does not differentiate between an audit and an investigation, in the author’s view, it is incumbent on the Revenue Commissioners in the initial notification letters to all taxpayers of an impending investigation or inquiry to offer the same penalty mitigation opportunities. This in the author’s view would ensure that Revenue observes the confines of the statutory provision and also ensures observance with the constitutional guarantee to hold all citizens equal before the law.

It is therefore submitted that the Revenue Commissioners have exceeded their powers by creating a less punitive type of investigation in the form of a Revenue audit as outlined in the Code of Practice for Revenue Audits.

